
OFFICE OF THRIFT SUPERVISION
WASHINGTON, D.C. 20552

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008**

OTS Docket Number 08551

WASHINGTON MUTUAL BANK

(Exact name of registrant as specified in its charter)

Federal Charter

(State or other jurisdiction of
incorporation or organization)

1301 Second Avenue, Seattle, WA

(Address of principal executive offices)

68-0172274

(I.R.S. Employer
Identification Number)

98101

(Zip Code)

(206) 461-2000

(Registrant's telephone number, including area code)

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 No

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

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

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

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

Common Stock – 331,386

Note: Registrant meets the conditions set forth in General Instructions (H)(1)(a) and (b) of Form 10-Q and is therefore filing this form with reduced disclosure format.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2008
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Part I – FINANCIAL INFORMATION
WASHINGTON MUTUAL BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(in millions)			
Interest Income				
Loans held for sale	\$ 52	\$ 421	\$ 138	\$ 984
Loans held in portfolio	3,604	3,785	7,558	7,684
Available-for-sale securities	330	351	682	681
Trading assets	115	106	230	217
Other interest and dividend income	94	82	171	183
Total interest income	<u>4,195</u>	<u>4,745</u>	<u>8,779</u>	<u>9,749</u>
Interest Expense				
Deposits	1,115	1,726	2,444	3,501
Borrowings	726	863	1,717	1,882
Total interest expense	<u>1,841</u>	<u>2,589</u>	<u>4,161</u>	<u>5,383</u>
Net interest income	2,354	2,156	4,618	4,366
Provision for loan losses	<u>5,912</u>	<u>372</u>	<u>9,423</u>	<u>606</u>
Net interest income (expense) after provision for loan losses	(3,558)	1,784	(4,805)	3,760
Noninterest Income				
Revenue from sales and servicing of home mortgage loans	(109)	300	302	423
Revenue from sales and servicing of consumer loans	159	403	407	846
Depositor and other retail banking fees	767	720	1,470	1,384
Credit card fees	177	183	358	355
Securities fees and commissions	64	70	122	131
Insurance income	22	22	44	43
Loss on trading assets	(305)	(145)	(520)	(253)
Gain (loss) on other available-for-sale securities	(402)	4	(384)	39
Gain (loss) on extinguishment of borrowings	47	1	46	(5)
Other income	298	203	452	315
Total noninterest income	<u>718</u>	<u>1,761</u>	<u>2,297</u>	<u>3,278</u>
Noninterest Expense				
Compensation and benefits	929	956	1,833	1,937
Occupancy and equipment	460	354	816	730
Telecommunications and outsourced information services	123	132	253	261
Depositor and other retail banking losses	61	58	124	119
Advertising and promotion	102	113	208	211
Professional fees	51	51	85	87
Foreclosed asset expense	217	56	372	95
Other expense	425	376	798	721
Total noninterest expense	<u>2,368</u>	<u>2,096</u>	<u>4,489</u>	<u>4,161</u>
Minority interest expense	<u>75</u>	<u>42</u>	<u>151</u>	<u>85</u>
Income (loss) before income taxes	(5,283)	1,407	(7,148)	2,792
Income taxes	<u>(2,094)</u>	<u>472</u>	<u>(2,875)</u>	<u>946</u>
Net Income (Loss)	<u>\$(3,189)</u>	<u>\$ 935</u>	<u>\$(4,273)</u>	<u>\$ 1,846</u>

See Notes to Consolidated Financial Statements.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(UNAUDITED)

	<u>June 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
	(dollars in millions)	
Assets		
Cash and cash equivalents.....	\$ 7,217	\$ 9,537
Federal funds sold and securities purchased under agreements to resell	2,750	1,877
Trading assets (including securities pledged of zero and \$247)	2,172	2,627
Available-for-sale securities, total amortized cost of \$25,382 and \$27,503:		
Mortgage-backed securities (including securities pledged of \$121 and \$1,221).....	18,191	19,240
Investment securities (including securities pledged of \$112 and \$3,078)	<u>5,837</u>	<u>8,021</u>
Total available-for-sale securities.....	24,028	27,261
Loans held for sale	1,877	5,403
Loans held in portfolio.....	239,601	244,356
Allowance for loan losses	<u>(8,455)</u>	<u>(2,571)</u>
Loans held in portfolio, net	231,146	241,785
Investment in Federal Home Loan Banks	3,498	3,351
Mortgage servicing rights	6,175	6,278
Goodwill	7,284	7,287
Other assets	<u>20,875</u>	<u>20,403</u>
Total assets	<u>\$ 307,022</u>	<u>\$ 325,809</u>
Liabilities		
Deposits:		
Noninterest-bearing deposits	\$ 37,396	\$ 35,066
Interest-bearing deposits	<u>150,865</u>	<u>151,590</u>
Total deposits	188,261	186,656
Federal funds purchased and commercial paper	75	2,003
Securities sold under agreements to repurchase.....	214	4,148
Advances from Federal Home Loan Banks	58,363	63,852
Other borrowings	24,227	30,751
Other liabilities.....	7,590	8,089
Minority interests	<u>3,912</u>	<u>3,917</u>
Total liabilities.....	282,642	299,416
Stockholder's Equity		
Common stock, \$1 par value: 1,000,000 shares authorized, 331,386 shares issued and outstanding	—	—
Capital surplus	28,236	25,237
Accumulated other comprehensive loss.....	(872)	(165)
Retained earnings.....	<u>(2,984)</u>	<u>1,321</u>
Total stockholder's equity	<u>24,380</u>	<u>26,393</u>
Total liabilities and stockholder's equity.....	<u>\$ 307,022</u>	<u>\$ 325,809</u>

See Notes to Consolidated Financial Statements.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
(UNAUDITED)

	<u>Number of Common Shares</u>	<u>Capital Surplus</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Retained Earnings</u>	<u>Total</u>
		(dollars in millions, shares in thousands)			
BALANCE, December 31, 2006	331	\$ 23,585	\$ (112)	\$ 7,443	\$ 30,916
Comprehensive income:					
Net income	-	-	-	1,846	1,846
Other comprehensive income, net of tax:					
Net unrealized loss from securities arising during the period, net of reclassification adjustments....	-	-	(302)	-	(302)
Net unrealized gain from cash flow hedging instruments.....	-	-	22	-	<u>22</u>
Total comprehensive income					1,566
Cash dividends paid to parent company	-	-	-	(3,400)	(3,400)
Contributions from parent company	<u>-</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>2</u>
BALANCE, June 30, 2007	<u>331</u>	<u>\$ 23,587</u>	<u>\$ (392)</u>	<u>\$ 5,889</u>	<u>\$ 29,084</u>
 BALANCE, December 31, 2007	 331	 \$ 25,237	 \$ (165)	 \$ 1,321	 \$ 26,393
Cumulative effect from the adoption of accounting pronouncements, net of income taxes.....	<u>-</u>	<u>-</u>	<u>-</u>	<u>(32)</u>	<u>(32)</u>
Adjusted balance	331	25,237	(165)	1,289	26,361
Comprehensive loss:					
Net loss	-	-	-	(4,273)	(4,273)
Other comprehensive loss, net of tax:					
Net unrealized loss from securities arising during the period, net of reclassification adjustments....	-	-	(689)	-	(689)
Net unrealized loss from cash flow hedging instruments.....	-	-	(18)	-	<u>(18)</u>
Total comprehensive loss					(4,980)
Contributions from parent company	<u>-</u>	<u>2,999</u>	<u>-</u>	<u>-</u>	<u>2,999</u>
BALANCE, June 30, 2008	<u>331</u>	<u>\$ 28,236</u>	<u>\$ (872)</u>	<u>\$(2,984)</u>	<u>\$ 24,380</u>

See Notes to Consolidated Financial Statements.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended	
	June 30,	
	2008	2007
	(in millions)	
Cash Flows from Operating Activities		
Net income (loss).....	\$ (4,273)	\$ 1,846
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses.....	9,423	606
Loss (gain) from home mortgage loans.....	19	(212)
Gain from credit card loans.....	-	(259)
Loss (gain) on available-for-sale securities.....	384	(39)
(Gain) loss on extinguishment of borrowings.....	(46)	5
Depreciation and amortization.....	138	301
Change in fair value of MSR.....	492	333
Stock dividends from Federal Home Loan Banks.....	(72)	(55)
Capitalized interest income from option adjustable-rate mortgages.....	(591)	(706)
Origination and purchases of loans held for sale, net of principal payments.....	(18,601)	(54,636)
Proceeds from sales of loans originated and held for sale.....	20,271	57,926
Net decrease (increase) in trading assets.....	476	(826)
(Increase) decrease in other assets.....	(66)	177
Decrease in other liabilities.....	(941)	(462)
Net cash provided by operating activities.....	<u>6,613</u>	<u>3,999</u>
Cash Flows from Investing Activities		
Purchases of available-for-sale securities.....	(5,594)	(8,961)
Proceeds from sales of available-for-sale securities.....	6,813	4,368
Principal payments and maturities on available-for-sale securities.....	1,563	1,177
Purchases of Federal Home Loan Bank stock.....	(130)	(24)
Redemption of Federal Home Loan Bank stock.....	55	1,188
Origination and purchases of loans held in portfolio, net of principal payments.....	2,132	6,529
Proceeds from sales of loans.....	19	22,692
Proceeds from sales of foreclosed assets.....	545	354
Net (increase) decrease in federal funds sold and securities purchased under agreements to resell.....	(873)	476
Purchases of premises and equipment, net.....	(30)	(123)
Net cash provided by investing activities.....	<u>4,500</u>	<u>27,676</u>

(The Consolidated Statements of Cash Flows are continued on the next page.)

See Notes to Consolidated Financial Statements.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

(Continued from the previous page.)

	Six Months Ended	
	June 30,	
	2008	2007
	(in millions)	
Cash Flows from Financing Activities		
Increase (decrease) in deposits	\$ 1,605	\$(15,569)
(Decrease) increase in short-term borrowings	(5,511)	1,908
Proceeds from long-term borrowings	5	13,284
Repayments of long-term borrowings	(7,042)	(8,286)
Repayments of advances from Federal Home Loan Banks	19,157	20,016
Repayments of advances from Federal Home Loan Banks	(24,647)	(42,904)
Proceeds from issuance of preferred securities by subsidiary	-	497
Cash dividends paid to parent company	-	(3,400)
Contributions from parent company	<u>3,000</u>	<u>-</u>
Net cash used by financing activities	<u>(13,433)</u>	<u>(34,454)</u>
Decrease in cash and cash equivalents	(2,320)	(2,779)
Cash and cash equivalents, beginning of period	9,537	6,886
Cash and cash equivalents, end of period	<u>\$ 7,217</u>	<u>\$ 4,107</u>
Noncash Activities		
Loans exchanged for mortgage-backed securities	\$ 59	\$ 472
Real estate acquired through foreclosure	1,088	627
Loans transferred from held for sale to held in portfolio	1,434	2,624
Loans transferred from held in portfolio to held for sale	2	2,908
Cash Paid During the Period For		
Interest on deposits	\$ 2,461	\$ 3,562
Interest on borrowings	1,805	2,103
Income taxes	661	1,286

See Notes to Consolidated Financial Statements.

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1: Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements are unaudited and include the accounts of Washington Mutual Bank and its subsidiaries (“WMB” or the “Bank”). The Bank’s financial reporting and accounting policies conform to accounting principles generally accepted in the United States of America (“GAAP”), which include certain practices of the banking industry. The Bank is a direct, wholly-owned subsidiary of Washington Mutual, Inc. (“Washington Mutual” or the “Company”). In the opinion of management, all normal recurring adjustments have been included for a fair statement of the interim financial information. All significant intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The results of operations in the interim statements are not necessarily indicative of the results that may be expected for the full year. The interim financial information should be read in conjunction with Washington Mutual Bank’s 2007 Annual Report on Form 10-K/A.

Cumulative Effect from the Adoption of Accounting Pronouncements

On January 1, 2008, the Bank adopted Financial Accounting Standards Board (“FASB”) Statement No. 157, *Fair Value Measurements* (“Statement No. 157”), and Emerging Issues Task Force (“EITF”) Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (“Issue No. 06-4”). The cumulative effect, net of income taxes, on the Consolidated Statements of Stockholder’s Equity and Comprehensive Income upon the adoption of Statement No. 157 and Issue No. 06-4 was \$1 million and \$(33) million.

Recently Issued Accounting Standards Not Yet Adopted

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (“Statement No. 161”). Statement No. 161 amends and requires enhanced qualitative, quantitative and credit risk disclosures about an entity’s derivative and hedging activities, but does not change the scope or accounting principles of Statement No. 133. Statement No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. Because Statement No. 161 impacts the Bank’s disclosure and not its accounting treatment for derivative financial instruments and related hedged items, the Bank’s adoption of Statement No. 161 will not impact the Consolidated Statement of Income and the Consolidated Statement of Financial Condition.

In April 2008, the FASB issued FASB Staff Position (“FSP”) FAS 142-3, *Determination of the Useful Life of Intangible Assets* (“FSP FAS 142-3”), which amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 is effective for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Bank is currently evaluating the effect FSP FAS 142-3 will have on the Consolidated Financial Statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (“Statement No. 162”). Statement No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

nongovernmental entities. This statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Bank is currently evaluating the effect, if any, that Statement No. 162 will have on the Consolidated Financial Statements.

In May 2008, the FASB issued Statement No. 163, *Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60* ("Statement No. 163"). Statement No. 163 requires an insurance enterprise that issues financial guarantee insurance contracts to initially recognize the premiums received (or premiums expected to be received) for issuing the contracts as unearned premium revenue and to recognize that premium revenue over the period of the contract and in proportion to the amount of insurance protection provided. Statement No. 163 also requires recognition of a claim liability before an event of default if there is evidence that credit deterioration of the guaranteed obligation has occurred. This statement is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008, except for some disclosures about the insurance enterprise's risk-management activities and claim liabilities. Statement No. 163 requires that disclosures about the risk-management activities of the insurance enterprise and its claim liabilities be effective for the first period (including interim periods) beginning after its issuance. The Bank is currently evaluating the effect, if any, that Statement No. 163 will have on the Consolidated Financial Statements.

In June 2008, the FASB ratified the consensus reached by the EITF on Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock* ("Issue No. 07-5"). Issue No. 07-5 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and is applicable to outstanding instruments as of January 1, 2009. The cumulative effect of the change in accounting principle, if any, shall be recognized as an adjustment to beginning retained earnings as of January 1, 2009. The Bank is currently evaluating the effect, if any, that Issue No. 07-5 will have on the Consolidated Financial Statements.

In June 2008, the FASB ratified the consensus reached by the EITF on Issue No. 08-3, *Accounting By Lessees for Maintenance Deposits* ("Issue No. 08-3"), which clarifies that maintenance deposits shall be recognized as deposit assets and the amount that is not probable of being returned shall be recognized as additional expense. Issue No. 08-3 is effective for financial statements that are issued for fiscal years and interim periods beginning after December 15, 2008. The Bank is currently evaluating the effect, if any, that Issue No. 08-3 will have on the Consolidated Financial Statements.

Note 2: Restructuring Activities

In the second quarter of 2008, Washington Mutual implemented a series of initiatives designed to further consolidate the home loans business and corporate support and other business functions and significantly reduce future operating costs. As part of these activities, Washington Mutual discontinued all lending conducted through its wholesale channel, closed all of its remaining freestanding home loan centers and sales offices, closed or consolidated certain loan fulfillment centers and reduced functions that primarily supported home loans activities that have been discontinued. In connection with these activities, the Bank expects to incur pre-tax restructuring charges of approximately \$390 million, which consists of approximately \$110 million in termination benefits, approximately \$140 million in lease terminations and other decommissioning costs and approximately \$140 million in fixed asset write-downs. Of the total expense expected to be incurred, \$204 million was recorded in the second quarter of 2008, which consisted of \$66 million in employee termination benefits, \$46 million in lease termination and other decommissioning costs and \$92 million of fixed asset write-downs. These restructuring activities are expected to be substantially

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

completed by the fourth quarter of 2008.

Charges for termination benefits were recorded in compensation and benefits expense; charges for lease terminations, other decommissioning costs and fixed asset write-downs were recorded in occupancy and equipment expense in the Consolidated Statements of Income.

At June 30, 2008, the outstanding liability of these restructuring charges was \$103 million. Substantially all of the outstanding liability related to termination benefits is expected to be paid during the remainder of 2008. The liability related to lease terminations is expected to be paid over the remaining terms of the leases, substantially all of which will expire by December 31, 2013.

Note 3: Mortgage Banking Activities

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in millions)			
Revenue from sales and servicing of home mortgage loans:				
Sales activity:				
Gain (loss) from home mortgage loans and originated mortgage-backed securities ⁽¹⁾	\$ (162)	\$ 66	\$ (19)	\$ 212
Revaluation gain (loss) from derivatives economically hedging loans held for sale	11	126	(9)	72
Gain (loss) from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments	(151)	192	(28)	284
Servicing activity:				
Home mortgage loan servicing revenue ⁽²⁾	438	526	908	1,041
Change in MSR fair value due to payments on loans and other	(301)	(401)	(531)	(757)
Change in MSR fair value due to valuation inputs or assumptions	542	530	42	434
Revaluation loss from derivatives economically hedging MSR	(637)	(547)	(89)	(579)
Home mortgage loan servicing revenue, net of MSR valuation changes and derivative risk management instruments	42	108	330	139
Total revenue from sales and servicing of home mortgage loans	<u>\$ (109)</u>	<u>\$ 300</u>	<u>\$ 302</u>	<u>\$ 423</u>

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

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

WASHINGTON MUTUAL BANK AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

Changes in the balance of mortgage servicing rights (“MSR”) were as follows:

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(in millions)			
Fair value, beginning of period	\$ 5,726	\$ 6,507	\$ 6,278	\$ 6,193
Home loans:				
Additions	205	592	386	1,351
Change in MSR fair value due to payments on loans and other	(301)	(401)	(531)	(757)
Change in MSR fair value due to valuation inputs or assumptions	542	530	42	434
Sale of MSR	-	-	(1)	-
Net change in commercial real estate MSR ⁽¹⁾	<u>3</u>	<u>3</u>	<u>1</u>	<u>10</u>
Fair value, end of period	<u>\$ 6,175</u>	<u>\$ 7,231</u>	<u>\$ 6,175</u>	<u>\$ 7,231</u>
Unrealized gain still held ⁽²⁾	<u>\$ 544</u>	<u>\$ N/A</u>	<u>\$ 42</u>	<u>\$ N/A</u>

⁽¹⁾ Changes in commercial real estate MSR fair value are included in other income on the Consolidated Statements of Income.

⁽²⁾ Pursuant to the disclosure requirements of Statement No. 157 that was adopted by the Bank on January 1, 2008, this represents the amount of gains for the period included in earnings attributable to the change in unrealized gains relating to MSR still held at June 30, 2008.

Changes in the portfolio of mortgage loans serviced for others were as follows:

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(in millions)			
Balance, beginning of period	\$ 449,126	\$ 467,782	\$ 456,484	\$ 444,696
Home loans:				
Additions	9,828	29,949	19,690	74,500
Sale of servicing	-	-	(109)	-
Loan payments and other	(17,534)	(24,213)	(34,711)	(46,682)
Net change in commercial real estate loans	<u>181</u>	<u>1,349</u>	<u>247</u>	<u>2,353</u>
Balance, end of period	<u>\$ 441,601</u>	<u>\$ 474,867</u>	<u>\$ 441,601</u>	<u>\$ 474,867</u>

Note 4: Guarantees

In the ordinary course of business, the Bank sells loans to third parties and in certain circumstances retains credit risk exposure on those loans and may be required to repurchase them. The Bank may also be required to repurchase sold loans when representations and warranties made by the Bank in connection with those sales are breached. Under certain circumstances, such as when a loan sold to an investor and serviced by the Bank fails to perform according to its contractual terms within the six months after its origination or upon written request of the investor, the Bank will review the loan file to determine whether or not errors may have been made in the process of originating the loan. If errors are discovered and it is determined that such errors constitute a breach of a representation or warranty made to the investor in connection with the Bank’s sale of the loan, then if the breach had a material adverse effect on the value of the loan, the Bank will be required to either repurchase the loan or indemnify the investor for losses sustained. Reserves established to repurchase loans or indemnify investors are recorded as a reduction to revenue from sales and servicing of home mortgage loans on the Consolidated Statements of Income.

In addition, the Bank is a party to and from time to time enters into agreements that contain general indemnification provisions, primarily in connection with agreements to sell and service loans or other assets or the sales of mortgage servicing rights. These provisions typically require the Bank to make payments to the purchasers or other third parties to indemnify them against losses they may incur due to actions taken by the Bank prior to entering into the agreement or due to a breach of representations, warranties and covenants made in connection with the agreement or possible changes

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in or interpretations of tax law.

The Bank has recorded reserves of \$375 million and \$268 million as of June 30, 2008 and December 31, 2007, to cover its estimated exposure related to all of the aforementioned loss contingencies.

From time to time, the Bank and its subsidiaries enter into agreements in connection with the issuance of debt or equity securities which contain standard representations, warranties and indemnifications to third parties against damages, losses and expenses arising from those transactions. The extent of the Bank's obligation under these agreements depends on the occurrence of future events that cannot be determined. Accordingly, the Bank's potential future liability under these agreements cannot be estimated and it has therefore not accrued for these potential future liabilities.

Note 5: Covered Bond Program

In September 2006, WMB launched a €20 billion Covered Bond Program ("the Program") intended to diversify its investor base, lengthen the maturity profile of its liabilities and provide an additional source of stable funding. Under the Program, the Bank may, from time to time, issue floating rate U.S. dollar-denominated mortgage bonds secured principally by its portfolio of residential mortgage loans to a statutory trust not affiliated with the Bank, which in turn will issue Euro-denominated covered bonds secured by the mortgage bonds.

At June 30, 2008 and December 31, 2007, €6.00 billion in principal amount of Euro-denominated covered bonds with an average interest rate of 4.08% and \$7.78 billion in principal amount of mortgage bonds, which are included in other borrowings on the Consolidated Statements of Financial Condition, have been issued and are outstanding. Mortgage bonds are floating rate instruments with the applicable interest rate payable on mortgage bonds tied to short-term interest rates. Euro-denominated covered bonds (and related mortgage bonds) issued on September 26, 2006, mature on each of September 27, 2011 and September 27, 2016, respectively; additional Euro-denominated covered bonds (and related mortgage bonds) issued on May 18, 2007, mature on May 19, 2014.

At June 30, 2008, rating agencies required 13.4% over-collateralization with respect to assets comprising the cover pool. Over-collateralization requirements may change from time to time based on rating agency requirements, market conditions and composition of the cover pool.

To be included in the cover pool, mortgage loans must satisfy eligibility criteria which are as follows: (a) no mortgage bond issuer event of default would occur as a result of including the mortgage loan in the cover pool; (b) current ratings on covered bonds would not be adversely affected as a result of including the mortgage loan in the cover pool; (c) the mortgage loan does not have an outstanding principal balance greater than \$3,000,000; and (d) the mortgage loan is approved for inclusion in the cover pool by the rating agencies. The foregoing eligibility criteria may change from time to time subject to approval by the rating agencies. The Bank may add and remove mortgage loans from the cover pool that collateralizes mortgage bonds.

At June 30, 2008, outstanding Euro-denominated covered bonds were rated AAA by each of Standard & Poor's and Fitch, and A2 by Moody's. Euro-denominated covered bonds were on "negative watch" by Moody's and Fitch. Mortgage bonds are not rated. Under current program covenants, due to the recent downgrades of the Bank's long-term ratings by Moody's and Standard & Poor's, the Program may not issue additional covered bond series.

There are no material contingent liabilities, guarantees, or reimbursement programs entered into between the Bank, its affiliates and the issuing trusts established under the Program. The Bank is obligated to reimburse the issuing trusts for certain fees and expenses (primarily rating agency fees

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and trustee service fees) associated with the issuance of covered bonds as such fees and expenses become due; however, these are not material.

The statutory trusts formed in connection with the Program are not qualifying special purpose entities (“QSPEs”) that meet all the conditions for non-consolidation in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“Statement No. 140”). The statutory trusts are special purpose entities (“SPEs”) (which also meet the definition of variable interest entities), for purposes of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (“FIN46(R)”), but do not qualify for consolidation in the Bank’s financial statements. Specifically, under the Program documentation, the Bank’s interests in the statutory trusts do not cause the Bank to absorb the majority of expected losses or entitle it to receive the majority of residual returns, if any, upon the liquidation of the statutory trusts. The statutory trusts’ variable interests, including the covered bonds they issued, and the swap and the guaranteed investment contracts into which they entered, collectively absorb the majority of expected losses. Finally, the Bank does not control the exercise of decision-making over the statutory trusts and has no voting rights with respect to the statutory trusts.

In addition, the Bank created a separate account to guarantee payments to the statutory trusts SPEs. The separate account does not guarantee payments to an issuing trust. Rather, it constitutes an account to support payments under the mortgage bonds, which are direct obligations of the Bank. Pre-funding arrangements for direct obligations of the Bank or its subsidiaries would not affect consideration of the obligations by downstream holders of the obligations. The documentation for the Program does not entitle or obligate the Bank to absorb potential gains or losses from the statutory trusts.

The issuing trusts enter into swap arrangements which economically hedge the interest rate and currency risks borne by those trusts. Those risks result from the differences between cash inflows from the mortgage bonds held by the trust and cash outflows of the covered bonds issued by the trust. The Bank does not satisfy the conditions to consolidate the trusts and therefore is not subject to accounting requirements under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, (“Statement No. 133”) with respect to those derivative instruments.

The Bank has no reporting or disclosure obligations under Statement No.133 regarding foreign currency hedges and FASB Statement No. 52, *Foreign Currency Translation*, with respect to foreign exchange transactions. The Bank is not the issuer of the Euro-denominated covered bonds; its obligations under the Program are denominated in U.S. dollars. In addition, it is the non-consolidated statutory trusts, rather than the Bank, that are parties to the currency hedging arrangements related to the Program.

At June 30, 2008 and December 31, 2007, loans totaling \$9.74 billion and \$9.09 billion were pledged to secure borrowings issued under the Program.

Note 6: Fair Value

On January 1, 2008, the Bank adopted FASB Statement No. 157, *Fair Value Measurements* (“Statement No. 157”). Statement No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements for fair value measurements. The Bank deferred the application of Statement No. 157 for nonfinancial assets and nonfinancial liabilities as provided for by FASB Staff Position (“FSP”) FAS 157-2, *Effective Date of FASB Statement No. 157*. Issued in February 2008, FSP FAS 157-2 defers the effective date of Statement No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for nonfinancial assets and nonfinancial liabilities, except items that are recognized or disclosed at fair value in an entity’s financial statements on a recurring basis (at least annually).

Statement No. 157 nullifies the guidance in EITF 02-3, *Issues Involved in Accounting for*

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Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, which required the deferral of gains or losses at inception of a transaction involving a derivative financial instrument in the absence of observable data supporting the valuation and requires retrospective application for certain financial instruments as of the beginning of the fiscal year it is adopted.

The Bank's adoption of Statement No. 157 on January 1, 2008 resulted in a \$1 million cumulative-effect adjustment, net of income taxes, to the opening balance of retained earnings.

Fair Value Hierarchy

Statement No. 157 defines the term "fair value" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. As required by Statement No. 157, the Bank's policy is to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.

Statement No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels, considering the relative reliability of the inputs. The fair value hierarchy assigns the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of an input to the valuation that is significant to the fair value measurement. The three levels of inputs within the fair value hierarchy are defined as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market.
- Level 3 – Valuation is modeled using significant inputs that are unobservable in the market. These unobservable inputs reflect the Bank's own estimates of assumptions that market participants would use in pricing the asset or liability.

Estimation of Fair Value

Fair value is based on quoted prices in an active market when available. In certain cases where a quoted price for an asset or liability is not available, the Bank uses internal valuation models to estimate its fair value. These models incorporate inputs such as forward yield curves, loan prepayment assumptions, expected loss assumptions, market volatilities and pricing spreads utilizing market-based inputs where readily available. The Bank's estimates of fair value reflect inputs and assumptions which management believes are comparable to those that would be used by other market participants. The valuations are the Bank's estimates, and are often calculated based on internal valuation models and consider the economic environment, estimates of future loss experience, the risk characteristics of the asset or liability and other such factors. As an estimate, the fair value cannot be determined with precision and may not be realized in an actual sale or transfer of the asset or liability in a current market exchange.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value and the general classification of these instruments pursuant to the fair value hierarchy.

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Trading assets and available-for-sale securities – Trading assets and available-for-sale securities are carried at fair value on a recurring basis. When available, fair value is based on quoted prices in an active market and as such, would be classified as Level 1 (e.g., U.S. Government securities). If quoted market prices are not available, fair values are estimated using quoted prices of securities with similar characteristics, discounted cash flows or other pricing models. Trading assets and available-for-sale securities that the Bank classifies as Level 2 include certain agency and non-agency mortgage-backed securities, U.S. states and political subdivisions debt securities and other debt and equity securities. Trading assets classified as Level 3 include certain retained interests in securitizations, which are largely comprised of interests retained from credit card securitizations and other such securities for which fair value estimation requires the use of unobservable inputs. The Bank values interests retained in credit card securitizations using a discounted cash flow approach that incorporates the Bank’s expectations of prepayment speeds and its expectations of net credit losses and finance charges and fees related to the securitized assets. Risk-adjusted discount rates are based on quotes from third party sources.

In addition, trading assets and available-for-sale securities classified as Level 3 include certain non-agency mortgage-backed securities for which quoted prices or readily observable market inputs are not available and the fair value is estimated using significant assumptions that are unobservable in the market. Since the third quarter of 2007, the valuation of certain mortgage-backed securities has been impacted by adverse market conditions as the observability of inputs to the valuation of these securities has diminished significantly. The Bank generally values its non-agency mortgage-backed securities using a discounted cash flow approach using spreads for similar securities obtained from third-party sources such as broker-dealers. Due to the decline in liquidity in the mortgage-backed securities market, the spreads for certain securities obtained from multiple sources may not be available or may vary widely. As a result, the Bank must exercise significant judgment in selecting the spreads used to estimate the fair values of these securities. The Bank also employs a credit model within the valuation process that projects loss expectations including severity and frequency as an input in valuing credit-sensitive securities.

Loans held for sale – Loans that the Bank intends to sell or securitize are designated as held for sale. In some instances, the Bank may use a fair value hedge, as prescribed by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (“Statement No. 133”). Loans held for sale achieving hedge accounting treatment, as prescribed by Statement No. 133, will be carried at fair value on a recurring basis. Loans held for sale where hedge accounting treatment does not apply are carried at the lower of cost or fair value and as such, when these loans are reported at fair value, it is on a nonrecurring basis. The fair values of loans held for sale are generally based on observable market prices of securities that have loan collateral or interests in loans that are similar to the held-for-sale loans or whole loan sale prices if formally committed. If market quotes are not readily available, fair value is estimated using a discounted cash flow model, which takes into account expected prepayment factors and the degree of credit risk associated with the loans. Conforming mortgage loans held for sale which are carried at fair value are largely classified as Level 2. Nonconforming loans held for sale where fair value is based on unobservable inputs are classified as Level 3.

Loans which are transferred from held for sale to held in portfolio are transferred at the lower of cost or fair value and as such, are reported at fair value on a nonrecurring basis. Such loans are classified as either Level 2 or Level 3. The Bank may also record nonrecurring fair value adjustments to commercial real estate loans that are deemed impaired, as prescribed by FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, where the fair value is based on the current appraised value of the loan’s collateral.

Mortgage servicing rights (“MSR”) – MSR is classified as Level 3 as quoted prices are not available and the Bank uses an Option Adjusted Spread (“OAS”) valuation methodology to estimate

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the fair value of MSR. The OAS methodology projects cash flows over multiple interest rate scenarios and discounts these cash flows using risk-adjusted discount rates. Significant assumptions used in the valuation of MSR include market interest rates, projected prepayment speeds, cost of service, ancillary income and option adjusted spreads. Additionally, an independent broker estimate of the fair value of the MSR is obtained quarterly along with other market-based evidence. Management uses this information along with the OAS valuation methodology to estimate the fair value of MSR.

Derivatives – Quoted market prices are used to value exchange traded derivatives, such as futures which the Bank would classify as Level 1. However, substantially all of the Bank’s derivatives are traded in over-the-counter (“OTC”) markets where quoted market prices are not readily available. The fair value of OTC derivatives, which may include interest rate swaps, forward commitments to purchase or sell mortgage-backed securities, options and foreign currency swaps, is determined using quantitative models that require the use of multiple observable market inputs including forward interest rate projections, exchange rates and interest rate volatilities. Significant market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. These instruments fall within Level 2.

The Bank has also entered into mortgage loan commitments that are accounted for as derivatives and are valued based upon models with significant unobservable market inputs. These mortgage loan commitments are classified as Level 3. In accordance with the provisions of SEC Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value Through Earnings Under Generally Accepted Accounting Principles*, which the Bank adopted on January 1, 2008, the expected net future cash flows related to the associated servicing of loans should be included in the fair value estimation of derivative loan commitments. Under previous accounting rules, the expected value of net servicing cash flows was not recognized until the loan was funded and sold.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents for each hierarchy level the Bank's assets and liabilities that are measured at fair value on a recurring basis at June 30, 2008:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
	(in millions)			
Assets				
Trading assets	\$ 2,172	\$ –	\$ 399	\$ 1,773
Available-for-sale securities	24,028	124	22,147	1,757
Loans held for sale ⁽¹⁾	1,005	–	1,005	–
Mortgage servicing rights	6,175	–	–	6,175
Derivatives, included in other assets	1,789	–	1,779	10
Total	<u>\$ 35,169</u>	<u>\$ 124</u>	<u>\$ 25,330</u>	<u>\$ 9,715</u>
As a percentage of total assets	11%	–%	8%	3%
Liabilities				
Derivatives, included in other liabilities	\$ 810	\$ –	\$ 808	\$ 2
Other liabilities ⁽²⁾	61	61	–	–
Total	<u>\$ 871</u>	<u>\$ 61</u>	<u>\$ 808</u>	<u>\$ 2</u>

⁽¹⁾ Loans achieving hedge accounting treatment as prescribed by Statement No. 133.

⁽²⁾ Represents deferred compensation balances in which the value is based on exchange-traded securities.

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The following table presents changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the three and six months ended June 30, 2008:

	<u>Three Months Ended June 30, 2008</u>			<u>Six Months Ended June 30, 2008</u>		
	<u>Trading Assets</u>	<u>Available- for-sale Securities</u>	<u>Derivatives⁽³⁾</u>	<u>Trading Assets</u>	<u>Available- for-sale Securities</u>	<u>Derivatives⁽³⁾</u>
	(in millions)					
Fair value, beginning of period	\$ 2,131	\$ 1,657	\$ 41	\$ 2,297	\$ 2,677	\$ 15
Total gains or (losses) (realized/unrealized):						
Included in earnings	(158)	(395)	(2)	(132)	(448)	63
Included in other comprehensive income (loss)	—	281	—	—	(156)	—
Purchases, issuances and settlements	(228)	(90)	(31)	(422)	(148)	(70)
Net transfers into or out of Level 3 ⁽¹⁾	28	304	—	30	(168)	—
Fair value, end of period	<u>\$ 1,773</u>	<u>\$ 1,757</u>	<u>\$ 8</u>	<u>\$ 1,773</u>	<u>\$ 1,757</u>	<u>\$ 8</u>
Net unrealized gains still held ⁽²⁾	<u>\$ (157)</u>	<u>\$ (396)</u>	<u>\$ 8</u>	<u>\$ (134)</u>	<u>\$ (450)</u>	<u>\$ 8</u>

Note: For changes in the fair value of MSR, see Note 3 to the Consolidated Financial Statements – “Mortgage Banking Activities.”

- ⁽¹⁾ Assets and liabilities transferred into or out of Level 3 during the period are reported at their fair values on the last day of the same period.
- ⁽²⁾ Represents the amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains (losses) relating to assets and liabilities classified as Level 3 that are still held at June 30, 2008.
- ⁽³⁾ Level 3 derivative assets and liabilities have been netted on these tables for presentation purposes only.

The following table summarizes gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in earnings for Level 3 assets and liabilities for the three and six months ended June 30, 2008:

	<u>Three Months Ended June 30, 2008</u>			<u>Six Months Ended June 30, 2008</u>		
	<u>Trading Assets</u>	<u>Available- for-sale Securities</u>	<u>Derivatives⁽¹⁾</u>	<u>Trading Assets</u>	<u>Available- for-sale Securities</u>	<u>Derivatives⁽¹⁾</u>
	(in millions)					
Interest income – available-for-sale securities	\$ —	\$ 11	\$ —	\$ —	\$ 24	\$ —
Interest income – trading assets	112	—	—	216	—	—
Revenue from sales and servicing of home mortgage loans	—	—	(2)	—	—	60
Revenue from sales and servicing of consumer loans	12	—	—	121	—	—
Loss on other available-for-sale securities ...	—	(406)	—	—	(472)	—
Loss on trading assets	(282)	—	—	(469)	—	—
Other income	—	—	—	—	—	3
Total	<u>\$ (158)</u>	<u>\$ (395)</u>	<u>\$ (2)</u>	<u>\$ (132)</u>	<u>\$ (448)</u>	<u>\$ 63</u>

Note: For gains and losses due to changes in fair value of MSR, see Note 3 to the Consolidated Financial Statement – “Mortgage Banking Activities.”

- ⁽¹⁾ Gains and losses on Level 3 derivative exposures have been netted on these tables for presentation purposes only.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances. These adjustments to fair value usually result from the application of lower of cost or fair value accounting or recognition of impairment of assets.

Loans held for sale included loans which were adjusted to fair value using Level 2 and Level 3 inputs within the fair value hierarchy. These loans had an aggregate cost of \$687 million and \$41

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million and a fair value of \$685 million and \$37 million at June 30, 2008 and March 31, 2008. The losses of \$2 million and \$6 million were included in earnings within the revenue from sales and servicing of home mortgage loans classification for the three and six months ended June 30, 2008.

The following table summarizes loans transferred from loans held for sale to loans held in portfolio, including losses for the three and six months ended June 30, 2008:

	Three Months Ended June 30, 2008			Six Months Ended June 30, 2008		
	Aggregate Cost	Fair Value	Loss	Aggregate Cost	Fair Value	Loss
	(in millions)					
Commercial loans transferred to loans held in portfolio ⁽¹⁾	\$ -	\$ -	\$ -	\$ 145	\$ 143	\$ (2)
Home loans transferred to loans held in portfolio ⁽²⁾	21	17	(4)	68	55	(13)
Total	<u>\$ 21</u>	<u>\$ 17</u>	<u>\$ (4)</u>	<u>\$ 213</u>	<u>\$ 198</u>	<u>\$ (15)</u>

⁽¹⁾ Loans were adjusted to the lower of cost or fair value using Level 2 inputs with losses included within other noninterest income.

⁽²⁾ Loans were adjusted to the lower of cost or fair value using Level 3 inputs with losses included within revenue from sales and servicing of home mortgage loans.

Fair Value Option

FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“Statement No. 159”) became effective on January 1, 2008. Statement No. 159 permits an instrument by instrument irrevocable election to account for selected financial assets and financial liabilities at fair value. The Bank did not elect to apply the fair value option to any eligible financial assets or financial liabilities on January 1, 2008 or during the first half of 2008. Subsequent to the initial adoption, the Bank may elect to account for selected financial assets and financial liabilities at fair value. Such an election could be made at the time an eligible financial asset, financial liability or firm commitment is recognized or when certain specified reconsideration events occur.

Note 7: Related Party Transactions

In the ordinary course of business, the Bank accepts deposits from affiliated companies. At June 30, 2008 and December 31, 2007, deposits from affiliated companies, such as Washington Mutual, Inc., its parent company, that were not eliminated in consolidation totaled \$6.42 billion and \$4.94 billion of which \$129 million and \$243 million were interest-bearing. Interest expense associated with these deposits was \$1 million and \$5 million for the three months ended June 30, 2008 and 2007 and \$2 million and \$10 million for the six months ended June 30, 2008 and 2007.

Following the end of the second quarter of 2008, the Bank received a \$2 billion capital contribution from Washington Mutual, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

Risk Factors

Washington Mutual Bank's ("WMB" or the "Bank") Form 10-Q and other documents that it files with the Office of Thrift Supervision ("OTS") contain forward-looking statements. In addition, the Bank'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 as "will," "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 Bank's revenues, income, capital expenditures, 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 made and management does not undertake to update them to reflect changes or events that occur after that date except as required by federal securities laws.

There are a number of significant factors which could cause actual conditions, events or results to differ materially from those described in the forward-looking statements, many of which are beyond management's control or its ability to accurately forecast or predict. Factors that might cause the Bank's future performance to vary from that described in its forward-looking statements include market, credit, operational, regulatory, strategic, liquidity, capital and economic factors as discussed in "Management's Discussion and Analysis" and in other periodic reports filed with the OTS. In addition, other factors besides those listed below or discussed in reports filed with the OTS could adversely affect the Bank's results and this list is not a complete set of all potential risks or uncertainties. Significant among the factors are the following which are described in greater detail in Part I Item 1A – "Risk Factors" in the Bank's 2007 Annual Report on Form 10-K/A:

- Economic conditions that negatively affect housing prices and the job market have resulted, and may continue to result, in a deterioration in credit quality of the Bank's loan portfolios, and such deterioration in credit quality has had, and could continue to have, a negative impact on the Bank's business;
- The Bank's access to market-based liquidity sources may be negatively impacted if market conditions persist or if further ratings downgrades occur. Funding costs may increase from current levels, and gain on sale may be reduced, leading to reduced earnings;
- If the Bank has significant additional losses, it may need to raise additional capital;
- Changes in interest rates may adversely affect the Bank's business, including net interest income and earnings;
- Certain of the Bank's loan products have features that may result in increased credit risk;
- The Bank uses estimates in determining the fair value of certain of its assets, which estimates may prove to be imprecise and result in significant changes in valuation;
- The Bank is subject to risks related to credit card operations, and this may adversely affect its credit card portfolio and its ability to continue growing the credit card business;
- The Bank is subject to operational risk, which may result in incurring financial losses and reputational issues;

- The Bank's failure to comply with laws and regulations could have adverse effects on the Bank's operations and profitability;
- Changes in the regulation of financial services companies, housing government-sponsored enterprises, mortgage originators and servicers, and credit card lenders could adversely affect the Bank;
- The Bank's business and earnings are highly sensitive to general business, economic and market conditions, and continued deterioration in these conditions may adversely affect its business and earnings;
- The Bank may face damage to its professional reputation and business as a result of allegations and negative public opinion as well as pending and threatened litigation; and
- The Bank is subject to significant competition from banking and nonbanking companies.

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

Controls and Procedures

Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

Management reviews and evaluates the design and effectiveness of the Bank's internal control over financial reporting on an ongoing basis, which may result in the discovery of deficiencies, some of which may be significant. Management changes its internal control over financial reporting as needed to maintain its effectiveness, correcting any deficiencies, as needed, in order to ensure the continued effectiveness of the Bank's internal control over financial reporting. There have not been any changes in the Bank's internal control over financial reporting during the second quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting. For management's assessment of the Bank's internal control over financial reporting, refer to the Bank's 2007 Annual Report on Form 10-K/A, "Management's Report on Internal Control Over Financial Reporting."

Critical Accounting Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States of America ("GAAP") requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the financial statements. Various elements of the Bank's accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent

uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those the Bank applied, which might have produced different results that could have had a material effect on the financial statements.

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

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of the Board of Directors. The Bank believes that the judgments, estimates and assumptions used in the preparation of its financial statements are appropriate given the facts and circumstances as of June 30, 2008. The nature of these judgments, estimates and assumptions are described in greater detail in the Bank's 2007 Annual Report on Form 10-K/A in the "Critical Accounting Estimates" section of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements – "Summary of Significant Accounting Policies."

Fair Value of Certain Financial Instruments and Other Assets

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

Adoption of FASB Statement No. 157, Fair Value Measurement

On January 1, 2008, the Bank adopted FASB Statement No. 157, *Fair Value Measurement* ("Statement No. 157"). Statement No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels, based on the relative reliability of the inputs. The fair value hierarchy assigns the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels are defined as follows:

- Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities.
- Level 2 – Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market.
- Level 3 – Valuation is modeled using significant inputs that are unobservable in the market.

In accordance with Statement No. 157, it is the Bank's policy to rely on the use of observable market information whenever possible when developing fair value measurements. Generally, for assets that are reported at fair value, the Bank uses quoted market prices or internal valuation models to estimate their fair value. These models incorporate inputs such as forward yield curves, loan prepayment assumptions, expected loss assumptions, market volatilities and pricing spreads utilizing market-based inputs where readily available. The degree of management judgment involved in estimating the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market value inputs. For financial instruments that are actively traded in the

marketplace or whose values are based on readily available market value data, little judgment is necessary when estimating the instrument's fair value. Financial instruments that are valued using market-based information will usually be classified as either Level 1 or Level 2.

When observable market prices and data are not readily available, significant management judgment often is necessary to estimate fair value. These financial instruments are classified as Level 3 and include those assets and liabilities in which internal valuation models using significant unobservable inputs are used to estimate fair value. The models' inputs reflect assumptions, such as discount rates and prepayment speeds, which the Bank believes market participants would use in valuing the financial instruments. The various assumptions used in the Bank's valuation models are periodically adjusted to account for changes in current market conditions. Accordingly, results from valuation models in one period may not be indicative of future period measurements, and changes made to assumptions could result in significant changes in valuation.

Substantially all of the Bank's Level 1 assets at June 30, 2008 were U.S. Government securities. Assets and liabilities generally included as Level 2 include substantially all of the Bank's available-for-sale securities, including mortgage-backed securities, debt and equity securities issued by U.S. states, political subdivisions or commercial enterprises; those conforming mortgage loans held for sale that are carried at fair value; and derivative contracts traded in over-the-counter markets, such as interest rate swaps, forwards and options, and foreign currency swaps.

Level 3 assets are comprised of the Bank's mortgage servicing rights ("MSR"), substantially all trading assets, mortgage loan commitments that are accounted for as derivatives, and certain available-for-sale securities in which market-based information to estimate fair value was not available. The Bank's Level 3 assets totaled \$9.72 billion at June 30, 2008 and represented approximately 28% of total assets measured at fair value on a recurring basis and approximately 3% of the Bank's total assets.

See Note 6 to the Consolidated Financial Statements – "Fair Value" for a further description of the valuation methodologies used for assets and liabilities measured at fair value.

Fair Value of Reporting Units and Goodwill Impairment

Under FASB Statement No. 142, *Goodwill and Other Intangible Assets*, goodwill must be allocated to reporting units and tested for impairment. Goodwill is tested 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 by Washington Mutual, Inc. ("Washington Mutual" or the "Company") at the reporting unit level. The Bank's goodwill totaled \$7.28 billion as of June 30, 2008. The first part of the test is a comparison, at the reporting unit level, of the fair value of each reporting unit to its carrying value, including goodwill. If the fair value is less than the carrying value, then the second part of the test is needed to measure the amount of potential goodwill impairment. The implied fair value of the reporting unit goodwill is calculated and compared with the actual carrying value of goodwill recorded within the reporting unit. If the carrying value of reporting unit goodwill exceeds the implied fair value of that goodwill, then an impairment loss would be recognized for the amount of the difference, which would be recorded as a charge against net income.

The estimation of fair value for each reporting unit is determined primarily through a discounted cash flow approach that considers the market environment and the Company's expectations about future conditions. Estimated fair value computed under this approach contemplates cash flow projections based on the internal business forecasts for each reporting unit, and appropriate discount rates. Estimation of fair value involves significant management judgment about future conditions that are inherently uncertain, including the results of operations and the extent and timing of credit losses. 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.

In the second quarter, the Company considered the continuing adverse conditions within the market environment and the Company's best estimates regarding future conditions including credit losses, and concluded that there was no goodwill impairment within its reporting units with recorded goodwill as of June 30, 2008. A continuing period of market disruption, Washington Mutual's diminished trading value and market capitalization, or further market deterioration are factors the Company will continue to consider in future evaluations of recorded goodwill for impairment, including particularly its annual evaluation to be conducted in the third quarter of 2008 and subsequent evaluations.

Overview

The Bank recorded a net loss in the second quarter of 2008 of \$3.19 billion, compared with net income of \$935 million in the second quarter of 2007, primarily due to the Bank's significant increase in loan reserves by \$3.74 billion to \$8.46 billion.

The Bank recorded a provision for loan losses of \$5.91 billion in the second quarter of 2008, an increase of \$5.54 billion from the second quarter of 2007 and significantly higher than second quarter 2008 net charge-offs, which totaled \$2.17 billion. Net charge-offs in the second quarter of 2007 were \$271 million. Adverse trends in key credit risk indicators, including high inventory levels of unsold homes, rising foreclosure rates, the significant contraction in the availability of credit for nonconforming mortgage products and negative job growth trends exerted severe pressure on the performance of the single-family residential ("SFR") loan portfolio, particularly loans in geographic areas in which the Bank's lending activities have been concentrated in recent years. Nationwide sales volume of existing homes in June 2008 was 15% lower than June 2007, leading to a supply of unsold homes of approximately 11.1 months, a 22% increase from June 2007, while the national median sales price for existing homes fell by 6% between those periods. Since July 2006, average home prices declined 19%, as measured by the S&P Case-Shiller 10-City Composite Home Price Index, or 22% when this index is weighted to reflect the geographic distribution of the Bank's SFR portfolio. Foreclosure filings were also up significantly, increasing by 121% from the second quarter of 2007 to the second quarter of 2008.

The deteriorating housing market conditions resulted in sharply higher delinquency rates and restructurings of troubled loans, as the Bank has intensified its efforts to work with borrowers to keep them in their homes whenever it can do so. The ratio of nonperforming assets to total assets rose to 3.65% at June 30, 2008, compared with 1.29% at June 30, 2007. Restructured nonaccrual loans accounted for 0.47% of the nonperforming assets to total assets ratio at June 30, 2008, compared with 0.05% of the ratio at June 30, 2007. Cure rates on early stage delinquencies, representing loans that are up to three payments past due, have also deteriorated, as declining home values and the reduced availability of credit throughout the mortgage market have created conditions in which many borrowers cannot refinance their mortgage or sell their home at a price that is sufficient to repay their mortgage.

Deteriorating trends in delinquency rates began migrating across the different types of loans in the Bank's SFR portfolio starting in 2007. Rising levels of delinquencies initially occurred within the subprime mortgage channel during the first half of 2007, followed by the appearance of higher delinquencies in home equity loans and lines of credit during the second half of 2007. During the first half of 2008, Option ARMs have been the product type exhibiting the greatest increase in delinquency rates. The increases in Option ARM delinquencies are generally concentrated in geographic markets that have experienced the most significant levels of housing price depreciation, particularly in the inland regions of California and the Southeastern section of the country. While Option ARM loans that have experienced negative amortization are subject to payment recasting events, the presence of this feature has not been a significant contributor to the increase in delinquency rates, as the majority of recasts are not contractually scheduled to occur until 2010 and later years.

In addition to higher delinquency levels within its SFR loan portfolio, the Bank also began experiencing deteriorating trends in loan loss severities starting in 2007, which continued to increase in the second quarter of 2008, reflecting the steep decline in home prices. Annualized net SFR charge-offs as a percentage of the average balance of the SFR portfolio increased from 0.39% in the second quarter of 2007 to 4.21% in the second quarter of 2008.

In response to these deteriorating trends in housing market conditions, delinquencies and loss severities, the Bank has continued in 2008 to update its loan loss provisioning assumptions for its SFR portfolio, changing key assumptions used to evaluate default frequencies and loss severities, to reflect these trends. These updated assumptions accounted for approximately one-third of the provision recorded in the second quarter of 2008 and approximately \$1.2 billion of the provision recorded in the first quarter of 2008. Refer to Credit Risk Management – “Allowance for Loan Losses” section for further discussion of these changes and a general discussion of the Allowance for Loan Losses.

The Bank also experienced declines in the credit performance of its credit card portfolio during the first half of 2008, reflecting a softening U.S. economy and increased national unemployment, the macroeconomic factors that generally have the greatest impact on consumer spending and credit card performance. Annualized net credit card charge-offs as a percentage of the average balance of the credit card portfolio were 6.51% in the second quarter of 2008 and 3.63% in the second quarter of 2007. The national unemployment rate increased to 5.5% in June 2008 from 4.6% in June 2007, while the U.S. economy lost approximately 191,000 net jobs during the second quarter of 2008, compared with net job growth of 315,000 in the second quarter of 2007.

With the elevated levels of loan loss provisioning and charge-offs in its loan portfolios, Washington Mutual took steps to bolster its capital and liquidity positions during the second quarter. In April 2008, Washington Mutual issued approximately \$7.2 billion of equity, comprised of common stock; perpetual, non-cumulative convertible preferred stock that was subsequently converted into common shares on June 30, 2008; and warrants, of which \$3.0 billion was contributed to the Bank during the second quarter of 2008 and an additional \$2.0 billion was contributed following the end of the second quarter. The Bank also reduced the size of its balance sheet by \$19 billion since the beginning of 2008. The Bank expects that 2008 will be the peak year for loan loss provisioning.

At June 30, 2008, the Bank’s Tier 1 capital to adjusted total assets ratio was 7.07%, and its total risk-based capital to total risk-weighted assets ratio was 12.44%, exceeding the regulatory guidelines for well-capitalized institutions, and the tangible equity to total tangible assets ratio was 7.02%, above the Bank’s established target of 5.50%.

Net interest income was \$2.35 billion in the second quarter of 2008, compared with \$2.16 billion in the second quarter of 2007. The increase was due to the expansion of the net interest margin, which increased, on a taxable-equivalent basis, from 3.09% in the second quarter of 2007 to 3.31% in the second quarter of 2008. As the Bank’s short-term wholesale borrowing costs repriced to current market rates faster than most of its interest-earning assets, the margin was aided by lower short-term interest rates, reflecting the actions taken by the Federal Reserve to stimulate the economy in light of the deteriorating housing market and higher unemployment rates. Since June 30, 2007, the target Federal Funds rate declined from 5.25% to 2.00%.

Noninterest income totaled \$718 million in the second quarter of 2008, compared with \$1.76 billion in the same quarter of 2007. Results from the sales and servicing of home mortgage loans declined from net revenue of \$300 million in the second quarter of 2007 to net expense of \$109 million in the second quarter of 2008. Continuing illiquidity in the secondary market for nonconforming loans, along with the Bank’s decisions to discontinue all lending through the subprime mortgage channel in the fourth quarter of 2007 and the wholesale mortgage channel in April 2008 led to significantly lower mortgage production activity. Additionally, the provision for loan repurchases rose significantly, primarily reflecting an increase in the volume of investor requests to repurchase loans the Bank had previously sold. Revenue from the sales and servicing of consumer

loans declined from \$403 million in the second quarter of 2007 to \$159 million in the second quarter of 2008 as the absence of securitization sales activity from the continued illiquid secondary market for unsecured loan products decreased the amount of gain on sale and higher net credit losses on securitized loans lowered excess servicing income. The Bank also recorded a \$407 million loss through earnings from the write-down of certain mortgage backed securities within the available-for-sale securities portfolio, reflecting credit deterioration in which the declines in value were determined to represent an other-than-temporary impairment condition.

Noninterest expense totaled \$2.37 billion in the second quarter of 2008, compared with \$2.10 billion in the second quarter of 2007. With high volumes of delinquent loans migrating to foreclosure status and the steep declines in home prices, foreclosed asset expense increased from \$56 million in the second quarter of 2007 to \$217 million in the second quarter of 2008. Foreclosure expenses are expected to remain elevated until housing market conditions stabilize. In addition to the actions taken in the fourth quarter of 2007 to resize the home loans business and corporate and other functions, the Bank initiated additional measures in the second quarter of 2008 to significantly reduce expenses, primarily within the home loans business and corporate support functions. The Bank expects to incur approximately \$450 million of restructuring and resizing costs related to these measures, of which \$207 million were recorded in the second quarter, and anticipates that annualized expense savings of approximately \$1 billion will be realized upon the completion of these initiatives.

Recently Issued Accounting Standards Not Yet Adopted

Refer to Note 1 to the Consolidated Financial Statements – “Summary of Significant Accounting Policies.”

Earnings Performance

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

	Three Months Ended June 30,					
	2008			2007		
	Average Balance	Rate	Interest Income	Average Balance	Rate	Interest Income
	(dollars in millions)					
Assets (Taxable-Equivalent Basis⁽¹⁾)						
Interest-earning assets ⁽²⁾ :						
Federal funds sold and securities purchased under agreements to resell.....	\$ 2,161	2.15%	\$ 11	\$ 3,964	5.39%	\$ 53
Trading assets	2,267	20.49	115	4,853	8.76	106
Available-for-sale securities ⁽³⁾ :						
Mortgage-backed securities	19,138	5.67	271	19,169	5.39	259
Investment securities.....	4,989	4.99	63	7,314	5.21	95
Loans held for sale	3,672	5.62	52	26,225	6.43	421
Loans held in portfolio ⁽⁴⁾ :						
Loans secured by real estate:						
Home loans ⁽⁵⁾⁽⁶⁾	107,278	5.83	1,563	90,797	6.44	1,462
Home equity loans and lines of credit ⁽⁶⁾	60,964	5.12	777	54,431	7.59	1,030
Subprime mortgage channel ⁽⁷⁾	16,933	6.05	256	20,152	6.80	343
Home construction ⁽⁸⁾	1,973	7.41	37	2,043	6.72	34
Multi-family	32,782	6.13	502	29,412	6.65	489
Other real estate.....	10,205	6.26	159	6,843	7.03	120
Total loans secured by real estate	230,135	5.73	3,294	203,678	6.84	3,478
Consumer:						
Credit card	9,443	11.56	271	10,101	10.44	263
Other.....	179	16.85	7	254	12.44	8
Commercial.....	1,954	6.76	33	1,943	7.73	37
Total loans held in portfolio.....	241,711	5.98	3,605	215,976	7.02	3,786
Other	11,036	3.00	83	2,078	5.47	29
Total interest-earning assets.....	284,974	5.91	4,200	279,579	6.80	4,749
Noninterest-earning assets:						
Mortgage servicing rights	6,115			6,782		
Goodwill	7,283			9,054		
Other assets	15,947			18,808		
Total assets.....	<u>\$ 314,319</u>			<u>\$ 314,223</u>		

(This table is continued on the next page.)

⁽¹⁾ Includes taxable-equivalent adjustments primarily related to tax-exempt income on U.S. states and political subdivisions securities and loans related to the Bank's community lending and investment activities. The federal statutory tax rate was 35% for the periods presented.

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

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

⁽⁴⁾ Interest income for loans held in portfolio includes amortization of net deferred loan origination costs of \$77 million and \$155 million for the three months ended June 30, 2008 and 2007.

⁽⁵⁾ Capitalized interest recognized in earnings that resulted from negative amortization within the Option ARM portfolio totaled \$255 million and \$344 million for the three months ended June 30, 2008 and 2007.

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

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

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

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	Three Months Ended June 30,					
	2008			2007		
	Average Balance	Rate	Interest Expense	Average Balance	Rate	Interest Expense
	(dollars in millions)					
Liabilities						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking deposits.....	\$ 22,619	1.39%	\$ 78	\$ 30,373	2.51%	\$ 190
Savings and money market deposits	62,134	2.17	335	59,098	3.35	493
Time deposits	<u>69,161</u>	4.08	<u>702</u>	<u>84,330</u>	4.96	<u>1,043</u>
Total interest-bearing deposits.....	153,914	2.91	1,115	173,801	3.98	1,726
Federal funds purchased and commercial paper	79	3.05	1	2,169	5.36	29
Securities sold under agreements to repurchase	406	2.20	2	8,416	5.35	112
Advances from Federal Home Loan Banks.....	60,402	3.36	505	22,063	5.36	295
Other.....	<u>24,162</u>	3.62	<u>218</u>	<u>32,281</u>	5.31	<u>427</u>
Total interest-bearing liabilities.....	238,963	3.10	<u>1,841</u>	238,730	4.35	<u>2,589</u>
Noninterest-bearing sources:						
Noninterest-bearing deposits.....	36,928			35,064		
Other liabilities	7,048			8,469		
Minority interests	3,912			2,657		
Stockholder's equity.....	<u>27,468</u>			<u>29,303</u>		
Total liabilities and stockholder's equity.....	<u>\$ 314,319</u>			<u>\$ 314,223</u>		
Net interest spread and net interest income on a taxable-equivalent basis		2.81	<u>\$ 2,359</u>		2.45	<u>\$ 2,160</u>
Impact of noninterest-bearing sources		0.50			0.64	
Net interest margin on a taxable-equivalent basis		3.31			3.09	

	Six Months Ended June 30,					
	2008			2007		
	Average Balance	Rate	Interest Income	Average Balance	Rate	Interest Income
(dollars in millions)						
Assets (Taxable-Equivalent Basis⁽¹⁾)						
Interest-earning assets ⁽²⁾ :						
Federal funds sold and securities purchased under agreements to resell.....	\$ 2,139	2.81%	\$ 30	\$ 3,947	5.39%	\$ 105
Trading assets	2,426	19.05	230	5,150	8.45	217
Available-for-sale securities ⁽³⁾ :						
Mortgage-backed securities	19,037	5.74	546	18,813	5.44	511
Investment securities.....	5,509	5.20	143	6,702	5.21	175
Loans held for sale.....	4,323	6.40	138	30,810	6.40	984
Loans held in portfolio ⁽⁴⁾ :						
Loans secured by real estate:						
Home loans ⁽⁵⁾⁽⁶⁾	108,514	6.05	3,282	94,054	6.45	3,032
Home equity loans and lines of credit ⁽⁶⁾	61,080	5.70	1,733	53,726	7.57	2,020
Subprime mortgage channel ⁽⁷⁾	17,519	6.19	543	20,381	6.74	686
Home construction ⁽⁸⁾	2,058	7.54	78	2,052	6.63	68
Multi-family	32,369	6.23	1,009	29,614	6.61	979
Other real estate.....	10,001	6.37	317	6,803	7.03	238
Total loans secured by real estate	231,541	6.02	6,962	206,630	6.81	7,023
Consumer:						
Credit card.....	9,233	11.16	513	10,500	11.03	574
Other.....	188	17.18	16	261	12.56	16
Commercial.....	1,972	7.06	69	1,874	7.84	73
Total loans held in portfolio.....	242,934	6.23	7,560	219,265	7.03	7,686
Other.....	8,510	3.33	141	2,767	5.65	78
Total interest-earning assets.....	284,878	6.18	8,788	287,454	6.81	9,756
Noninterest-earning assets:						
Mortgage servicing rights	5,998			6,545		
Goodwill	7,285			9,054		
Other assets.....	18,270			19,092		
Total assets.....	<u>\$ 316,431</u>			<u>\$ 322,145</u>		

(This table is continued on the next page.)

- ⁽¹⁾ Includes taxable-equivalent adjustments primarily related to tax-exempt income on U.S. states and political subdivisions securities and loans related to the Bank's community lending and investment activities. The federal statutory tax rate was 35% for the periods presented.
- ⁽²⁾ Nonaccrual assets and related income, if any, are included in their respective categories.
- ⁽³⁾ The average balance and yield are based on average amortized cost balances.
- ⁽⁴⁾ Interest income for loans held in portfolio includes amortization of net deferred loan origination costs of \$140 million and \$314 million for the six months ended June 30, 2008 and 2007.
- ⁽⁵⁾ Capitalized interest recognized in earnings that resulted from negative amortization within the Option ARM portfolio totaled \$591 million and \$706 million for the six months ended June 30, 2008 and 2007.
- ⁽⁶⁾ Excludes home loans and home equity loans and lines of credit in the subprime mortgage channel.
- ⁽⁷⁾ Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio.
- ⁽⁸⁾ Represents loans to builders for the purpose of financing the acquisition, development and construction of single-family residences for sale and construction loans made directly to the intended occupant of a single-family residence.

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	Six Months Ended June 30,					
	2008			2007		
	Average Balance	Rate	Interest Expense	Average Balance	Rate	Interest Expense
	(dollars in millions)					
Liabilities						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking deposits.....	\$ 23,502	1.58%	\$ 184	\$ 31,093	2.57%	\$ 397
Savings and money market deposits	59,073	2.43	715	57,051	3.32	939
Time deposits	<u>71,693</u>	4.33	<u>1,545</u>	<u>87,960</u>	4.96	<u>2,165</u>
Total interest-bearing deposits.....	154,268	3.19	2,444	176,104	4.01	3,501
Federal funds purchased and commercial paper	544	3.58	10	3,003	5.44	81
Securities sold under agreements to repurchase	646	3.28	10	10,247	5.43	276
Advances from Federal Home Loan Banks.....	61,600	3.83	1,175	29,019	5.37	773
Other.....	<u>25,377</u>	4.13	<u>522</u>	<u>28,366</u>	5.34	<u>752</u>
Total interest-bearing liabilities.....	242,435	3.45	<u>4,161</u>	246,739	4.40	<u>5,383</u>
Noninterest-bearing sources:						
Noninterest-bearing deposits.....	35,170			35,321		
Other liabilities.....	7,812			8,576		
Minority interests	3,913			2,553		
Stockholder's equity.....	<u>27,101</u>			<u>28,956</u>		
Total liabilities and stockholder's equity.....	<u>\$ 316,431</u>			<u>\$ 322,145</u>		
Net interest spread and net interest income on a						
taxable-equivalent basis.....		2.73	<u>\$ 4,627</u>		2.41	<u>\$ 4,373</u>
Impact of noninterest-bearing sources		0.51			0.62	
Net interest margin on a taxable-equivalent basis		3.24			3.03	

Net Interest Income

Net interest income, expressed on a taxable-equivalent basis, increased \$199 million and \$254 million for the three and six months ended June 30, 2008 as compared to the same periods in 2007. The increase was largely due to the expansion of the net interest margin, which increased, on a taxable-equivalent basis, 22 basis points and 21 basis points during the three and six months ended June 30, 2008 as compared to 2007. The decrease in deposit and borrowing costs, aided by actions taken by the Federal Reserve which lowered the target Federal Funds rate from 5.25% at June 30, 2007 to 2.00% at June 30, 2008, more than offset the downward repricing of the loan portfolio, which generally responds to declining interest rates at a slower pace than the Bank's wholesale borrowing sources. An increase in nonaccruing home loans also contributed to the decline in the yield on average interest-earning assets.

Average total noninterest-bearing liabilities used to fund average total interest-earning assets increased from approximately 15% for the three months ended June 30, 2007 to approximately 16% for the same period in 2008, reflecting, in part, the effects from Washington Mutual's April 2008 \$7.2 billion capital issuance, of which \$3.0 billion was contributed to the Bank during the second quarter of 2008.

Noninterest Income

Noninterest income consisted of the following:

	Three Months Ended		Percentage	Six Months Ended		Percentage
	June 30,			June 30,		
	2008	2007	Change	2008	2007	Change
(dollars in millions)						
Revenue from sales and servicing of home mortgage loans.....	\$ (109)	\$ 300	–%	\$ 302	\$ 423	(29)%
Revenue from sales and servicing of consumer loans.....	159	403	(61)	407	846	(52)
Depositor and other retail banking fees.....	767	720	7	1,470	1,384	6
Credit card fees.....	177	183	(3)	358	355	1
Securities fees and commissions.....	64	70	(9)	122	131	(6)
Insurance income.....	22	22	(1)	44	43	–
Loss on trading assets.....	(305)	(145)	111	(520)	(253)	106
Gain (loss) on other available-for-sale securities.....	(402)	4	–	(384)	39	–
Gain (loss) on extinguishment of borrowings.....	47	1	–	46	(5)	–
Other income.....	298	203	47	452	315	43
Total noninterest income.....	<u>\$ 718</u>	<u>\$ 1,761</u>	(59)	<u>\$ 2,297</u>	<u>\$ 3,278</u>	(30)

Revenue from sales and servicing of home mortgage loans

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

	Three Months Ended		Percentage	Six Months Ended		Percentage
	June 30,			June 30,		
	2008	2007	Change	2008	2007	Change
(dollars in millions)						
Revenue from sales and servicing of home mortgage loans:						
Sales activity:						
Gain (loss) from home mortgage loans and originated mortgage-backed securities ⁽¹⁾	\$ (162)	\$ 66	–%	\$ (19)	\$ 212	–%
Revaluation gain (loss) from derivatives economically hedging loans held for sale.....	11	126	(91)	(9)	72	–
Gain (loss) from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments.....	(151)	192	–	(28)	284	–
Servicing activity:						
Home mortgage loan servicing revenue ⁽²⁾	438	526	(17)	908	1,041	(13)
Change in MSR fair value due to payments on loans and other.....	(301)	(401)	(25)	(531)	(757)	(30)
Change in MSR fair value due to valuation inputs or assumptions.....	542	530	2	42	434	(90)
Revaluation loss from derivatives economically hedging MSR.....	(637)	(547)	17	(89)	(579)	(85)
Home mortgage loan servicing revenue, net of MSR valuation changes and derivative risk management instruments.....	42	108	(62)	330	139	139
Total revenue from sales and servicing of home mortgage loans.....	<u>\$ (109)</u>	<u>\$ 300</u>	–	<u>\$ 302</u>	<u>\$ 423</u>	(29)

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

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

The following table presents MSR valuation and the corresponding risk management derivative instruments and securities during the three and six months ended June 30, 2008 and 2007:

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
MSR Valuation and Risk Management:				
(in millions)				
Change in MSR fair value due to valuation inputs or assumptions	\$ 542	\$ 530	\$ 42	\$ 434
Loss on MSR risk management instruments:				
Revaluation loss from derivatives economically hedging MSR.....	(637)	(547)	(89)	(579)
Revaluation loss from certain trading securities.....	(2)	(4)	(2)	-
Total loss on MSR risk management instruments.....	<u>(639)</u>	<u>(551)</u>	<u>(91)</u>	<u>(579)</u>
Total changes in MSR valuation and risk management	<u>\$ (97)</u>	<u>\$ (21)</u>	<u>\$ (49)</u>	<u>\$ (145)</u>

The following table reconciles the loss on investment securities that are designated as MSR risk management instruments to loss on trading assets that are reported within noninterest income during the three and six months ended June 30, 2008 and 2007:

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
(in millions)				
Loss on trading assets resulting from:				
MSR risk management instruments	\$ (2)	\$ (4)	\$ (2)	\$ -
Other	<u>(303)</u>	<u>(141)</u>	<u>(518)</u>	<u>(253)</u>
Total loss on trading assets.....	<u>\$ (305)</u>	<u>\$ (145)</u>	<u>\$ (520)</u>	<u>\$ (253)</u>

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

Loss from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments, was \$151 million in the second quarter of 2008 compared with a gain of \$192 million in the same period of 2007, and a loss of \$28 million for the six months ended June 30, 2008, compared with a gain of \$284 million for the same period in 2007. The decreases for the three and six months ended June 30, 2008 reflected significantly lower sales and production volume as the Bank discontinued all lending through the subprime mortgage channel in the fourth quarter of 2007 and the wholesale mortgage channel in April 2008 and retained more loans in its portfolio in response to the severe contraction in the secondary mortgage markets for substantially all loans not eligible for purchase by the housing government-sponsored enterprises. Also contributing to the decline in performance was an increase in the provision for loan repurchases to \$171 million and \$227 million for the three and six months ended June 30, 2008 compared with \$11 million and \$34 million for the same periods in 2007, due primarily to an increase in repurchase demands for prime home mortgage loans previously sold.

The value of the MSR asset, which is estimated using an OAS valuation methodology classified as Level 3 in the fair value hierarchy, is subject to prepayment risk. Future expected net cash flows from servicing a loan in the servicing portfolio will not be realized if the loan pays off earlier than

expected. Moreover, since most loans within the servicing portfolio do not impose prepayment fees for early payoff, a corresponding economic benefit will not be received if the loan pays off earlier than expected. The fair value of the MSR is estimated from the present value of the future net cash flows the Bank expects to receive from the servicing portfolio. Accordingly, prepayment risk subjects the MSR to potential declines in fair value. Due to this risk, the realization of future expected net cash flows may differ significantly from period end fair value of the MSR asset.

Home mortgage loan servicing revenue, net of loan payments, increased by \$12 million and \$93 million for the three and six months ended June 30, 2008, compared with the same periods in 2007. The increase in net servicing revenue between the comparative six month periods was attributable to a slowdown in mortgage prepayments, reflecting diminished opportunities for borrowers to refinance during a period when the housing market is weakening, underwriting standards across the mortgage banking industry have tightened and rates for nonconforming loan products have increased above levels experienced prior to the illiquid secondary market conditions.

MSR valuation and risk management resulted in a loss of \$97 million in the second quarter of 2008, compared with a loss of \$21 million in the second quarter of 2007 as the decline in the value of MSR risk management instruments more than offset the increase in MSR valuation. Loss from MSR valuation and risk management was \$49 million for the six months ended June 30, 2008, compared with \$145 million for the same period in 2007. The performance of the MSR risk management instruments was adversely affected by the flat-to-inverted slope of the yield curve during the first quarter of 2007, which had the effect of increasing hedging costs during that period.

All Other Noninterest Income Analysis

Revenue from sales and servicing of consumer loans decreased \$244 million for the three months ended June 30, 2008, compared with the same period in 2007, predominantly due to a decline in the performance of the securitized credit card loan portfolio primarily resulting from higher credit costs and a \$104 million decrease in gain from securitizations as the Bank did not enter into credit card securitization sales during the second quarter of 2008. For the six months ended June 30, 2008, revenue from sales and servicing of consumer loans decreased \$439 million compared with the same period in 2007, primarily due to the absence of new credit card securitization sales in the first half of 2008 due to the challenging capital markets environment. This led to a decrease of \$259 million in gain from securitizations for the six months ended June 30, 2008, compared with the same period in 2007.

The increase in depositor and other retail banking fees was largely due to higher transaction fees and an increase in the number of noninterest-bearing checking accounts. The number of noninterest-bearing retail checking accounts at June 30, 2008 totaled approximately 11.6 million compared with approximately 10.4 million at June 30, 2007.

Loss on trading assets increased \$160 million for the three months ended June 30, 2008, compared with the same period in 2007, primarily due to a decline in the value of retained interests from credit card securitizations reflecting unfavorable market conditions. The increase in loss on trading assets for the first half of 2008, compared with the same period in 2007, was a result of downward adjustments to the fair value of trading assets backed by Alt-A loans and the decrease in the value of retained interests from credit card securitizations.

The Bank recognized impairment losses of \$407 million and \$474 million for the three and six months ended June 30, 2008 on certain mortgage securities backed by Alt-A, prime and subprime collateral where the Bank determined that the decline in the fair value of the securities below their amortized cost represented an other-than-temporary condition. Specifically, other-than-temporary impairment losses were recognized on mortgage-backed securities which have experienced adverse changes in their estimated cash flows or where management judgmentally considered it probable that the Bank will be unable to collect all amounts due, in both cases taking into account available

evidence related to the nature and credit risk characteristics of the specific securities, including downgrades on securities and projections considering expected default rates, loss severity and loss timing. Partially offsetting the impairment losses for the six months ended June 30, 2008 was a realized net gain on sale of available-for-sale securities of \$90 million driven by higher sales volume.

During the second quarter of 2008, the Bank retired approximately \$600 million of its senior and subordinated debt reflecting the reduction in the funding requirements resulting from the reduction of the balance sheet in the first half of 2008. These senior and subordinated debts were retired at a discounted value resulting in a gain on extinguishment of borrowings of \$47 million in the second quarter of 2008.

A significant portion of the \$95 million increase in other income during the second quarter of 2008, compared with the second quarter of 2007, was due to indemnification payments from Washington Mutual, Inc. for losses incurred on Long Beach Mortgage's loans that were originated prior to the merger of Long Beach Mortgage into the Bank on March 1, 2006. These payments were eliminated in consolidation at Washington Mutual, Inc.'s reporting level. For the six months ended June 30, 2008, other income increased \$137 million compared with the same period in 2007, primarily due to the indemnification payments from Washington Mutual Inc. and an \$85 million gain from the partial redemption of shares associated with the Bank's portion of the Visa initial public offering.

Noninterest Expense

Noninterest expense consisted of the following:

	Three Months Ended		Percentage Change	Six Months Ended		Percentage Change
	June 30,			June 30,		
	2008	2007		2008	2007	
	(dollars in millions)					
Compensation and benefits	\$ 929	\$ 956	(3)%	\$ 1,833	\$ 1,937	(5)%
Occupancy and equipment	460	354	30	816	730	12
Telecommunications and outsourced information services	123	132	(7)	253	261	(3)
Depositor and other retail banking losses	61	58	6	124	119	4
Advertising and promotion	102	113	(9)	208	211	(2)
Professional fees	51	51	–	85	87	(3)
Postage	101	106	(4)	204	213	(4)
Foreclosed asset expense	217	56	289	372	95	294
Other expense	<u>324</u>	<u>270</u>	20	<u>594</u>	<u>508</u>	17
Total noninterest expense	<u>\$ 2,368</u>	<u>\$ 2,096</u>	13	<u>\$ 4,489</u>	<u>\$ 4,161</u>	8

In the second quarter of 2008, Washington Mutual implemented a series of initiatives designed to significantly reduce operating expenses. These initiatives included further consolidation of the home loans business and other savings across corporate support and other business functions. In connection with these activities, the Bank recorded restructuring charges of \$204 million and resizing charges of \$3 million in the second quarter. Restructuring charges consisted of \$66 million in employee termination benefits, \$46 million in lease termination and other decommissioning costs and \$92 million of fixed asset write-downs. The restructuring charges are described further in Note 2 to the Consolidated Financial Statements – “Restructuring Activities.”

Compensation and benefits expense decreased during the three and six months ended June 30, 2008, compared with the same periods in 2007, primarily due to lower home loan mortgage banking incentive compensation that resulted from the significant decline in home loan volume. The decreases were partially offset by lower levels of deferred compensation costs resulting from a decline in loan originations during the first half of 2008. Reflecting Washington Mutual's initiatives to resize the

home loans business and corporate and other support functions, the number of employees decreased from 49,912 at June 30, 2007 to 43,167 at June 30, 2008.

Occupancy and equipment expense increased during the three and six months ended June 30, 2008, compared with the same periods in 2007, predominantly due to charges of \$138 million and \$150 million recognized in the three and six months ended June 30, 2008 related to Washington Mutual's restructuring of its home loans business. The increases were significantly offset by reduced expense levels resulting from the previous expense reduction actions taken by the Bank to streamline the home loans business and corporate and other support functions.

The increase in foreclosed asset expense for the three and six months ended June 30, 2008, compared with the same periods in 2007, was due to the deterioration in the credit environment and further weakening in the housing market. The total number of foreclosed properties has increased while the values of those properties have generally declined. The Bank expects that foreclosed asset expense will remain elevated until home prices begin to stabilize.

A significant portion of the increase in other noninterest expense for the three and six months ended June 30, 2008, compared with the same periods in 2007, was due to an increase in FDIC deposit insurance premiums of the Bank and Washington Mutual Bank fsb ("WMBfsb"), a subsidiary of WMB. Other noninterest expense during the six months ended June 30, 2008 included a \$38 million partial recovery of the Visa litigation expense recorded during the second half of 2007.

Ratio of Earnings to Fixed Charges

The ratio of earnings to fixed charges was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Ratio of earnings to fixed charges ⁽¹⁾ :				
Including interest on deposits	*	1.53	*	1.51
Excluding interest on deposits	*	2.55	*	2.42

⁽¹⁾ As defined in Item 503(d) of Regulation S-K.

* The earnings for the three and six months ended June 30, 2008 were inadequate to cover total fixed charges. The deficiencies in coverage for the periods were \$5.28 billion and \$7.15 billion.

Regulatory Capital

The regulatory capital ratios calculated for WMB and WMBfsb along with the capital amounts and ratios for the minimum regulatory requirement and the minimum amounts and ratios required to be categorized as well-capitalized under the regulatory framework for prompt corrective action were as follows:

	<u>June 30, 2008</u>					
	<u>Actual</u>		<u>Minimum Regulatory Requirement</u>		<u>Minimum to be Categorized as Well-Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(dollars in millions)					
WMB						
Stockholder's equity of the Bank	\$ 24,380					
Allowable minority interest.....	3,912					
Accumulated losses on certain available-for-sale securities and cash flow hedges, net of taxes	840					
	<u>29,132</u>					
Adjustments for tangible equity:						
Goodwill and certain other intangible assets.....	(7,382)					
Non-includable subsidiaries.....	(333)					
Disallowed servicing assets.....	(384)					
Tangible equity to total tangible assets.....	<u>\$ 21,033</u>	7.02%	<u>\$ 5,993</u>	>2.00%	n/a	n/a
Adjustment for Tier 1 capital:						
Qualifying intangible assets	166					
Tier 1 capital to adjusted total assets (leverage).....	<u>\$ 21,199</u>	7.07	<u>\$ 11,998</u>	4.00 ⁽¹⁾	<u>\$ 14,997</u>	5.00%
Adjustments for risk-based capital:						
Low level recourse and residual interests	(1,267)					
Adjusted Tier 1 capital to total risk-weighted assets	<u>\$ 19,932</u>	8.40	<u>\$ 9,487</u>	4.00	<u>\$ 14,230</u>	6.00
Additional adjustments for risk-based capital:						
Qualifying subordinated debt.....	6,559					
Allowable allowance for credit losses.....	3,032					
Other assets required to be deducted.....	(10)					
Total risk-based capital to total risk-weighted assets	<u>\$ 29,513</u>	12.44	<u>\$ 18,973</u>	8.00	<u>\$ 23,717</u>	10.00

⁽¹⁾ The minimum leverage ratio guideline is 3% for financial institutions that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings, effective management and monitoring of market risk and, in general, are considered top-rate, strong banking organizations.

June 30, 2008

WMBfsb	<u>Actual</u>		<u>Minimum Regulatory Requirement</u>		<u>Minimum to be Categorized as Well-Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Stockholder's equity of WMBfsb.....	\$ 29,230					
Accumulated losses on certain available-for-sale securities and cash flow hedges, net of taxes.....	781					
	30,011					
Adjustments for tangible equity:						
Goodwill and certain other intangible assets.....	—					
Non-includable subsidiaries.....	—					
Disallowed servicing assets.....	—					
Tangible equity to total tangible assets.....	<u>\$ 30,011</u>	63.45%	<u>\$ 946</u>	>2.00%	n/a	n/a
Adjustment for Tier 1 capital:						
Qualifying intangible assets.....	—					
Tier 1 capital to adjusted total assets (leverage).....	<u>\$ 30,011</u>	63.45	<u>\$ 1,892</u>	4.00 ⁽¹⁾	<u>\$ 2,365</u>	5.00%
Adjustments for risk-based capital:						
Low level recourse and residual interests.....	(35)					
Adjusted Tier 1 capital to total risk-weighted assets	<u>\$ 29,976</u>	165.24	<u>\$ 726</u>	4.00	<u>\$ 1,088</u>	6.00
Additional adjustments for risk-based capital:						
Qualifying subordinated debt.....	—					
Allowable allowance for credit losses.....	65					
Other assets required to be deducted.....	—					
Total risk-based capital to total risk-weighted assets.....	<u>\$ 30,041</u>	165.60	<u>\$ 1,451</u>	8.00	<u>\$ 1,814</u>	10.00

⁽¹⁾ The minimum leverage ratio guideline is 3% for financial institutions that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings, effective management and monitoring of market risk and, in general, are considered top-rate, strong banking organizations.

Risk Management

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

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

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

Management's governing risk committee is the Enterprise Risk Management Committee. This committee and its subcommittees include representation from the Company's lines of business and the

Enterprise Risk Management function. Subcommittees of the Enterprise Risk Management Committee provide specialized risk governance and include the Credit Risk Management Committee, the Market Risk Committee and the Operational Risk Committee.

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

Management is responsible for balancing risk and reward in determining and executing business strategies. Business lines, Enterprise Risk Management and Treasury divide the responsibilities of conducting measurement and monitoring of the Bank's risk exposures. Risk exceptions, depending on their type and significance, are elevated to management or Board committees responsible for oversight.

Credit Risk Management

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

The Bank recorded a provision for loan losses of \$5.91 billion in the second quarter of 2008 compared with a provision of \$372 million in the second quarter of last year and a significant increase in net charge-offs to \$2.17 billion for the quarter ended June 30, 2008. The increase in the provision for loan losses reflected the further decline in housing prices which increased expected loss severities, increased delinquencies, reduced availability of credit and the weakening economy. Cure rates on early stage delinquencies, representing loans that are up to three payments past due, deteriorated significantly as declining home prices and the reduced availability of credit prevented many borrowers from refinancing their mortgage or selling their home at a price sufficient to repay their mortgage. On a national basis, the supply of unsold homes in June 2008 increased 22% from June 2007 to approximately 11.1 months. In turn, this has contributed to a 6% decline in the national median sales price for existing homes between those same periods. Since July 2006, average home prices declined 19%, as measured by the S&P Case-Shiller 10-City Composite Home Price Index, or 22% if weighted to reflect the geographic distribution of the Bank's single-family residential portfolio. California and Florida have seen some of the sharpest declines in home prices, where 51% and 8% of the Bank's total single-family residential loans at June 30, 2008 were located. Housing market weakness was also evident in the change in the national volume of foreclosure filings which increased by 121% from the second quarter of 2007 to the second quarter of 2008. Average loss severities on late-stage delinquent loans and foreclosed assets have increased as lower collateral values have been insufficient to cover the recorded investment in the loan. Approximately one-third of net single-family residential charge-offs recorded in both the second quarter of 2008 and for the six months ended June 30, 2008 were recorded on loans that were more than 180 days past due. As housing prices continued to decline, additional charge-offs were recorded on late-stage delinquent loans. These loans experienced prior charge-offs when they became 180 days past due, to the extent their carrying amounts exceeded net realizable values. The ratio of nonperforming assets to total

assets increased from 2.18% at the end of 2007 to 3.65% at June 30, 2008. Increasing early stage credit card delinquencies and a more seasoned credit card portfolio partially contributed to the increase in the allowance for loan losses.

Reflecting higher incurred losses inherent in the portfolio resulting primarily from these economic factors, the Bank increased its allowance for loan losses, both in absolute terms and as a percentage of loans held in portfolio from \$2.57 billion or 1.05% of loans held in portfolio at December 31, 2007 to \$8.46 billion or 3.53% of total loans held in portfolio at June 30, 2008. Credit costs are expected to remain elevated throughout the remainder of 2008 and 2009 while the Bank expects 2008 to be the peak year for provisioning.

In light of these deteriorating conditions in the U.S. housing market, the Bank has taken actions to reduce its potential future exposure to credit risk, including tightening underwriting standards across all loan products, shifting the product strategy toward originating conforming mortgage loans that can be sold to housing government-sponsored enterprises, elimination of negatively amortizing products including Option ARMs, discontinuation of all lending conducted through the wholesale channel, and the reduction or suspension of undrawn home equity lines of credit. During 2008, single-family residential loans decreased \$8.50 billion or 4% with most of the decrease coming from the Option ARM portfolio. The Bank reduced or suspended \$8.23 billion of available credit under home equity lines of credit in the quarter ended June 30, 2008 and \$6.06 billion in the quarter ended March 31, 2008, as permitted by the Bank's contractual agreements with its customers. At June 30, 2008, the Bank had unfunded commitments to extend credit on home equity lines of credit of \$41.0 billion. The Bank also actively manages credit lines available to qualified credit card customers based on an evaluation of predictive risk indicators, such as account performance and risk scores.

The Bank has also decided to focus its residential mortgage loan origination business on the retail channel and as a result, the Bank expects to be better positioned to manage the credit risk of loans being added to the portfolio as home loans and home equity loans and lines of credit originated through the retail channel performed better at June 30, 2008 than loans with comparable risk characteristics originated through the Bank's wholesale channel.

<u>Origination Channel</u>	<u>June 30, 2008</u>	
	<u>Portfolio Loans</u>	<u>Nonaccrual Loans</u>
	(in millions)	
Retail ⁽¹⁾	\$ 96,913	\$ 2,711
Wholesale.....	55,567	2,750
Purchased/Correspondent	10,692	813
Subprime mortgage channel.....	<u>15,983</u>	<u>3,008</u>
Total home and home equity loans and lines of credit held in portfolio	<u>\$179,155</u>	<u>\$ 9,282</u>

⁽¹⁾ 94% or \$55.39 billion of the Bank's prime home equity portfolio was originated in the retail channel.

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, individual 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 by the borrower is not expected. Restructured loans are reported as nonaccrual loans and interest received on such loans is accounted for using the cash method until such time as the Bank determines that collectability of principal and interest is reasonably assured, at which point the loan is returned to accrual status and reported as an accruing restructured loan. At June 30, 2008, restructured loans of \$1.43 billion were reported as nonaccrual loans in accordance with the Bank's policy, accounting for 47 basis points of the 365 basis points of the nonperforming assets to total assets ratio.

Nonaccrual loans and foreclosed assets (“nonperforming assets”) consisted of the following:

	June 30, 2008	Nonaccrual Loans as a % of Loan Category	March 31, 2008	Nonaccrual Loans as a % of Loan Category	December 31, 2007	Nonaccrual Loans as a % of Loan Category
(dollars in millions)						
Nonperforming assets:						
Nonaccrual loans ⁽¹⁾⁽²⁾⁽³⁾ :						
Loans secured by real estate:						
Home loans ⁽⁴⁾⁽⁵⁾	\$ 4,753	4.53%	\$ 3,500	3.23%	\$ 2,299	2.08%
Home equity loans and lines of credit ⁽⁴⁾	1,521	2.52	1,102	1.80	835	1.37
Subprime mortgage channel ⁽⁶⁾	3,008	18.74	2,882	16.62	2,721	14.61
Home construction ⁽⁷⁾	79	4.14	77	3.68	56	2.51
Multi-family	181	0.55	142	0.44	131	0.41
Other real estate	87	0.83	87	0.87	52	0.55
Total nonaccrual loans secured by real estate	9,629	4.24	7,790	3.36	6,094	2.61
Consumer	1	0.02	2	0.02	1	0.02
Commercial	57	3.03	28	1.43	24	1.26
Total nonaccrual loans held in portfolio	9,687	4.04	7,820	3.22	6,119	2.50
Foreclosed assets ⁽⁸⁾	1,512		1,357		979	
Total nonperforming assets	<u>\$ 11,199</u>		<u>\$ 9,177</u>		<u>\$ 7,098</u>	
Total nonperforming assets as a percentage of total assets	3.65%		2.89%		2.18%	

⁽¹⁾ Nonaccrual loans held for sale, which are excluded from the nonaccrual balances presented above, were \$2 million, zero and \$4 million at June 30, 2008, March 31, 2008 and December 31, 2007. Loans held for sale are accounted for at the lower of cost or fair value, with valuation changes included as adjustments to noninterest income.

⁽²⁾ Credit card loans are exempt under regulatory rules from being classified as nonaccrual because they 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.

⁽³⁾ Includes nonaccrual restructured loans of \$1.43 billion, \$668 million and \$631 million at June 30, 2008, March 31, 2008 and December 31, 2007. Excludes accruing restructured loans of \$462 million, \$370 million and \$249 million at June 30, 2008, March 31, 2008 and December 31, 2007.

⁽⁴⁾ Excludes home loans and home equity loans and lines of credit in the subprime mortgage channel.

⁽⁵⁾ Includes nonaccrual Option ARM loans of \$3.23 billion, \$2.50 billion and \$1.63 billion at June 30, 2008, March 31, 2008 and December 31, 2007.

⁽⁶⁾ Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio.

⁽⁷⁾ 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.

⁽⁸⁾ Foreclosed real estate securing Government National Mortgage Association (“GNMA”) loans of \$21 million, \$25 million and \$37 million at June 30, 2008, March 31, 2008 and December 31, 2007 have been excluded. These assets are fully collectible as the corresponding GNMA loans are insured by the Federal Housing Administration (“FHA”) or guaranteed by the Department of Veterans Affairs (“VA”).

Allowance for Loan Losses

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

Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. The Bank maintains a comprehensive governance structure and a certification and validation process that is designed to support, among other things, the appropriateness of the estimate of the allowance for loan losses. Subsequent evaluations of the loan portfolio, in light of factors then prevailing, may result in significant changes in the allowance for loan losses in future periods.

The dynamics involved in determining incurred credit losses can vary considerably based on the existence, type and quality of the security underpinning the loan and the credit characteristics of the borrower. Hence, real estate secured loans are generally accorded a proportionately lower allowance for loan losses than unsecured credit card loans held in portfolio. Similarly, loans to higher risk borrowers, in the absence of mitigating factors, are generally accorded a proportionately higher allowance for loan losses. Certain real estate secured loans that have features which may result in increased credit risk when compared with real estate secured loans without those features are discussed in the Bank's 2007 Annual Report on Form 10-K/A – "Credit Risk Management."

In estimating the allowance for loan losses, the Bank allocates a portion of the allowance to its various loan product categories based on the credit risk profile of the underlying loans. The tools used for this determination include statistical estimation techniques that assess default and loss outcomes based on an evaluation of past performance of similar pools of loans in the Bank's portfolio, other factors affecting default and loss, as well as industry historical loan loss data (primarily for homogeneous loan portfolios). Non-homogeneous loans are individually reviewed and assigned loss factors commensurate with the applicable level of estimated risk.

The allocated allowance is supplemented by the unallocated allowance. The unallocated component of the allowance reflects management's assessment of various risk factors that are not fully captured by the statistical estimation techniques used to determine the allocated component of the allowance. Conditions not directly attributable to credit risks inherent in specific loan products (due to the imprecision that is inherent in credit loss estimation techniques) that are evaluated in connection with the unallocated allowance include national and local economic trends and conditions, industry and borrower concentrations within portfolio segments, recent loan portfolio performance, trends in loan growth, changes in underwriting criteria, and the regulatory and public policy environment. Both the allocated and the unallocated allowance are available to absorb credit losses inherent in the homogeneous loan portfolio as of the balance sheet date.

In response to increasingly adverse credit trends and consistent with its practice of routinely and regularly evaluating the accuracy of statistical estimation techniques, the Bank made significant changes to key assumptions used to estimate incurred losses in its loan portfolio. For example, in the second quarter of 2008, the Bank shortened the historical time period used to evaluate default frequencies for its prime mortgage portfolio from a three-year period to a one-year period to reflect the evolving risk profile of the loan portfolio and adjusted its severity assumptions for all single-family mortgages to reflect the continuing decline in home prices. These updated assumptions accounted for approximately one-third of the provision recorded in the second quarter of 2008. In the first quarter of 2008, the Bank shortened the time period used to evaluate default frequencies in its home equity loans and lines of credit and subprime mortgage channel portfolios from a three-year historical period to a one-year historical period. These updated assumptions accounted for approximately \$1.2 billion of the provision recorded in the first quarter of 2008. By providing greater emphasis to more recent default data, the allowance for loan losses better reflects the evolving risk profile of the loan portfolio.

Additionally, in response to increasingly adverse credit trends, including declining home prices, the Bank updated its assumptions used to estimate the net realizable value of loans to determine the amount of related charge-offs. These updated assumptions resulted in additional charge-offs of approximately \$130 million in the second quarter of 2008.

Refer to Note 1 to the Consolidated Financial Statements – "Summary of Significant Accounting Policies" in the Bank's 2007 Annual Report on Form 10-K/A for further discussion of the Allowance for Loan Losses.

Changes in the allowance for loan losses were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(dollars in millions)			
Balance, beginning of period.....	\$ 4,714	\$ 1,540	\$ 2,571	\$ 1,630
Allowance transferred to loans held for sale	–	(81)	–	(229)
Other.....	–	–	–	7
Provision for loan losses	<u>5,912</u>	<u>372</u>	<u>9,423</u>	<u>606</u>
	10,626	1,831	11,994	2,014
Loans charged off:				
Loans secured by real estate:				
Home loans ⁽¹⁾	(687)	(21)	(1,017)	(57)
Home equity loans and lines of credit ⁽¹⁾	(726)	(55)	(1,212)	(84)
Subprime mortgage channel ⁽²⁾	(572)	(103)	(960)	(143)
Home construction ⁽³⁾	(3)	(1)	(12)	(1)
Multi-family.....	(3)	–	(7)	–
Other real estate.....	<u>(1)</u>	<u>(1)</u>	<u>(3)</u>	<u>(1)</u>
Total loans secured by real estate.....	(1,992)	(181)	(3,211)	(286)
Consumer:				
Credit card.....	(169)	(106)	(303)	(202)
Other.....	(2)	(2)	(4)	(5)
Commercial.....	<u>(51)</u>	<u>(15)</u>	<u>(90)</u>	<u>(23)</u>
Total loans charged off.....	(2,214)	(304)	(3,608)	(516)
Recoveries of loans previously charged off:				
Loans secured by real estate:				
Home loans ⁽¹⁾	–	1	1	2
Home equity loans and lines of credit ⁽¹⁾	17	3	26	6
Subprime mortgage channel ⁽²⁾	3	11	4	12
Other real estate.....	<u>1</u>	<u>–</u>	<u>1</u>	<u>1</u>
Total loans secured by real estate.....	21	15	32	21
Consumer:				
Credit card.....	16	15	28	31
Other.....	–	–	–	6
Commercial.....	<u>6</u>	<u>3</u>	<u>9</u>	<u>4</u>
Total recoveries of loans previously charged off.....	43	33	69	62
Net charge-offs.....	<u>(2,171)</u>	<u>(271)</u>	<u>(3,539)</u>	<u>(454)</u>
Balance, end of period.....	<u>\$ 8,455</u>	<u>\$ 1,560</u>	<u>\$ 8,455</u>	<u>\$ 1,560</u>
Net charge-offs (annualized) as a percentage of average loans held in portfolio.....	3.59%	0.50%	2.91%	0.41%
Allowance as a percentage of loans held in portfolio.....	3.53	0.73	3.53	0.73

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

⁽²⁾ Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio. Charge-offs in the second quarter of 2007 include \$26 million of amounts primarily related to uncollected borrower expenses incurred in prior periods by and owed to a third party loan servicer.

⁽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.

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

In a stressed housing market with increasing delinquencies and declining housing prices, such as currently exists, the adequacy of collateral securing a loan becomes an important factor in determining future loan performance as borrowers with more equity in their properties generally have a greater vested interest in keeping their loans current than borrowers with little to no equity in their properties. Generally, homes purchased prior to the end of 2004 have benefited from more home price appreciation than homes purchased more recently. The credit performance of earlier vintage loans in the Bank's residential loan portfolio is generally more favorable than loans originated or purchased more recently, although lately there has been some pressure on earlier vintages, such as the 2005 vintages.

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

Statistical estimation techniques used to estimate the allowance for loan losses in single-family residential portfolios incorporate estimates of changes in housing prices using Office of Federal Housing Enterprise Oversight ("OFHEO") cumulative growth rates available at the time the assessments are conducted. The estimate of the allowance at June 30, 2008 incorporated OFHEO data as of March 31, 2008 as well as more current data evidencing conditions in the housing market, such as provided by the National Association of Realtors, and internal estimates of future loss severity reflecting recent actual experience and forecasted home prices. As indicated in the footnotes to the loan-to-value/vintage tables that follow, estimated current loan-to-value ratios reflected in the tables are estimated using OFHEO home price index data as of March 31, 2008.

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

The table below analyzes the composition of home loans held in portfolio at June 30, 2008:

Loan-to-Value Ratio at Origination	Year of Origination					Total	% of Total
	Pre-2005	2005	2006	2007	2008		
(dollars in millions)							
Home loans:							
≤ 50%.....	\$ 3,381	\$ 1,162	\$ 752	\$ 2,722	\$ 517	\$ 8,534	8%
>50-60%.....	3,710	1,662	1,370	3,696	534	10,972	11
>60-70%.....	8,515	4,867	3,652	7,402	848	25,284	24
>70-80%.....	14,622	10,460	9,629	17,012	1,271	52,994	51
>80-90%.....	1,659	633	559	1,543	214	4,608	4
>90%.....	963	186	184	394	10	1,737	2
Total home loans held in portfolio ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾	<u>\$ 32,850</u>	<u>\$ 18,970</u>	<u>\$ 16,146</u>	<u>\$ 32,769</u>	<u>\$ 3,394</u>	<u>\$104,129</u>	<u>100%</u>
As a percentage of total.....	32%	18%	16%	31%	3%	100%	
Nonaccrual loans as a percentage of total.....	3.01	5.21	7.38	4.78	0.29	4.56	
Average loan-to-value ratio at origination.....	69	71	72	70	66	70	
Average estimated current loan-to-value ratio ⁽⁶⁾	48	71	81	74	66	66	

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

⁽²⁾ Excluded from the balances of home loans held in portfolio are \$233 million of home loans that are insured by the Federal Housing Administration (“FHA”) or guaranteed by the Department of Veterans Affairs (“VA”), of which \$13 million have loan-to-value ratios of ≤ 80% and \$220 million have loan-to-value ratios of >80%.

⁽³⁾ Originations and purchases of home loans with loan-to-value ratios at origination of >80% amounted to \$1.96 billion in the first half of 2008.

⁽⁴⁾ Included in the balance of home loans held in portfolio are the following interest-only home loans and their related loan-to-value ratios at origination: \$31.24 billion (≤80%), \$859 million (>80-90%) and \$178 million (>90%). Originations and purchases of interest-only loans amounted to \$3.94 billion in the first half of 2008.

⁽⁵⁾ Excludes \$646 million for which LTV or vintage data was unavailable.

⁽⁶⁾ The average estimated current loan-to-value ratio reflects the outstanding balance at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the March 31, 2008 OFHEO home price index.

The table below analyzes the composition of Option ARM home loans held in portfolio at June 30, 2008:

Loan-to-Value Ratio at Origination	Year of Origination					Total	% of Total
	Pre-2005	2005	2006	2007	2008		
(dollars in millions)							
Home loan Option ARMs:							
≤ 50%.....	\$ 1,037	\$ 628	\$ 387	\$ 698	\$ 15	\$ 2,765	6%
>50-60%.....	1,238	906	773	1,261	29	4,207	8
>60-70%.....	3,870	3,085	2,527	3,161	74	12,717	24
>70-80%.....	7,491	6,479	7,308	8,063	92	29,433	56
>80-90%.....	898	450	442	890	21	2,701	5
>90%.....	259	92	125	121	2	599	1
Total home loan Option ARMs held in portfolio ⁽¹⁾⁽²⁾	<u>\$14,793</u>	<u>\$11,640</u>	<u>\$11,562</u>	<u>\$14,194</u>	<u>\$ 233</u>	<u>\$ 52,422</u>	<u>100%</u>
As a percentage of total	28%	22%	22%	27%	1%	100%	
Nonaccrual loans as a percentage of total.....	4.02	6.62	8.49	6.14	0.43	6.14	
Average loan-to-value ratio at origination	71	72	73	72	70	72	
Average estimated current loan-to-value ratio ⁽³⁾	50	74	83	78	71	70	

⁽¹⁾ Originations and purchases of Option ARMs amounted to \$241 million in the first half of 2008.

⁽²⁾ Excludes \$267 million for which LTV or vintage data was unavailable.

⁽³⁾ The average estimated current loan-to-value ratio reflects the outstanding balance at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the March 31, 2008 OFHEO home price index.

Option ARM Home Loans

During the second quarter of 2008, the Bank eliminated the production of negatively amortizing products, including Option ARMs, and continued its modification practices of working with selected customers to convert their Option ARMs into other products which do not have negative amortization features. The Option ARM home loan portfolio decreased \$5.98 billion during the first half of 2008.

The Option ARM home loan product is an adjustable-rate mortgage loan that provides the borrower with the option each month to make a fully-amortizing, interest-only, or minimum payment. The minimum payment is typically insufficient to cover interest accrued in the prior month and any unpaid interest is deferred and added to the principal balance of the loan.

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

A recasting event occurs every 60 months or sooner upon reaching a negative amortization cap. When a recasting event occurs, a new minimum monthly payment is calculated without regard to any limits on the increase or decrease in amount that would otherwise apply under the annual 7.5% payment cap. This new minimum monthly payment is calculated to be sufficient to fully repay the principal balance of the loan, including any theretofore deferred interest, over the remainder of the loan term using the fully-indexed rate then in effect. A recasting event occurs immediately whenever the unpaid principal balance reaches the negative amortization cap, which is expressed as a percent of the original loan balance. Prior to 2006, the negative amortization cap was 125% of the original loan balance (or 110% of the original loan balance for loans secured by property located in New York and loans purchased through the correspondent channel). For all Option ARM loans originated in 2006,

the negative amortization cap was 110% of the original loan balance. For Option ARM loans originated in 2007, the negative amortization cap was raised to 115%, with the exception of loans secured by property located in New York and loans purchased through the correspondent channel where the negative amortization cap remains at 110%. Declines in mortgage rates to which Option ARM loans are indexed will generally delay the time frame within which negatively amortizing Option ARM loans reach their negative amortization caps. Conversely, increases in mortgage rates to which Option ARM loans are indexed will generally accelerate the timeframe within which negatively amortizing Option ARM loans reach their negative amortization caps.

Assuming all Option ARM loans recast no earlier than five years after origination, as of June 30, 2008, \$2.2 billion or 4% of the Bank's Option ARM portfolio is scheduled to recast in the latter half of 2008 and \$7.1 billion or 13% is scheduled to recast in 2009. This \$9.3 billion of Option ARM loans that are contractually scheduled to recast through 2009 are not expected to have a material effect on the future cash flows and liquidity of the Bank. The primary risks of the Option ARM portfolio on cash flows and liquidity are related to (a) the deficiency of cash flows that could be experienced if a portion of the loans ceases paying principal and interest, and (b) the decline in liquidity resources that could be experienced if a portion of the Option ARM portfolio becomes unavailable for collateralized borrowing (i.e., in the event the loans become non-performing). Given the most extreme hypothetical scenario in which all of these \$9.3 billion of loans reach the 5-year recasting event on the same day, none of these loans prepay on or prior to that date and no future interest or principal payments are received, the effect on daily cash flows would be *de minimis* to the Bank's normal and routine changes in deposit balances and normal and routine variances in principal and interest payments received on all loans in the Bank's held for investment portfolios. Additionally, the Option ARM loans that are scheduled to recast in 2008 and 2009 are predominantly loans that were originated in 2003 and 2004. The relatively low estimated current loan-to-value ratio and other favorable characteristics of the pre-2005 vintages represent a substantial risk mitigant relative to the recast of such loans in 2008 and 2009 such that the actual impact of nonperforming assets on the Bank's borrowing capacity would not be expected to be material.

The Bank identifies and measures risks associated with Option ARM loans in a number of ways. These include monthly monitoring of borrower actual payment performance on the mortgage loans as well as quarterly updates of information on borrowers' broader credit standing as measured by updated FICO scores. Post-origination, property value estimates are generally updated through reference to local area indices of home price appreciation. For seriously delinquent loans being reviewed for loss mitigation or write-down activities, these are supplemented by updated estimates of value on individual properties. Trends in the incidence and depth of negative amortization are monitored, including their correlations with the overall trends in Treasury yields and the 12-Month Treasury Average ("MTA") index. The relationship of these attributes to actual historical delinquency performance are studied, and subsequent loan origination and loss mitigation practices are modified to reflect new information and manage risks. The Bank's loss mitigation practices include modifying Option ARMs into other products which do not have negative amortization features.

The table below provides an analysis of the geographic distribution of the Bank's home loan Option ARM portfolio and nonaccrual loan balances at June 30, 2008:

	<u>Portfolio</u>		<u>Nonaccrual</u>		<u>Weighted Average Estimated Current Loan-to-Value Ratio (Portfolio)</u>
	<u>(dollars in millions)</u>				
California:					
Northern coastal.....	\$ 7,702	15%	\$ 298	9%	70%
Southern coastal.....	14,333	27	667	21	71
Other	<u>4,300</u>	<u>8</u>	<u>294</u>	<u>9</u>	79
Total California	26,335	50	1,259	39	72
Florida.....	6,919	13	831	26	72
New York/New Jersey	4,673	9	251	8	62
Washington/Oregon	1,970	4	58	2	63
Illinois	1,379	2	114	3	68
Massachusetts	1,193	2	90	3	70
Other ⁽¹⁾	<u>10,402</u>	<u>20</u>	<u>624</u>	<u>19</u>	70
Total Option ARMs held in portfolio.....	<u>\$ 52,871</u>	<u>100%</u>	<u>\$ 3,227</u>	<u>100%</u>	70%

⁽¹⁾ Of this category, Arizona had the largest portfolio and nonaccrual balances of approximately \$1.06 billion and \$66 million.

The table below analyzes the composition of prime home equity loans and lines of credit held in portfolio at June 30, 2008:

Combined Loan-to-Value Ratio at Origination ⁽¹⁾	Year of Origination					Total	% of Total
	Pre-2005	2005	2006	2007	2008		
	(dollars in millions)						
Prime home equity loans and lines of credit:							
≤ 50%.....	\$ 2,834	\$ 1,308	\$ 1,385	\$ 1,490	\$ 239	\$ 7,256	12%
>50-60%	1,848	932	909	1,042	116	4,847	8
>60-70%	2,749	1,528	1,443	1,724	187	7,631	13
>70-80%	6,334	4,310	3,707	4,948	327	19,626	33
>80-90%	2,718	3,904	5,223	6,354	101	18,300	31
>90%	541	189	200	450	3	1,383	3
Total prime home equity loans and lines of credit held in portfolio ⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾	<u>\$17,024</u>	<u>\$12,171</u>	<u>\$12,867</u>	<u>\$16,008</u>	<u>\$ 973</u>	<u>\$ 59,043</u>	<u>100%</u>
As a percentage of total	29%	20%	22%	27%	2%	100%	
Nonaccrual loans as a percentage of total	1.12	2.47	3.64	3.39	0.41	2.55	
Average combined loan-to-value ratio at origination ⁽¹⁾	69	74	75	76	63	73	
Average estimated current combined loan-to-value ratio ⁽¹⁾⁽⁷⁾	51	69	78	80	64	69	

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

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

⁽³⁾ 26% of prime home equity loans and lines of credit were in first lien position at June 30, 2008.

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

⁽⁵⁾ Extensions of credit under prime home equity loans and lines of credit with combined loan-to-value ratios at origination of >80% amounted to \$91 million in the first half of 2008.

⁽⁶⁾ Excludes \$735 million for which LTV or vintage data was unavailable.

⁽⁷⁾ The average estimated current combined loan-to-value ratio reflects the outstanding balance or commitment amount (in the case of lines of credit) at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the March 31, 2008 OFHEO home price index.

The prime home equity loans and lines of credit held in portfolio at June 30, 2008, as shown in the immediately preceding table, included the following home equity loans and lines of credit in *junior lien* position:

Combined Loan-to-Value Ratio at Origination ⁽¹⁾	Year of Origination					Total	% of Total
	Pre-2005	2005	2006	2007	2008		
	(dollars in millions)						
Prime <i>junior lien</i> home equity loans and lines of credit:							
≤ 50%.....	\$ 1,032	\$ 644	\$ 856	\$ 740	\$ 106	\$ 3,378	8%
>50-60%.....	955	646	773	711	79	3,164	7
>60-70%.....	1,632	1,170	1,284	1,201	126	5,413	12
>70-80%.....	4,117	3,469	3,353	3,527	217	14,683	34
>80-90%.....	2,270	3,549	5,026	5,014	42	15,901	37
>90%.....	262	77	165	418	3	925	2
Total prime <i>junior lien</i> home equity loans and lines of credit held in portfolio ⁽²⁾⁽³⁾⁽⁴⁾	<u>\$10,268</u>	<u>\$ 9,555</u>	<u>\$11,457</u>	<u>\$11,611</u>	<u>\$ 573</u>	<u>\$ 43,464</u>	<u>100%</u>
As a percentage of total.....	24%	22%	26%	27%	1%	100%	
Nonaccrual loans as a percentage of total.....	1.12	2.54	3.68	3.28	0.17	2.67	
Average combined loan-to-value ratio at origination ⁽¹⁾	72	76	77	78	65	76	
Average estimated current combined loan-to-value ratio ⁽¹⁾⁽⁵⁾ ...	55	73	80	82	65	73	

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

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

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

⁽⁴⁾ Excludes \$603 million for which LTV or vintage data was unavailable.

⁽⁵⁾ The average estimated current combined loan-to-value ratio reflects the outstanding balance or commitment amount (in the case of lines of credit) at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the March 31, 2008 OFHEO home price index.

The subprime mortgage channel loans held in portfolio at June 30, 2008 were as follows:

Loan-to-Value Ratio at Origination	Year of Origination					Total	% of Total
	Pre-2005	2005	2006	2007	2008		
(dollars in millions)							
Subprime mortgage channel:							
≤ 50%.....	\$ 195	\$ 98	\$ 218	\$ 57	\$ —	\$ 568	4%
>50-60%.....	231	135	208	82	—	656	4
>60-70%.....	485	301	462	196	—	1,444	9
>70-80%.....	1,502	2,058	2,052	752	—	6,364	40
>80-90%.....	1,604	1,063	1,784	582	—	5,033	31
>90%.....	28	108	1,579	203	—	1,918	12
Total subprime mortgage channel loans held in portfolio ⁽¹⁾	<u>\$ 4,045</u>	<u>\$ 3,763</u>	<u>\$ 6,303</u>	<u>\$ 1,872</u>	<u>\$ —</u>	<u>\$ 15,983</u>	<u>100%</u>
As a percentage of total.....	25%	24%	39%	12%	—%	100%	
Nonaccrual loans as a percentage of total.....	14.51	26.20	17.37	17.74	—	18.77	
Average loan-to-value ratio at origination ⁽²⁾	77	79	83	80	n/a	80	
Average estimated current loan-to-value ratio ⁽³⁾	58	73	84	83	n/a	75	

⁽¹⁾ Excludes \$92 million for which LTV or vintage data was unavailable.

⁽²⁾ Origination loan-to-value used for first liens and combined loan-to-value used for second liens.

⁽³⁾ The average estimated current loan-to-value ratio reflects the outstanding balance at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the March 31, 2008 OFHEO home price index.

The Bank monitors delinquency rates for all loans held in portfolio. Increasing early stage delinquency rates (i.e. loans 30-89 days) are indicative of possible future credit problems when the Bank has serious doubts as to the ability of such borrowers to cure the delinquency condition. Such loans have a greater propensity to migrate into nonaccrual status as cure rates on early stage delinquencies have deteriorated with the continued decline in the U.S. housing market. Delinquency rates for home loans, home equity loans and lines of credit and subprime mortgage channel loans that were more than 30 days past due but less than 90 days past due were 2.89%, 1.47% and 6.45% at June 30, 2008 as compared with 2.02%, 1.43% and 6.67% at December 31, 2007. The balance of potential problem non-homogeneous loans, which consists of accruing loans that were reviewed for potential impairment and were subsequently determined to not be impaired amounted to \$112 million and \$170 million at June 30, 2008 and December 31, 2007.

90 Days or More 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 \$75 million and \$98 million at June 30, 2008 and December 31, 2007. The majority of these loans are either VA- or FHA-insured with little or no risk of loss of principal or interest. Managed credit card loans that were 90 days or more contractually past due and still accruing interest were \$924 million and \$836 million at June 30, 2008 and December 31, 2007, including \$280 million and \$174 million related to loans held in portfolio. The delinquency rate on managed credit card loans that were 30 days or more delinquent at June 30, 2008 and December 31, 2007 was 7.05% and 6.47%.

Derivative Counterparty Credit Risk

Derivative financial instruments expose the Bank to credit risk in the event of nonperformance by counterparties to such agreements. This risk consists primarily of the termination value of agreements where the Bank is in a favorable position. Credit risk related to derivative financial instruments is considered within the fair value measurement of the instrument. The Bank manages the credit risk associated with its various derivative counterparties through counterparty credit review, counterparty exposure limits, diversifying transactions across a number of counterparties and monitoring procedures. The Bank's agreements generally include master netting agreements whereby the counterparties are entitled to settle their positions "net." The Bank obtains collateral from certain counterparties and monitors all exposure and collateral requirements daily to manage risk. The fair value of collateral received from a counterparty is continually monitored and the Bank may request additional collateral from counterparties or return collateral pledged as deemed appropriate. The Bank's risk management practices assist to mitigate the change in expected effects on the Bank's cash flow and liquidity in the event of non-performance or failure by derivative counterparties.

At June 30, 2008 and December 31, 2007, the gross positive fair value of the Bank's derivative financial instruments was \$1.77 billion and \$1.96 billion. The Bank's master netting agreements at June 30, 2008 and December 31, 2007 reduced the exposure to this gross positive fair value by \$741 million and \$316 million. The Bank's collateral against derivative financial instruments was \$648 million and \$1.26 billion at June 30, 2008 and December 31, 2007. Accordingly, the Bank's net exposure to derivative counterparty credit risk at June 30, 2008 and December 31, 2007 was \$382 million and \$391 million.

Liquidity Risk and Capital Management

Liquidity Risk

The objective of liquidity risk management is to ensure that the Bank 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 in various market conditions. Changes in market conditions, the composition of its balance sheet and risk tolerance levels are among the factors that influence the Bank's liquidity profile.

The Bank has a liquidity risk management policy and contingent funding plan. The Bank has policies that require current and forecasted liquidity positions to be monitored against pre-established limits and requires that contingency liquidity plans be maintained.

Liquidity is forecasted over short-term (operational) and long-term (strategic) horizons. Both approaches require that the Bank maintains minimum amounts of liquidity that exceed forecasted needs (excess liquidity). Whereas the focus for operational liquidity is to maintain sufficient excess liquidity to satisfy unanticipated funding requirements, strategic liquidity focuses on stress-testing liquidity risks and ensuring that sufficient excess liquidity is maintained under various scenarios to meet policy standards.

While current market conditions have limited its liquidity sources, the Bank's current sources of liquidity provide it the ability to fund its operations and meet all debt service obligations. The principal sources of liquidity available to the Bank in the current environment are collateralized borrowings with the most significant source being advances made available through its memberships in the Federal Home Loan Bank system, and FDIC-insured deposits originated through the retail banking network or from retail deposit brokers. Other sources of funding, primarily those accessed directly through capital market transactions, covered bonds and uninsured institutional deposits are dependent on maintaining certain credit ratings assigned by various nationally recognized statistical rating organizations ("NRSROs"). Because of downgrades made to those ratings by the NRSROs, many of these sources of liquidity are not currently available to the Bank.

Principal sources of liquidity are retail deposits, FHLB advances, repurchase agreements, federal funds purchased, the maturity and repayment of portfolio loans, securities held in the available-for-sale portfolio, loans designated as held for sale and the Federal Reserve Bank's discount window. Retail deposits, most of which are comprised of accounts with balances less than \$100,000, continue to provide a significant source of stable funding. The Bank's continuing ability to retain its retail deposit base and to attract new deposits depends on various factors such as customer service satisfaction levels, the competitiveness of interest rates offered on deposit products, the Bank's reputation and depositor perception of the Bank's stability and future prospects, which perceptions can be influenced at times by external events, such as instability in the banking industry generally, and rumor and speculation.

The Federal Home Loan Bank system continues to provide the Bank with a reliable and significant source of liquidity. The Bank continues to have qualifying assets that are available to pledge as collateral for additional FHLB Advances, repurchase agreements and other collateral-dependent liquidity sources.

With the disruptions in the credit markets, credit card securitizations cannot be transacted on terms that are attractive to the Bank, and mortgage loan sales are currently limited primarily to conforming loans eligible for purchase by Freddie Mac and Fannie Mae. Accordingly, the Bank's liquidity planning assumes that the government-sponsored enterprises will be the only reliable sources of liquidity in the secondary market for the foreseeable future.

In connection with credit card securitizations, the Bank will be required to fund spread accounts to make payments to securitization investors and credit enhancers in the event their share of cash flows is insufficient to cover the required amounts due. This generally occurs when the performance of securitized loans deteriorates causing excess servicing amounts to decrease below contractually specified levels. As of June 30, 2008, there are no spread account funding requirements.

As part of its funding diversification strategy, the Bank launched a €20 billion covered bond program in September 2006. While €14 billion remains unissued under this program, no further issuances may occur until the Bank's credit ratings assigned by the NRSROs are upgraded or the ratings-based restrictions applicable to the program are eliminated. Existing floating-rate U.S. dollar-denominated mortgage bonds were issued by the Bank and collateralize the outstanding Euro-denominated covered bonds. The covered bonds were issued by a statutory trust that is not consolidated by the Bank. The mortgage bonds are secured principally by residential mortgage loans in the Bank's portfolio. For more information on the covered bonds program, see Note 5 to the Consolidated Financial Statements – "Covered Bond Program."

Under the Global Bank Note Program, which was established in August 2003 and renewed in December 2005, the Bank may issue notes in the United States and in international capital markets in a variety of currencies and structures. The Bank had \$12.38 billion available under this program as of June 30, 2008.

Senior unsecured long-term obligations of the Bank are rated BBB by Fitch, BBB by Standard & Poor's, Baa2 by Moody's and BBBH by DBRS. Short-term obligations are rated F2 by Fitch, A2 by Standard & Poor's, P2 by Moody's and R-2H by DBRS.

Capital Management

The Bank's capital adequacy is monitored to ensure sufficient capital is maintained to provide for losses based on the risks inherent in the combination of businesses. The views of investors, credit rating agencies, lenders and regulators are considered in determining capital ratio targets.

Capital is typically generated through the issuance of equity securities and from the retention of earnings. The Bank is not currently generating capital through earnings due to the high levels of loan loss provisioning that has resulted from the severe downturn in the credit environment. On a

consolidated basis, capital may also be raised through issuance of capital securities by various subsidiaries of the Bank, in particular Washington Mutual Preferred Funding LLC (“WMPF LLC”). Target capital levels are estimated so as to meet both expected and unexpected future losses.

In April 2008, Washington Mutual issued \$7.2 billion of capital through a private sale of common stock, Series S and Series T Contingently Convertible Perpetual Non-cumulative Preferred Stock and warrants to acquire common stock. Of the total amount, \$3.0 billion was contributed by Washington Mutual in the form of Tier 1 regulatory capital to the Bank during the second quarter and an additional \$2.0 billion of Tier 1 regulatory capital was contributed following the end of the second quarter.

In the fourth quarter of 2007, Washington Mutual issued \$3.0 billion of Series R Non-cumulative Perpetual Convertible Preferred Stock for net proceeds of approximately \$2.9 billion. Of the total net proceeds received from the sale of Series R Preferred Stock, \$1.0 billion was contributed to the Bank.

In 2006 and 2007, the Bank issued a total of \$3.9 billion of perpetual, non-cumulative preferred securities through its indirect subsidiary, WMPF LLC. The high equity content characteristics of these securities are acknowledged by the OTS, the Bank’s primary regulator, and the rating agencies as qualifying elements in the composition of financial institutions’ core capital structures. Accordingly, such securities are included as equity components within the Bank’s capital ratios.

Capital Composition and Capital Ratios

The regulatory capital ratios of WMB and WMBfsb and minimum regulatory capital ratios to be categorized as well-capitalized are included in “Regulatory Capital” in Management’s Discussion and Analysis.

OTS capital guidelines require that the dominant form of a savings association’s equity (referred to as “core” or “Tier 1” capital under OTS guidelines) should be common voting shares and that savings associations should avoid undue reliance on preferred securities. Preferred securities issued by WMPF LLC (an indirect subsidiary of WMB) qualify as part of WMB’s Tier 1 capital. As a prudential safeguard, the OTS limits the portion of a savings association’s Tier 1 core capital that may be comprised of preferred securities to an amount that cannot exceed 25% of its Tier 1 capital. At June 30, 2008, the aggregate amount of preferred securities issued by WMPF LLC represented 18.45% of WMB’s total Tier 1 capital. The capital structure of WMBfsb does not contain any preferred securities.

The Bank’s broker-dealer subsidiaries are also subject to capital requirements. At June 30, 2008 and December 31, 2007, all of its broker-dealer subsidiaries were in compliance with their applicable capital requirements.

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

From time to time the Bank issues debt denominated in foreign currencies. When such transactions occur, the Bank uses derivatives to offset the associated foreign currency exchange risk.

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.

MSR Risk Management

The Bank manages potential changes in the fair value of MSR through a comprehensive risk management program. The intent is to utilize risk management instruments to mitigate the effects of changes in MSR fair value within the context of the Bank's overall mortgage portfolio. Risk management instruments may include interest rate contracts, forward rate agreements, 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 may consist of interest rate swaps, interest rate swaptions, interest rate futures and interest rate caps and floors. The Bank may purchase or sell option contracts, depending on the portfolio risks it seeks to manage. The Bank 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 expected prepayments that result from changes in spot and future primary mortgage rates and in changes in other applicable market interest 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. Primary mortgage rates may move more or less than the rates on Treasury bonds or interest rate swaps or the yields on mortgage-backed securities. Potential differences in the change in value between MSR and MSR risk management instruments are what is referred to as basis risk. The Bank generally constructs its hedge portfolio to minimize basis risk.

The Bank continuously manages the MSR, adjusting the mix of instruments used to offset MSR fair value changes as interest rates and market conditions warrant. The objective is to maintain the portfolio of risk management instruments that will be effective in managing changes in MSR fair value within the context of the overall portfolio management strategy, while maintaining sufficient liquidity to adapt to changes in market conditions. In this context, the Bank also manages the size of the MSR asset through the structuring of servicing agreements when loans are sold and by periodically selling or purchasing servicing assets.

The Bank uses an Option Adjusted Spread ("OAS") valuation methodology to estimate the fair value of MSR. The OAS methodology projects MSR cash flows over multiple interest rate scenarios and discounts these cash flows using risk-adjusted discount rates. The significant assumptions used in the valuation of MSR include market interest rates, projected prepayment speeds, cost to service, ancillary income and option adjusted spreads. Additionally, an independent broker estimate of the fair value of the mortgage servicing rights is obtained quarterly along with other market-based evidence. Management uses this information together with its OAS valuation methodology to estimate the fair value of MSR.

The Bank believes this overall risk management strategy is the most efficient approach to managing MSR fair value risk within the portfolio context. The success of this strategy 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 Bank 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 mortgages to be sold in the secondary market. The interest rate 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 Bank 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 Bank 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 Bank. 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 Bank's operations.

To analyze interest rate risk sensitivity, management projects net interest income under a variety of interest rate scenarios, assuming both parallel and non-parallel shifts in the yield curve. These scenarios illustrate net interest income sensitivity due to changes in the level of interest rates, the slope of the yield curve and the spread between Treasury and LIBOR/swap ("LIBOR") rates. Management also periodically projects the interest rate sensitivity of net income due to changes in the level of interest rates. Additionally, management projects the discounted value 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 income, net interest income and discounted cash flow analyses requires numerous assumptions. Prepayment speeds, decay rates (the estimated runoff of deposit accounts that do not have a stated maturity), future deposits 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 and borrowings are estimated based on market rates while the rates on deposits and loans are estimated based on the rates offered by the Bank to 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 Bank'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 interest rate scenarios accompanied by a shift toward a greater proportion of adjustable-rate production. Conversely, the Bank generally assumes an increase in total loan production in falling 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 interest rate environments primarily from an increase in mortgage refinancing activity. Conversely, the gain from mortgage loans may decline when 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 Bank'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 Bank'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.

July 1, 2008 and January 1, 2008 Net Interest Income Sensitivity Comparison

The table below indicates the sensitivity of net interest income as a result of hypothetical interest rate movements on market risk sensitive instruments. The base case assumptions used for this sensitivity analysis are similar to the Bank's most recent net interest income projection for the respective twelve month periods as of the date the analysis was performed. The comparative results assume parallel shifts in the forward yield curve with interest rates rising 100 basis points and decreasing 100 basis points in even quarterly increments over the twelve month periods ending June 30, 2009 and December 31, 2008. The base scenario for the implied forward rate analysis represents market expectations for interest rates for the next twelve months.

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 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, changes in loan volumes or loan and deposit pricing.

Comparative Net Interest Income Sensitivity

	<u>Gradual Change in Rates</u>	
	<u>-100 basis points</u>	<u>+100 basis points</u>
Implied forward rates:		
Net interest income change for the one year period beginning:		
July 1, 2008	0.82%	(0.85)%
January 1, 2008	2.76	(2.72)

The short-term Treasury and LIBOR implied forward rates in the July 1, 2008 net interest income sensitivity analyses were lower than the rates at January 1, 2008 while long-term rates were relatively stable. The more upward sloping implied forward curves in the July 1, 2008 analysis contributed to a more favorable interest rate environment that generally tended to enhance the net interest margin in all scenarios.

Net interest income sensitivity declined in the ± 100 basis point environments in the July 1, 2008 analysis compared to the January 1, 2008 analysis. The primary reason for the reduction in sensitivity was the continued execution of fixed-rate term FHLB advances and pay fixed-rate interest rate swaps, as well as the termination of receive fixed-rate swaps. The intent of the activity was to reduce the duration mismatch of assets and liabilities and net interest income sensitivity. Other factors contributing to the reduction in net interest income sensitivity were the projected shrinkage of the balance sheet (mainly due to the \$10 billion in balance sheet shrinkage that occurred from December 31, 2007 through June 30, 2008) and the reduction of loan volume production and sensitivity.

July 1, 2008 and January 1, 2008 Net Income Sensitivity Comparison

Similar to the net interest income sensitivity analysis, management also periodically projects net income in a variety of interest rate scenarios assuming parallel shifts in the implied forward yield curve. The net income simulations project changes in MSR and related hedges, all of which are carried at fair value and whose values are sensitive to changes in interest rates. The analysis assumes no changes in credit provisions, gain on sale, noninterest income or noninterest expense except for the fair value changes in MSR and related hedges.

In performing net income simulations, parallel shifts in the implied forward yield curve are assumed, with interest rates rising 100 basis points and decreasing 100 basis points in even quarterly increments over the twelve month periods ending June 30, 2009 and December 31, 2008. The interest rate scenarios are identical to the scenarios used for the net interest income comparison. The assumptions used in the base scenario are similar to the assumptions used in Washington Mutual's most current earnings forecast.

For the twelve month period ending June 30, 2009 using implied forward rates, net income is projected to increase approximately \$30 million in the -100 basis point simulation while it is projected to decrease approximately \$50 million in the +100 basis point simulation. In comparison, net income was projected to increase approximately \$160 million in the -100 basis point scenario and decrease approximately \$120 million in the +100 basis point scenario for the twelve month period ended December 31, 2008. The projected decrease in net income sensitivity in the +100 basis point scenario for the twelve month period ending June 30, 2009 as compared with the period ended December 31, 2008 was primarily due to decreases in net interest income sensitivity partially offset by changes in other income (fair value changes in the MSR and related hedges).

These net income and net interest income sensitivity analyses are limited in that they were performed at a particular point in time and do not reflect certain factors that would impact the Bank's financial performance in a changing interest rate environment. Most significantly, the impact of changes in gain on sale from mortgage loans that result from changes in interest rates is not modeled in the simulation. The net income and net interest income analyses also assume no changes in credit spreads. In addition, the net income sensitivity analysis assumes no changes in credit provisions, noninterest income or noninterest expense in the different scenarios other than changes in the fair value of MSR and related hedges. Additional or fewer provisions may be required in the rising or falling interest rate scenarios changing the projected net income sensitivity if the provisions were assumed to be sensitive to interest rate movements. The analyses assume management does not initiate additional 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 dependent on the reliability of various assumptions used, including prepayment forecasts and discount rates, and do not incorporate other factors that would impact the Bank's overall financial performance in such scenarios. 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 or systems, or from external events, including loss related to legal risk. Operational risk can occur in any activity, function or unit of Washington Mutual.

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 tools to quantify and monitor these risks. To help identify, assess and manage corporate-wide risks, Washington Mutual uses corporate support groups such as Legal, Compliance, Information Security, Continuity Assurance, Enterprise Spend Management 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 Bank'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 Bank's organizational structure and risk management philosophy. The Operational Risk Committee ensures consistent communication and oversight of significant operational risk issues within the Bank 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 within the Bank. 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 Bank-wide. Such tools include the collection of internal operational loss event data, relevant external operational loss event data, results from scenario analysis and assessments of the Bank's business environment and internal control factors. These elements are used to determine the Bank's operational risk profile and are included in the measurement of operational risk capital.

Goodwill Litigation

On August 9, 1989, the Financial Institutions Reform, Recovery and Enforcement Act was enacted. Among other things, the Act raised the minimum capital requirements for savings institutions and required a phase-out of the amount of supervisory goodwill that could be included in satisfying certain regulatory capital requirements. The exclusion of supervisory goodwill from the regulatory capital of many savings institutions led them to take actions to replace the lost capital either by issuing new qualifying debt or equity securities or to reduce assets. A number of these

institutions and their investors subsequently sued the United States Government seeking damages based on breach of contract and other theories (collectively “Goodwill Lawsuits”).

To date, trials have been concluded and opinions have been issued in a number of Goodwill Lawsuits in the United States Court of Federal Claims. Generally, in Goodwill Lawsuits in which opinions have been issued by the Court of Federal Claims, either the plaintiffs, the defendant (U.S. Government), or both the plaintiffs and the defendant, have opted to appeal the decision to the United States Court of Appeals for the Federal Circuit. Typically, following completion of these appeals, one or more parties has petitioned the United States Supreme Court for a writ of certiorari, but all such petitions have been denied. Generally, the appeals have resulted in the cases being remanded to the Court of Federal Claims for further trial proceedings.

American Savings Bank, F.A.

In December 1992, American Savings Bank, Keystone Holdings, Inc. and certain related parties brought a lawsuit against the U.S. Government, alleging, among other things, that in connection with the acquisition of American Savings Bank they entered into a contract with agencies of the United States and that the U.S. Government breached that contract. As a result of the Keystone acquisition, Washington Mutual succeeded to all of the rights of American Savings Bank, Keystone Holdings and the related parties in such litigation and will receive any recovery from the litigation.

In connection with the Keystone acquisition, there are 6 million shares of Washington Mutual’s common stock currently in escrow. In addition, as of December 31, 2007, the escrow included \$75.9 million in cash dividends paid on escrowed shares as well as interest accumulated on those dividends. Under the terms of the escrow arrangement, upon receipt of net cash proceeds from a final nonappealable judgment in or settlement of the litigation prior to the expiration of the escrow, one share (together with the dividends and interest attributable to such share) will be released from escrow to the Keystone investors for each \$18.4944 of net proceeds received by Washington Mutual. In September 2007, the escrow agreement was amended to extend the expiration date from December 20, 2008 to June 30, 2020. As a result of the amendment, in 2007, Washington Mutual received cash payments totaling \$17.2 million from the escrow. Additionally, Washington Mutual is entitled during 2008 to receive quarterly cash payments from the escrow, each in an amount equal to approximately 2% of the then value of the escrow. Thereafter, Washington Mutual is entitled to receive quarterly distributions from the escrow, each consisting of 130,435 shares of Washington Mutual’s common stock and the dividends and interest then in the escrow attributable to such shares.

On December 18, 2006, a summary judgment order in favor of plaintiffs was entered in the lawsuit in the amount of \$402 million. Following defendant’s appeal and oral argument, on March 6, 2008 the United States Court of Appeals for the Federal Circuit affirmed as to liability but partially reversed as to damages and reduced the judgment to \$55 million. It also remanded to the trial court for further proceedings including a determination regarding whether damages based on other theories and claims are appropriate. On June 9, 2008, the Court denied defendant’s motion for rehearing.

On July 31, 2008, the trial court rendered an oral decision granting plaintiffs’ motion to enter a final judgment on the \$55 million amount and indicated it would enter an order to that effect in the next several weeks and that the case would be set for trial on all other remaining claims. If such judgment is entered, defendant could file an appeal of that order. Washington Mutual cannot estimate when a final resolution of the case at trial level and all appeals will be concluded. In complex litigation such as this case, the appeals process could last several years. In the event of an appeal the amount of the court’s damages findings could be reduced or negated.

Dime Bancorp, Inc.

In January 1995, Anchor Savings Bank FSB, filed suit against the U.S. Government for unspecified damages involving supervisory goodwill related to its acquisition of eight troubled savings institutions from 1982-1985. Four of the acquisitions involved financial assistance from the

U.S. Government, and four did not. The Dime Savings Bank of New York, FSB acquired Anchor Savings Bank shortly after the case was brought and Dime Savings Bank assumed the rights under the litigation against the U.S. Government. Dime Bancorp distributed a Litigation Tracking Warrant™ (an “LTW”) for each share of its common stock outstanding on December 22, 2000 to each of its shareholders on that date. In January 2002, Dime Savings Bank and Dime Bancorp merged into WMB and Washington Mutual. As a result of these mergers, Washington Mutual assumed the litigation against the U.S. Government and the LTWs are now, when exercisable, exercisable for shares of Washington Mutual’s common stock. The events and conditions that would entitle a holder to exercise an LTW did not change as a result of these mergers and had not yet occurred as of December 31, 2007. For additional information concerning the Dime goodwill litigation and the LTWs, see Washington Mutual’s Current Reports on Form 8-K, dated March 12, 2003 and March 14, 2008, File No. 1-14667.

In a series of decisions issued in 2002, the Court of Federal Claims granted Washington Mutual’s summary judgment motions as to contract liability with respect to the four acquisitions involving financial assistance, but granted the U.S. Government’s motions with respect to the four unassisted acquisitions. On September 29, 2003, the Court denied the U.S. Government’s motion for summary judgment with respect to the claim for Washington Mutual’s lost profits, but granted the U.S. Government’s motion with respect to Washington Mutual’s alternative claims for reliance damages and for the value of the lost supervisory goodwill. A six-week trial on Washington Mutual’s lost profits claim started in June 2005, followed by a post-trial briefing which was completed in November 2005. On March 14, 2008, the U.S. Court of Federal Claims issued an order and findings in the case. The Court’s order and findings concluded that Anchor Savings had incurred recoverable damages in the amount of approximately \$382 million, plus an undetermined amount for a gross-up of Washington Mutual’s tax liabilities. The Court ordered the parties to provide certain information with respect to the gross-up by May 1, 2008, so that it could make a final determination in regard to the gross-up. The Court found that Anchor was entitled to damages for the lost profits resulting from its forced sale of its Residential Funding Corporation subsidiary and of large portions of its branch network. The Court awarded additional damages based on expectation damages from reduced stock proceeds, “wounded bank” damages and overpayment of FDIC premiums. On June 27, 2008, per the parties’ stipulation, the court entered an order allowing plaintiff to postpone its application for the gross-up until such time as it actually pays taxes upon the award in the case and entered a final judgment for approximately \$382 million. On July 16, 2008, the Court granted the defendant’s motion to correct a clerical error in calculation of damages and reduced the judgment to approximately \$356 million.

Washington Mutual anticipates that, with the exception of the court’s July 16, 2008 order reducing the judgment, the government will appeal the judgment. In such event, Washington Mutual cannot estimate when a final resolution of all appeals will be concluded. In complex litigation such as this case, the appeals process could last several years. In the event of an appeal the amount of the court’s damages findings could be reduced or negated.

Litigation is inherently uncertain, and significant uncertainty surrounds the legal issues involved in cases involving supervisory goodwill that underlie the value of the LTWs. As a result, Washington Mutual cannot predict if or when the conditions will be satisfied that will result in holders becoming entitled to exercise their LTWs or the value for which the LTWs will become exercisable.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, the Bank 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 Bank and its subsidiaries. Certain of these

actions and proceedings are based on alleged violations of consumer protection, banking and other laws.

Credit Card Industry Litigation

Over the past several years, MasterCard International and Visa U.S.A., Inc., as well as several of their member banks and bank affiliates (including in certain instances the Bank and Washington Mutual), have been involved in several different lawsuits challenging various practices of the MasterCard and Visa associations (the “Associations”).

In and around February 2001, a number of cardholder class actions were filed against the Associations and several member banks alleging, among other things, that they had conspired, in violation of antitrust laws, to fix the price of currency conversion services for credit card purchases made in a foreign currency by U.S. cardholders. Providian Financial Corporation and Providian National Bank were named as defendants; after the Providian merger, Washington Mutual and the Bank were added as defendants. Pursuant to orders of the Judicial Panel on Multidistrict Litigation, the cases were consolidated or coordinated for pretrial purposes. *In re Currency Conversion Fee Antitrust Litigation*, MDL 1409 (S.D.N.Y.). In July 2006, the parties agreed to settle the case for \$336 million. The Bank’s share of the settlement, which has been paid into an escrow account, was covered by existing reserves. The Court held a hearing on the motion for Final Judgment and Order of Dismissal on March 31, 2008. The Court has not yet issued its ruling.

On November 15, 2004, American Express filed an antitrust lawsuit against the Associations and several member banks, alleging, among other things, that the defendants jointly and severally implemented and enforced illegal exclusionary agreements that prevented member banks from issuing American Express cards. *American Express Travel Related Services Company, Inc. v. Visa U.S.A. Inc., et al.*, No. 04-Civ-08967 (S.D.N.Y. Filed Nov. 15, 2004). Providian Financial Corporation and Providian National Bank were named as defendants; after the Providian merger, Washington Mutual and the Bank were added as defendants. On November 7, 2007, American Express issued a press release announcing that it had reached an agreement with Visa Inc., Visa USA and Visa International to drop Visa and five of its member banks, including Washington Mutual, as defendants in the American Express Litigation. The settlement amounts totaling \$2.25 billion due to American Express are to be paid directly by Visa over the next four years. In November 2007, Washington Mutual announced that it would recognize a charge of \$38 million for its share of the settlement.

On June 22, 2005, a group of retail merchants filed a purported class action against the Associations and several member banks alleging, among other things, that the defendants conspired in violation of the antitrust laws to fix the level of interchange fees. Providian Financial Corporation and Providian National Bank were named as defendants; after the Providian merger, Washington Mutual and the Bank were added as defendants. *Photos Etc. Corporation, et al. v. Visa U.S.A. Inc., et al.*, No. 305-CV-1007 (D. Conn. Filed June 22, 2005). Since then, approximately 48 similar complaints have been filed on behalf of merchants against the card Associations and, in some cases, against member banks including the Bank. On October 19, 2005, the Judicial Panel on Multidistrict Litigation issued an order coordinating the cases for pretrial proceedings. *In re Payment Card Interchange Fee Litigation*, MDL 1720 (E.D.N.Y.). On April 24, 2006, the group of purported class plaintiffs filed a First Amended Class Action Complaint. The case is now in discovery.

Refer to Note 16 to the Consolidated Financial Statements – “Commitments, Guarantees and Contingencies” in the Bank’s 2007 Annual Report on Form 10-K/A for a further discussion of pending and threatened litigation action and proceedings against the Bank.

Item 6. Exhibits

(a) Exhibits

See Index of Exhibits on page 60.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Bank has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 14, 2008.

WASHINGTON MUTUAL BANK

By: /s/ THOMAS W. CASEY
Thomas W. Casey
Executive Vice President and Chief Financial Officer

By: /s/ MELISSA J. BALLENGER
Melissa J. Ballenger
*Senior Vice President and Controller
(Principal Accounting Officer)*

**WASHINGTON MUTUAL BANK
INDEX OF EXHIBITS**

Exhibit No.

- 3.1 Charter of WMB, as in effect on the date of this report (Incorporated by reference to WMB's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 3.2 Restated Bylaws of WMB, as in effect on the date of this report (Filed herewith).
- 4 WMB agrees to furnish the Office of Thrift Supervision, upon request, with copies of all instruments defining the rights of holders of long-term debt of WMB and its consolidated subsidiaries.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).
- 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith).
- 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith).

CERTIFICATION

I, Kerry K. Killinger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Washington Mutual Bank;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - (d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

/s/ KERRY K. KILLINGER

Kerry K. Killinger
Chief Executive Officer
of Washington Mutual Bank

CERTIFICATION

I, Thomas W. Casey, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Washington Mutual Bank;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - (d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

/s/ THOMAS W. CASEY

Thomas W. Casey
*Executive Vice President and Chief Financial Officer
of Washington Mutual Bank*

**WASHINGTON MUTUAL BANK
CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Kerry K. Killinger, the Chief Executive Officer of Washington Mutual Bank, does hereby certify that this report on Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of Washington Mutual Bank.

Date: August 14, 2008

By: /s/ KERRY K. KILLINGER

Kerry K. Killinger
Chief Executive Officer
of Washington Mutual Bank

A signed original of this written statement required by Section 906 has been provided to Washington Mutual Bank and will be retained by Washington Mutual Bank and furnished to the Office of Thrift Supervision or its staff upon request.

**WASHINGTON MUTUAL BANK
CERTIFICATION OF THE CHIEF FINANCIAL OFFICER**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Thomas W. Casey, the Chief Financial Officer of Washington Mutual Bank, does hereby certify that this report on Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of Washington Mutual Bank.

Date: August 14, 2008

By: /s/ THOMAS W. CASEY

Thomas W. Casey

*Executive Vice President and Chief Financial Officer
of Washington Mutual Bank*

A signed original of this written statement required by Section 906 has been provided to Washington Mutual Bank and will be retained by Washington Mutual Bank and furnished to the Office of Thrift Supervision or its staff upon request.