

WASHINGTON MUTUAL INC
Form 10-K/A
March 19, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL
YEAR ENDED DECEMBER 31, 2003**

Commission File Number 1-14667

WASHINGTON MUTUAL, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-1653725
(I.R.S. Employer
Identification Number)

1201 Third Avenue, Seattle, Washington
(Address of principal executive offices)

98101
(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock	New York Stock Exchange

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

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

Indicate by check mark 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 o.

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No o.

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The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2003:

Common Stock \$37,362,586,793⁽¹⁾

⁽¹⁾ Does not include any value attributable to 17,100,000 shares held in escrow.

The number of shares outstanding of the issuer's classes of common stock as of February 27, 2004:

Common Stock 868,397,759⁽²⁾

⁽²⁾ Includes 6,000,000 shares held in escrow.

Documents Incorporated by Reference

Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held April 20, 2004, are incorporated by reference into Part III.

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Explanatory Note

Washington Mutual, Inc. ("Washington Mutual" or the "Company") is filing this Amendment No. 1 on Form 10-K/A to amend its Annual Report on Form 10-K for the year ended December 31, 2003 to correct the funds transfer pricing methodology applied to the 2001 financial results of the Company's operating segments. Such information had no effect on previously reported 2001 consolidated results of operations or any other period presented in this report.

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

Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) solely to reflect the changes to segment information reported for 2001 in the tables and narrative discussion of Operating Segments on pages 40 through 44; and

Item 8 (Financial Statements and Supplementary Data) to reflect, in Notes 2 "Restatements of Financial Statements" and 25 "Operating Segments" to the Consolidated Financial Statements, the changes to segment information reported in the table for the year ended December 31, 2001 contained in Note 25, and to include the reissued report of the Company's independent auditors.

While this Amendment No. 1 also sets forth the complete text of each other item of the Company's Form 10-K for the year ended December 31, 2003, it does not change any information contained in these other items as originally filed on March 15, 2004. This Amendment No. 1 also does not reflect events that have occurred after the original filing of the Form 10-K.

PART I

BUSINESS

Overview

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With a history dating back to 1889, Washington Mutual, Inc. (together with its subsidiaries, "Washington Mutual," or the "Company") is a financial services company committed to serving consumers and small- to mid-sized businesses. Based on our consolidated assets at December 31, 2003, we were the largest thrift holding company in the United States and the eighth largest among all U.S.-based bank and thrift holding companies.

Company Growth

Our assets have grown over the last eight years primarily through the following significant acquisitions:

<u>Acquisition Name</u>	<u>Date Acquired</u>	<u>Loans</u>	<u>Deposits</u>	<u>Assets</u>
(in millions)				
Keystone Holdings, Inc.	Dec. 20, 1996	\$ 14,563	\$ 12,815	\$ 21,894
Great Western Financial Corporation	July 1, 1997	32,448	27,785	43,770
H.F. Ahmanson & Company ⁽¹⁾	Oct. 1, 1998	33,939	33,975	50,355
Mortgage operations of The PNC Financial Services Group, Inc. ⁽²⁾	Jan. 31, 2001	3,352		7,307
Bank United Corp.	Feb. 9, 2001	14,983	8,093	19,034
Fleet Mortgage Corp. ⁽²⁾	June 1, 2001	4,378		7,813
Dime Bancorp, Inc.	Jan. 4, 2002	21,660	15,171	31,305

(1) Includes loans, deposits and assets acquired by Ahmanson from Coast Savings Financial, Inc.

(2) This was an acquisition of selected assets and/or liabilities.

Our mission is to become the nation's leading retailer of consumer financial services. Our strategy is to focus primarily on middle-market consumers in the largest metropolitan areas. Through advertising, branding and positioning we build customer awareness of our home lending products and encourage households to conduct business with Washington Mutual. In selected metropolitan markets, we then overlay our retail banking operations and cross-sell key products, including checking accounts, deposit accounts and home equity products. Store expansion was a priority in 2003 and will continue to be a priority in 2004. We plan to achieve our mission principally through organic growth of our retail banking franchise and by driving efficiencies in our operations.

Business Segments

In the fourth quarter of 2003 we realigned our business segments and we now manage and report information concerning the Company's activities, operations, products and services around our two customer categories: consumers and commercial customers. Our realigned business segments are the Consumer Group and the Commercial Group. The Consumer Group separately reports information for two distinct reporting segments: the Retail Banking and Financial Services segment and the Mortgage Banking segment.

We manage interest rate risk, liquidity, capital, funding and securities held for general asset and liability management purposes on an enterprise-wide basis through our Treasury Division.

Consumer Group

The Consumer Group offers products and services to consumers and manages activities and operations affecting consumers. The Group serves approximately 11.6 million households through multiple

distribution channels, including 1,776 retail banking stores, 432 retail home loan stores, 2,990 ATMs, 39 wholesale home loan centers, correspondent lenders, telephone call centers and online banking.

The Consumer Group's primary objectives in 2004 are to increase the number of the Group's products and services used by consumers, thus increasing profitability, and to drive efficiencies in its operations. The Group plans to achieve its objective by cross-selling products and services to its existing customers and by establishing and enlarging its customer base in selected markets.

Retail Banking and Financial Services

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

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

Holding the Company's portfolio of home loans held for investment;

Managing and servicing the home equity and consumer loan portfolios; and

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

The segment's expansion of its national retail banking franchise is an integral element of the Consumer Group's strategy for achieving its 2004 objective. In 2004, the segment plans to open approximately 250 new retail banking stores, primarily in the Tampa, Chicago and New York metropolitan areas. In 2003, the segment opened 260 stores primarily in the Chicago, Houston, Dallas and New York metropolitan areas. New retail banking stores are configured on an award-winning and innovative retail banking platform that serves customers in an open, free-flowing retail environment.

Deposit products offered by the segment include the Company's signature free checking and Platinum accounts as well as other personal checking accounts, savings accounts, money market deposit accounts and time deposit accounts. The segment also offers home equity loans and lines of credit and consumer loans. Home equity loans and lines of credit accounted for 16% of loans held in portfolio at the end of 2003, up from 11% at the end of 2002. Home equity loans and lines of credit generally provide higher margins than home loans. As such, the Company believes they represent an attractive opportunity to grow the loan portfolio.

The segment holds loans in portfolio that are originated by the Mortgage Banking segment. Through our specialty mortgage finance program, the segment also purchases and re-underwrites loans to higher risk borrowers; such loans, while held in portfolio, are serviced by third parties.

Investment advisory and securities brokerage services are provided by approximately 600 financial consultants of WM Financial Services, Inc., a licensed broker-dealer. In addition, fixed annuities are offered to the public by approximately 1,300 licensed banking employees. The Company's mutual fund management business, WM Advisors, Inc., offers investment advisory and mutual fund distribution services and had assets under management at December 31, 2003 of \$17.87 billion.

Mortgage Banking

The principal activities of the Mortgage Banking segment include:

Originating and servicing home loans;

Buying and selling home loans in the secondary market; and

Providing insurance-related products.

The Mortgage Banking segment's primary objectives in 2004 are to drive significant efficiencies by fully integrating the mortgage banking companies we acquired in 2001 and 2002 and to increase the

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number of the Company's products and services used by customers. The segment is transitioning to a single non-proprietary servicing platform for home loans in 2004 and is also consolidating its origination systems and loan fulfillment centers.

In 2003 Washington Mutual was a leading originator and servicer of mortgage loans and expanded its distribution channel with the opening of 93 new retail home loan centers.

Through its multiple lending channels, the segment offers a diverse set of home loan products including:

Fixed-rate home loans;

Adjustable-rate home loans (where the interest rate may be adjusted as frequently as every month);

Hybrid home loans (where the interest rate is fixed for a predetermined time period, typically 3 or 5 years, and then reprices monthly or annually, depending on the product); and

Government insured or guaranteed home loans.

Home loans are either originated or purchased and are either held in portfolio by the Retail Banking and Financial Services segment or sold by the Mortgage Banking segment to institutional investors in the secondary market or to the housing government-sponsored enterprises. In general, the Retail Banking and Financial Services segment holds in portfolio purchased loans made to higher-risk borrowers and adjustable-rate mortgages, and the Mortgage Banking segment sells fixed-rate home loans, generally to the Federal National Mortgage Association ("Fannie Mae"), a government-sponsored enterprise. As conditions warrant, the Mortgage Banking segment may securitize adjustable-rate loans into available-for-sale securities to be held by the Treasury Division as part of the Company's overall asset and liability management strategy. In the future, the segment may securitize and sell adjustable-rate loans in the secondary market as part of the Company's capital management process.

Mortgage servicing involves the administration and collection of home loan payments. The Mortgage Banking segment performs most home loan servicing activities, including the servicing of loans held in portfolio by the Retail Banking and Financial Services segment. When loans are sold into the secondary market, the Company generally retains the right to service those loans and hence retains the customer relationship. The Company intends to use these customer relationships to cross-sell additional products and services.

All loans, whether originated or purchased, are subject to the same nondiscriminatory underwriting standards. When originating home loans, the Company follows established lending policies and procedures that require consideration of an applicant's credit profile relative to the size and characteristics of the loan. When purchasing home loans, the Company normally delegates the underwriting responsibility to the correspondent lenders that originate the loans. The Company requires correspondent lenders to comply with its underwriting and appraisal standards and performs quality control procedures to ensure that compliance occurs.

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

See Note 25 to the Consolidated Financial Statements "Operating Segments" for financial information regarding the two operating segments of the Consumer Group and refer to Management's Discussion and Analysis "Operating Segments" for a description of the principal differences between the previous and newly aligned segment structures.

Commercial Group

The principal activities of the Commercial Group include:

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Providing financing to developers, investors, mortgage bankers and homebuilders for the acquisition or construction of multi-family dwellings, other commercial properties and new homes;

Originating and servicing multi-family and other commercial real estate loans and either holding such loans in portfolio as part of its commercial asset management business or selling them in the secondary market;

Originating, selling and servicing home loans to higher-risk borrowers through the Company's subsidiary, Long Beach Mortgage Company; and

Offering a full array of commercial banking products and services.

The Group's primary objectives in 2004 are to improve productivity by consolidating operations and to increase market share in the highly fragmented multi-family, commercial real estate and commercial banking markets through organic growth. The Group expects to integrate approximately 80 commercial banking centers and small business centers with its existing multi-family and commercial real estate operations. Additional productivity improvements should result from centralizing servicing operations and automating and streamlining the underwriting and loan closing processes.

The multi-family lending business, which accounts for a majority of the Group's revenues, is comprised of three key activities: originating and managing loans retained in the loan portfolio, servicing loans and providing ancillary banking services to enhance customer retention. Combining these three activities into one integrated business model has allowed the Group to become a leading originator and holder of multi-family loans. The Group's multi-family lending program has a dominant market share of more than 20% in certain key cities along the west coast and is building market share on the east coast with recent office openings in Boston, Washington, D.C., and Miami.

As part of the Company's specialty mortgage finance program, the Group originates home loans to higher-risk borrowers through Long Beach Mortgage, which it then sells to secondary market participants, retaining the servicing relationship.

The Group also offers a full array of commercial banking products and services, including lines of credit, receivables and inventory financing, equipment loans, real estate financing, government-guaranteed loans, international trade financing, cash management and merchant bankcard services.

The Company completed the sale of Washington Mutual Finance Corporation, its consumer finance subsidiary, which was formerly part of the Commercial Group, on January 9, 2004. Washington Mutual Finance's operations are reported as discontinued operations elsewhere in this report on Form 10-K unless otherwise noted.

See Note 25 to the Consolidated Financial Statements "Operating Segments" for financial information regarding the Commercial Group and refer to Management's Discussion and Analysis "Operating Segments" for a description of the principal differences between the previous and newly aligned segment structures.

Available Information

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

The Company's Code of Conduct, which applies to all officers, directors and employees of the Company, and the Code of Ethics for Senior Financial Officers, which applies to the Company's Chief

Executive Officer, Chief Financial Officer, Controller, and each business segment or business line chief financial officer and controller, as well as any waiver of our Code of Conduct and amendment to or waiver of the Code of Ethics for Senior Financial Officers, are disclosed on our website located at www.wamu.com/ir.

Employees

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At December 31, 2003, we had 63,720 employees, compared with 55,200 at December 31, 2002 and 41,901 at December 31, 2001, which included 2,346, 2,330 and 2,717 employees related to the Company's discontinued operations. During 2003, our number of employees increased substantially to accommodate the high refinancing activity in the earlier part of the year and the opening of new retail banking stores. The increase in 2002 over the same period in 2001 was primarily due to the acquisitions of Dime and HomeSide Lending, Inc., which was acquired in two transactions in 2002. We believe that we have been successful in attracting quality employees and that our employee relations are good.

Factors That May Affect Future Results

Our Form 10-K and other documents that we file with the Securities and Exchange Commission have forward-looking statements. In addition, our 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 our expectations or predictions of future conditions, events or results. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. These statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made. There are a number of factors, many of which are beyond our control, that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements.

Some of these factors are described below.

General business and economic conditions may significantly affect our earnings.

Our business and earnings are sensitive to general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, money supply, fluctuations in both debt and equity capital markets, the strength of the U.S. economy, and of the local economies in which we conduct business. Changes in these conditions may adversely affect our business and earnings. For example, if short-term interest rates rise faster than mortgage rates, our net interest income, which is our largest component of net income, could be adversely affected. A prolonged economic downturn could increase the number of customers who become delinquent or default on their loans, or a rising interest rate environment could decrease the demand for loans. An increase in delinquencies or defaults could result in a higher level of charge-offs and provision for loan and lease losses, which could adversely affect our earnings.

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

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If we are unable to effectively manage the volatility of our mortgage banking business, our earnings could be adversely affected.

Changes in interest rates significantly affect the mortgage banking business. One of the principal risks of declining interest rates on the mortgage banking business is the acceleration of prepayments which reduce the fair value of our mortgage servicing rights ("MSR"). One of the ways we mitigate this risk is by purchasing financial instruments, such as fixed-rate investment securities, interest rate contracts and forward commitments to purchase mortgage-backed securities, which tend to increase in value when long-term interest rates decline. The success of this strategy, however, is dependent on management's judgments regarding the amount, type and mix of MSR risk management instruments that we select to manage the changes in fair value of our mortgage servicing asset. If this strategy is not successful, our net income could be adversely affected. Moreover, many of our interest rate and MSR risk management strategies depend on liquidity in mortgage-related financial instruments traded in the secondary market. If periods of illiquidity develop in these markets, our ability to effectively implement our MSR risk management strategies could be adversely affected. Another significant risk to the mortgage banking business is the effect of interest rates on loan volume and gain from mortgage loans. In rising interest rate environments, loan volume is generally lower and, accordingly, the overall amount of gain from mortgage loans is lower. Due to the high levels of salable fixed-rate loan volume in 2002 and 2003 that resulted from historically low mortgage interest rates, our gain from mortgage loans in 2003 and 2002 was higher than it is likely to be when mortgage interest rates rise above their historical low points for a sustained period of time. For further discussion of how interest rate risk, basis risk and MSR prepayment risk are managed, see "Market Risk Management."

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If we are unable to fully realize the operational and systems efficiencies sought to be achieved from our recently announced business segment realignment, our earnings could be adversely affected.

In the fourth quarter of 2003 we realigned our operating segment structure according to products and services that are grouped into two primary categories those offered to retail consumers and those offered to commercial customers in order to create a more highly integrated and unified retailing strategy and to streamline and simplify operations. To accomplish these goals we are eliminating redundancies throughout the organization, completing the integration of the mortgage banking companies we acquired in 2001 and 2002, transitioning to a single non-proprietary platform for the servicing of home loans, consolidating our mortgage origination systems and loan fulfillment centers and integrating call centers. We anticipate that these initiatives will result in operating efficiencies.

If we experience difficulties, such as a prolonged interruption of our service, as we realign our business segments and continue to integrate our systems and operations, including those of the acquired mortgage companies, we could experience higher than anticipated administrative costs and the loss of customers, among other things. These events could adversely affect our operations and financial condition.

The financial services industry is highly competitive.

We are subject to significant competition in attracting and retaining deposits and making loans as well as in providing other financial services in all of our market areas. We face pricing competition for loan and deposit products. In addition, customer convenience and service capabilities, such as product lines offered and the accessibility of services are significant competitive factors.

Our most direct competition for loans comes from commercial banks, other savings institutions, national mortgage companies and government-sponsored enterprises. Our most direct competition for deposits comes from commercial banks, other savings institutions, and credit unions doing business in our market areas. As with all banking organizations, we have also experienced competition from nonbanking sources, including mutual funds, corporate and government debt securities and other investment alternatives offered within and outside of our primary market areas.

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Changes in the regulation of financial services companies and housing government-sponsored enterprises could adversely affect our business.

Proposals for further regulation of the financial services industry are continually being introduced in Congress. Proposals that are now receiving a great deal of attention include consumer protection initiatives relating to the Real Estate Settlement Procedures Act, predatory lending, credit reporting and privacy. The agencies regulating the financial services industry also periodically adopt changes to their regulations. It is possible that one or more legislative proposals may be adopted or regulatory changes may be made that would have an adverse effect on our business. For further discussion of the regulations of financial services, see "Regulation and Supervision."

The Federal National Mortgage Association ("FNMA" or "Fannie Mae"), the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") and the Federal Home Loan Banks are housing government-sponsored enterprises ("GSEs") which play a powerful role in the mortgage industry. We have significant business relationships with these GSEs. Proposals are being considered in Congress and by various regulators which would affect the manner in which these GSEs conduct their business. These proposals include establishing a new independent agency to regulate GSEs, requiring GSEs to register their stock with the United States Securities and Exchange Commission, and reducing or limiting certain business benefits GSEs receive from the federal government. The enactment of any of these proposals could increase the costs incurred by, or otherwise adversely affect the business of, the GSEs, which in turn could have an adverse impact on our business. For discussion of the Federal Home Loan Bank System and the regulation of financial services, see "Regulation and Supervision."

Taxation

General

For federal income tax purposes, we report income and expenses using the accrual method of accounting on a calendar year basis. We are subject to federal income tax under existing provisions of the Internal Revenue Code of 1986, as amended, in generally the same manner as other corporations.

State Income Taxation

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Many of the states in which we do business impose corporate income taxes on companies doing business in those states. The State of Washington does not currently have a corporate income tax, but has a business and occupation tax on gross receipts. Currently, the tax does not apply to interest received on loans secured by first mortgages or deeds of trust on residential properties.

Assistance Agreement

In connection with the acquisition of Keystone Holdings, Inc. in 1996, we succeeded to the rights and obligations of Keystone Holdings and certain of its affiliates under a number of continuing agreements with the predecessor to the Federal Deposit Insurance Corporation ("FDIC"), including an Assistance Agreement. The Assistance Agreement provides, in part, for the payment to the Federal Savings & Loan Insurance Corporation Resolution Fund over time of 75% of most of the federal tax savings and 19.5% of most of the California tax savings (in each case computed in accordance with specific provisions contained in the Assistance Agreement) attributable to the utilization of certain tax loss carryforwards. The provision for such payments is reflected in the Consolidated Financial Statements as "Income Taxes."

See Note 14 to the Consolidated Financial Statements "Income Taxes" for further discussion.

Environmental Regulation

Our business and properties are subject to federal and state laws and regulations governing environmental matters, including the regulation of hazardous substances and wastes. For example, under

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the federal Comprehensive Environmental Response, Compensation, and Liability Act and similar state laws, owners and operators of contaminated properties may be liable for the costs of cleaning up hazardous substances without regard to whether such persons actually caused the contamination. Such laws may affect us both as an owner of properties used in or held for our business, and as a secured lender on property that is found to contain hazardous substances or wastes. Our general policy is to obtain an environmental assessment prior to foreclosing on commercial property. The existence of hazardous substances or wastes on such property may cause us to elect not to foreclose on the property, thereby limiting, and in some instances precluding, our realization on such loans.

Regulation and Supervision

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

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

General

Washington Mutual, Inc. is a Washington state corporation. It owns two federal savings associations and one Washington state-chartered savings bank, as well as numerous nonbank subsidiaries. Because our state bank has elected to be treated as a savings association for purposes of federal holding company law, Washington Mutual, Inc. is a savings and loan holding company. As a savings and loan holding company, Washington Mutual, Inc. is subject to regulation by the Office of Thrift Supervision (the "OTS").

Our federal savings associations are subject to extensive regulation and examination by the OTS, their primary federal regulator, as well as the FDIC. Our state bank is subject to regulation and supervision by the Director of Financial Institutions of the State of Washington (the "State Director") and by the FDIC. Our nonbank financial subsidiaries are also subject to various federal and state laws and regulations.

All of our banking subsidiaries are under the common control of Washington Mutual, Inc. and are insured by the FDIC. If an insured institution fails, claims for administrative expenses of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the failed institution) have priority over the claims of general unsecured creditors. In addition, the FDIC has authority to require any of our banking subsidiaries to reimburse it for losses it incurs in connection either with the failure of another of our banking subsidiaries or with the

FDIC's provision of assistance to one of our banking subsidiaries that is in danger of failure.

Payment of Dividends

Washington Mutual, Inc. is a legal entity separate and distinct from its banking and other subsidiaries. Its principal sources of funds are cash dividends paid by those subsidiaries, investment income, and borrowings. Federal and state laws limit the amount of dividends or other capital distributions that a banking institution, such as our federal associations and our state bank, can pay. Each of our banking subsidiaries has a policy to remain well-capitalized and, accordingly, would not pay dividends to the extent payment of the dividend would result in it not being well-capitalized. In addition, our federal associations must file a notice with the OTS at least 30 days before they can pay dividends to their parent companies.

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See Note 19 to the Consolidated Financial Statements "Regulatory Capital Requirements and Dividend Restrictions" for a more detailed description of the limits on the dividends our subsidiary banks can pay.

Capital Adequacy

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

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

As of December 31, 2003 each of our banking subsidiaries met all capital requirements to which it was subject and satisfied the requirements to be treated as well-capitalized. See Note 19 to the Consolidated Financial Statements "Regulatory Capital Requirements and Dividend Restrictions" for an analysis of our regulatory capital.

Holding Company Status and Acquisitions

Washington Mutual, Inc. is a multiple savings and loan holding company, as defined by federal law, because it owns more than one savings association. Washington Mutual, Inc. is regulated as a unitary savings and loan holding company, however, because the OTS deems our federal associations to have been acquired in supervisory transactions. Therefore, we are exempt from certain restrictions that would otherwise apply under federal law to the activities and investments of a multiple savings and loan holding company. These restrictions will apply to Washington Mutual, Inc. if any of our three banking institutions fails to meet a qualified thrift lender test established by federal law. As of December 31, 2003, the Company's three banking subsidiaries were in compliance with qualified thrift lender standards.

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

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

Federal Home Loan Bank System

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

One of our federal savings associations, Washington Mutual Bank, FA, currently is a member only of the San Francisco FHLB. Our state bank, Washington Mutual Bank, and our other federal association, Washington Mutual Bank fsb, are members of the Seattle FHLB.

Proposals have been made recently which would affect the operations and structure of the FHLB System. The Finance Board has proposed a regulation that would require each FHLB to register its stock with the United States Securities and Exchange Commission and provide more public disclosure. Congress is considering proposals which would establish a new regulator for the FHLB System, as well as for other housing government-sponsored entities. We cannot predict at this time which, if any, of these proposals may be adopted or what effect they would have on the business of the Company.

Deposit Insurance

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

The FDIC has established a risk-based system for setting deposit insurance assessments. Under the risk-based assessment system, an institution's insurance assessments vary according to the level of capital the institution holds and the degree to which it is the subject of supervisory concern. During 2003, the assessment rate for both SAIF and BIF deposits ranged from zero to 0.27% of assessable deposits. Our banking subsidiaries qualified for the lowest rate on their deposits in 2003 and paid no deposit insurance assessments.

Affiliate Transaction Restrictions

Our three banking subsidiaries are subject to the same affiliate and insider transaction rules applicable to member banks of the Federal Reserve System as well as additional limitations imposed by the OTS. These provisions prohibit or limit a banking institution from extending credit to, or entering into certain transactions with, affiliates (such as Washington Mutual, Inc.), principal stockholders, directors and executive officers of the banking institution and its affiliates. Each of our banking subsidiaries currently is in material compliance with all of these limitations.

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Federal Reserve, Consumer and Other Regulation

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

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

The Gramm-Leach-Bliley Act included provisions that give consumers new protections regarding the transfer and use of their nonpublic personal information by financial institutions. In addition, states are permitted under the Gramm-Leach-Bliley Act to have their own privacy

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laws, which may offer greater protection to consumers than the Gramm-Leach-Bliley Act. Numerous states in which the Company does business have enacted such laws.

The four federal banking agencies, including our regulators, have jointly issued expanded examination and supervision guidance relating to two areas affecting our activities—subprime lending and, most recently, mortgage banking and mortgage servicing rights.

The USA PATRIOT Act, which was enacted following the events of September 11, 2001, included numerous provisions designed to fight international money laundering and to block terrorist access to the U.S. financial system. We have established policies and procedures to ensure compliance with the Act's provisions, and the impact of the Act on our operations has not been material.

Community Reinvestment Act

The Community Reinvestment Act ("CRA") requires that our banking subsidiaries ascertain and help meet the credit needs of the communities we serve, including low- to moderate-income neighborhoods, while maintaining safe and sound banking practices. We maintain a CRA file that is available for public viewing. The file includes copies of our most recent CRA Public Evaluations, descriptions of our products and services, delivery outlet information, and public comments.

In September 2001, we announced a new ten-year \$375 billion community commitment, effective January 2002. This commitment replaced prior ones made by us and the companies we acquired. As of December 31, 2003, we had exceeded our yearly targets for lending in low- to moderate-income neighborhoods and underserved market areas.

Regulatory Enforcement

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

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Regulation of Nonbanking Affiliates

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

Executive Officers

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

Executive Officers	Age	Capacity in Which Served	Employee of Company Since
Kerry K. Killinger	54	Chairman of the Board of Directors, President and Chief Executive Officer	1983
Thomas W. Casey	41	Executive Vice President and Chief Financial Officer	2002
Craig J. Chapman	47	President, Commercial Group and Chief Administrative Officer	1998

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Executive Officers	Age	Capacity in Which Served	Employee of Company Since
Fay L. Chapman	57	Senior Executive Vice President and General Counsel	1997
Daryl D. David	49	Executive Vice President, Human Resources	2000
Jeremy V. Gross	46	Executive Vice President and Chief Information Officer	2001
William A. Longbrake	61	Vice Chair	1996
Robert H. Miles	47	Senior Vice President and Controller	1999
Deanna W. Oppenheimer	45	President, Consumer Group	1985
Craig E. Tall	58	Vice Chair, Corporate Development	1985
James G. Vanasek	60	Executive Vice President and Chief Enterprise Risk Officer	1999

Mr. Killinger established the Executive Committee in 1990 to facilitate and coordinate decision making by and communication among the most senior executive officers of the Company who, as a committee, determine the Company's strategic direction. The President's Council, established by Mr. Killinger in December 2002 and comprised of the Chief Financial Officer, the Chief Administrative Officer and the Group Presidents, is focused on operational efficiency, operational decision-making and strategic execution, with particular emphasis on operations and execution across business segments. The executive officers serving on these committees at December 31, 2003 are indicated below.

Mr. Killinger is Chairman, President and Chief Executive Officer of Washington Mutual. He was named President and Director in 1988, Chief Executive Officer in 1990 and Chairman in 1991. Mr. Killinger joined Washington Mutual as an Executive Vice President of Washington Mutual Bank in 1983. He has been a member of the Executive Committee since its formation in 1990.

Mr. Casey is Executive Vice President and Chief Financial Officer of Washington Mutual. As a member of the Executive Committee and the President's Council, he oversees all aspects of Washington Mutual's corporate finance, strategic planning and investor relations functions. Prior to joining Washington Mutual, Mr. Casey was with GE Capital Corp. from 1992 through 2002 where he held advising,

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controllershship and analyst positions prior to becoming a vice president of GE and Senior Vice President and CFO of GE Financial Assurance in 1999.

Mr. Chapman is President of the Commercial Group and Chief Administrative Officer. He is responsible for overseeing multi-family lending, commercial real estate, homebuilder finance, mortgage banker finance, Long Beach Mortgage Company, and commercial banking. As Chief Administrative Officer, Mr. Chapman oversees operational excellence, acquisition integration, corporate property services and strategic sourcing. After joining Washington Mutual in 1998 as President and Chief Executive Officer of Washington Mutual Finance Corporation, he became a member of the Executive Committee in 2001 and a member of the President's Council in 2002. Previously, Mr. Chapman served as President of AMRESO Residential Mortgage Corporation from 1996 to 1997.

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

Mr. David joined Washington Mutual in 2000 as Executive Vice President, Human Resources. He is responsible for talent acquisition, organizational capabilities, leadership development and rewards and benefits. Mr. David became a member of the Executive Committee in 2001. He joined Washington Mutual from Amazon.com where he was Vice President of Strategic Growth and Human Resources from 1999 to 2000. Previously, he served as Executive Vice President and Chief Administrative Officer of Sanga International from 1998 to 1999.

Mr. Gross joined Washington Mutual in 2001 as Executive Vice President and Chief Information Officer and became a member of the Executive Committee at that time. He is responsible for directing the Company's corporate technology strategy. Mr. Gross joined Washington Mutual from Sydney, Australia-based Westpac Banking Corp. where he was Group Executive of Technology, Operations and eCommerce from 1999 to 2001. From 1992 to 1999, he was Managing Director and Chief Technology Officer at Countrywide Credit Industries.

Mr. Longbrake has been Vice Chair since 1999 and a member of the Executive Committee since 1996. He serves as the Company's primary executive liaison with regulators, legislators, industry trade organizations, and government-sponsored enterprises. Mr. Longbrake was an Executive Vice President from 1996 to 1999 and served as the Company's Chief Financial Officer from 1996 to 2002.

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Mr. Miles has been Senior Vice President and Controller since January 2001. He serves as Washington Mutual's principal accounting officer. Mr. Miles joined the Company as Senior Vice President, Corporate Tax in June 1999. Prior to joining the Company, Mr. Miles was Director, Domestic Taxes of the former BankBoston, N.A. from 1996 to 1999.

Ms. Oppenheimer is President of the Consumer Group. She is responsible for two of the Company's reporting segments, Retail Banking and Financial Services, and Mortgage Banking. Additionally, Ms. Oppenheimer oversees corporate relations and the Company's Corporate Innovation and Research Center. Ms. Oppenheimer became Executive Vice President in 1993, has been a member of the Executive Committee since its formation in 1990, and became a member of the President's Council in 2002. She has been an officer of the Company since 1985.

Mr. Tall is Vice Chair of Corporate Development. He is responsible for overseeing the Company's corporate development, including acquisitions and divestitures. He is also Chairman of Washington Mutual's Strategic Capital Fund Investment Committee. Mr. Tall became an Executive Vice President in 1987 and Vice Chair in 1999. He has been a member of the Executive Committee since its formation in 1990.

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Mr. Vanasek is Executive Vice President and Chief Enterprise Risk Officer. He is responsible for overseeing credit risk management for the Company, as well as compliance, market and operational risk, internal audit and business continuity. Mr. Vanasek became a member of the Executive Committee in 2001. Prior to joining Washington Mutual in 1999, he spent eight years at the former Norwest Bank, in a variety of lending risk management positions including Chief Credit Officer.

Properties

The Company's headquarters are located at 1201 Third Avenue, Seattle, Washington 98101. As of December 31, 2003, we conducted business in 47 states through approximately 2,913 physical distribution centers.

The Company, in a joint venture with the Seattle Art Museum, is constructing a new headquarters building in downtown Seattle. On completion of the building, the Company will own approximately 900,000 square feet and will lease from the Seattle Art Museum an additional 250,000 square feet for a period of up to 25 years. The lessor has the right to cancel the lease, in whole or in part, at any time after the tenth year of the lease. Occupancy and the term of the lease are expected to commence concurrently in 2006.

Additionally, significant facilities that we owned or leased were as follows:

Location	Leased/Owned	Approximate Square Footage	Termination or Renewal Date ⁽¹⁾
1201 3rd Ave., Seattle, WA	Leased	400,000	2006-2010
1111 3rd Ave., Seattle, WA	Leased	249,000	2004-2017
1191 2nd Ave., Seattle, WA	Leased	238,000	2015
999 3rd Ave., Seattle, WA	Leased	158,000	2004-2006
1301 5th Ave., Seattle, WA	Leased	130,000	2005-2008
1501 4th Ave., Seattle, WA	Leased	112,000	2005-2010
2500 & 2530 223rd St. SE, Bothell, WA	Leased	106,000	2005-2008
18525 36th Ave. S, SeaTac, WA	Owned	106,000	n/a
Chatsworth, CA ⁽²⁾	Leased	454,000	2005-2015
Chatsworth, CA ⁽²⁾	Owned	343,000	n/a
Irvine, CA ⁽²⁾	Owned	421,000	n/a
Irvine, CA ⁽²⁾	Leased	176,000	2004-2010
Northridge, CA ⁽²⁾	Leased	348,000	2005-2006
Stockton, CA ⁽²⁾	Owned	329,000	n/a
3883 Airway Drive, Santa Rosa, CA	Owned	106,000	n/a
Jacksonville, FL ⁽²⁾	Leased	423,000	2004-2009
1501 Yamato Rd., Boca Raton, FL	Owned	167,000	n/a
7301 Baymeadows Way, Jacksonville, FL	Owned	145,000	n/a
2601 10th Ave. N., Lake Worth, FL	Owned	102,000	n/a
Vernon Hills, IL ⁽²⁾	Leased	419,000	2004-2006
3050 Highland Pkwy, Downers Grove, IL	Leased	176,000	2013
Houston, TX ⁽²⁾	Leased	352,000	2004-2008

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<u>Location</u>	<u>Leased/Owned</u>	<u>Approximate Square Footage</u>	<u>Termination or Renewal Date⁽¹⁾</u>
9601 McAllister Fwy, San Antonio, TX	Leased	159,000	2005
Florence, SC ⁽²⁾	Leased	245,000	2005-2008
11200 W. Parkland Ave., Milwaukee, WI	Owned	230,000	n/a
231 E. Ave., Albion, NY	Leased	221,000	2009-2011
EAB Plaza, Uniondale, NY	Leased	109,000	2007

(1) The Company has options to renew leases at most locations.

(2) Multiple locations.

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Legal Proceedings

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

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

Submission of Matters to a Vote of Security Holders

No matters were submitted to shareholders during the fourth quarter of 2003.

PART II

Market for our Common Stock and Related Stockholder Matters

Our common stock trades on The New York Stock Exchange under the symbol WM. As of February 27, 2004, there were 868,397,759 shares issued and outstanding (including 6 million shares held in escrow) held by 51,293 shareholders of record. The information regarding high and low quarterly sales prices of the Company's common stock, and the quarterly cash dividends declared thereon, is set forth in this Form 10-K/A in the "Quarterly Results of Operations" table included under Supplementary Data on page 151 and is expressly incorporated herein by reference.

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

Restatements of Financial Statements

During the fourth quarter of 2003, the Company concluded that the inclusion of certain components (i.e. deferred acquisition costs and claims stabilization reserves) in the cash surrender value of its bank-owned life insurance policies was incorrect. The accounting policy the Company previously used resulted in the overstatement of the cash surrender value of the policies and, accordingly, other noninterest income. This restatement also decreased other assets, and correspondingly, retained earnings by \$73 million, \$38 million and \$28 million as of December 31, 2002, 2001 and 2000. The restatement only affects periods commencing with the second quarter of 2000 when the policies were first acquired and had no tax effect. The Company has corrected its accounting for all affected prior reporting periods.

During the first quarter of 2004 and subsequent to the original filing of the Company's Annual Report on Form 10-K, the Company corrected the funds transfer pricing methodology applied to the financial results of the Company's operating segments for the year ending December 31, 2001. The correction revises certain operating segment information, including net interest income and net income, of its operating segment results reported for that year. The corrected information is included in the operating segment tables presented herein and in Note 25 to the Consolidated Financial Statements "Operating Segments." Such information had no effect on previously reported 2001 consolidated results of operations or any other period presented in this report.

Discontinued Operations

On November 24, 2003 the Company announced a definitive agreement to sell its subsidiary, Washington Mutual Finance Corporation, to CitiFinancial, a subsidiary of Citigroup, for approximately \$1.25 billion in cash. This sale was completed on January 9, 2004. Accordingly, Washington Mutual Finance is presented in this report as a discontinued operation with the results of operations and cash flows segregated from the Company's results of continuing operations for all periods presented on the Consolidated Statements of Income, Cash Flows and Notes to the Consolidated Financial Statements as well as the tables presented herein, unless otherwise noted. Likewise, the assets and liabilities of Washington Mutual Finance have each been combined and presented as separate captions on the Consolidated Statements of Financial Condition.

Controls and Procedures

Disclosure Controls and Procedures

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

We review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and improve our controls and procedures over time and correct any deficiencies that we may discover. While we believe the present design of our disclosure controls and procedures is effective, future events affecting our business may cause us to modify our disclosure controls and procedures.

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Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting during the fourth quarter of 2003 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Overview

Net income increased to \$3.88 billion or \$4.21 per diluted share in 2003, from \$3.86 billion or \$4.02 per diluted share in 2002, an increase of 5% on a per share basis. The increase in earnings per share was predominantly due to share repurchase activity that occurred during the year. During 2003, the Company repurchased a total of 65.9 million shares, as compared with 38.0 million shares repurchased in 2002. Largely in response to a favorable change in the federal income tax treatment of dividends and our financial performance, the Company's common stock dividend payout ratio increased from 25.92% in 2002 to 32.63% in 2003.

Net interest income declined to \$7.63 billion in 2003, a decrease of \$500 million from \$8.13 billion in 2002. This decrease was attributable to a 30 basis point decline in the net interest margin year-over-year. We expect the margin to contract further in 2004 as yields on our debt securities and loans continue to reprice downward to current market levels.

Home loan mortgage banking income was \$1.97 billion in 2003, an increase of \$1.27 billion from \$707 million in 2002. During the first part of 2003, the anemic recovery in the U.S. economy pressured home loan mortgage lending rates to historical lows. This, in turn, fueled an industry-wide mortgage refinance boom, and led to extremely high loan volume, an increase in gain from mortgage loans and high levels of noninterest-bearing custodial deposits (collected from loan payoff activity) during the first half of 2003. In the third quarter of 2003, the monthly average of the U.S. mortgage refinance index (seasonally adjusted) declined by 31%, which was caused by a sharp increase in mortgage interest rates. As a result, customer preferences began to shift from fixed-rate, salable production to adjustable-rate, portfolio activity, which resulted in a decline in gain from mortgage loans and lower levels of custodial balances. Market volatility and operational issues exacerbated the decrease in

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gain from mortgage loans during the third quarter of 2003. Refinancing activity diminished further in the fourth quarter of 2003 as mortgage interest rates remained above their historical low points and thus caused gain from mortgage loans to remain well below the levels recorded during the first half of the year. The volatility in mortgage interest rates in 2003 also caused significant fluctuations in the anticipated prepayment speeds of the Company's loans serviced for others portfolio and, as a result, led to significant changes in the amortization level and the fair value of the Company's MSR. The performance of the Company's MSR risk management instruments during the year, which consist of derivative financial instruments and available-for-sale securities, mitigated the financial effects of prepayment speed volatility.

Additional strides were made in retail banking market penetration as there was a net increase of over 800,000 retail checking accounts during the year, including over 180,000 during the fourth quarter, bringing the Company's total to more than 8 million accounts. The year produced depositor and other retail banking fees of \$1.82 billion, an increase of \$184 million from \$1.63 billion in 2002. At year end, the average mature retail banking household maintained 5.59 products and services with the Company, an increase from 5.28 at year end 2002. A total of 260 new retail banking stores were opened in 2003, bringing the total number of retail banking stores nationwide to 1,776 at the end of the year. The build out of our national retail banking franchise will continue in 2004, as we expect to open approximately 250 new stores and deepen existing relationships by cross-selling additional products to customers.

Noninterest expense was \$7.41 billion, an increase of \$1.22 billion from \$6.19 billion in 2002 due to higher personnel costs to accommodate the high refinancing activity in the earlier part of the year and the opening of new retail banking stores. With the refinancing boom over, the Company announced its cost containment initiative in the fourth quarter of 2003. The Company intends to reduce expenses in those areas of operations that are not integral to the Company's planned expansion of the retail banking

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franchise. The savings realized from this cost containment initiative will be used to facilitate this expansion. The recent realignment of the Company's operations into two major categories retail consumers and commercial customers will support this initiative by eliminating redundant operations and processes. The Company expects that the impact of this initiative, which is not scheduled to be completed until the middle of 2005, coupled with the costs to be incurred in 2004 from the continuing expansion of the retail banking franchise, will result in an increase in noninterest expense of no more than 5% in 2004, as compared with 2003.

Credit quality of the Company's loan portfolio improved in 2003 as the Company benefited from the strengthening U.S. economy during the latter part of the year and continued to take advantage of market opportunities to reduce specific credit risk exposures. At December 31, 2003, nonperforming assets as a percentage of total assets were 0.70 percent versus 0.93 percent at December 31, 2002. Total nonperforming assets were down \$546 million to \$1.94 billion at December 31, 2003, as compared with \$2.48 billion at December 31, 2002. The improved credit risk profile resulted in the recording of a \$202 million reversal in the allowance for loan and lease losses in the fourth quarter of 2003 and a provision for loan and lease losses of \$42 million for the year ended December 31, 2003.

In the fourth quarter of 2003, the Company entered into a definitive agreement to sell Washington Mutual Finance Corporation, a subsidiary of the Company, to CitiFinancial, a subsidiary of Citigroup, for approximately \$1.25 billion. The sale was completed on January 9, 2004 and resulted in a pre-tax gain of approximately \$660 million, to be recorded in the first