



Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Resource Library

4-18-2006

WaMU JPMorgan and Chase Home Loans Discussion Board of Directors Meeting

JPMorgan Chase & Co.

David Schneider

<https://elischolar.library.yale.edu/ypfs-documents/5144>

This resource is brought to you for free and open access by the Yale Program on Financial Stability and [EliScholar](#), a digital platform for scholarly publishing provided by Yale University Library. For more information, please contact ypfs@yale.edu.



Home Loans Discussion
Board of Directors Meeting

April 18, 2006

Confidential

David Schneider
President, Home Loans

Permanent Subcommittee on Investigations
EXHIBIT #3

JPM_WM00690890

Table of Contents



	<u>Page</u>
Home Loans Business Model	2
Home Loans Strategic Positioning	3
Shift to Higher Margin Products	4 – 5
Reduce Earnings Volatility	6
Continue to Attack Cost Structure	7 – 8
Risks	9
Summary – Next Steps	10
Appendix – Project Plan	11

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

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

Home Loans Business Model



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

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

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

April 2006 Board Meeting: Home Loans

(Confidential)

Page 2

In 2005, 85% of production was Prime

- 2005 volume by product (data behind slide)

<4% of production volume was sourced from Financial Centers

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

Goals were largely driven by overall market share growth

- Market share slides (data behind slide)

Home Loans Strategic Positioning



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

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

Financial Objectives

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

April 2006 Board Meeting: Home Loans

(Confidential)

Page 3

Definition of High Margin Products

- Home Equity, Subprime, Alt A, Option ARM

Historical net income:

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

ROE

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

Efficiency Ratio

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

Cost to Hedge

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

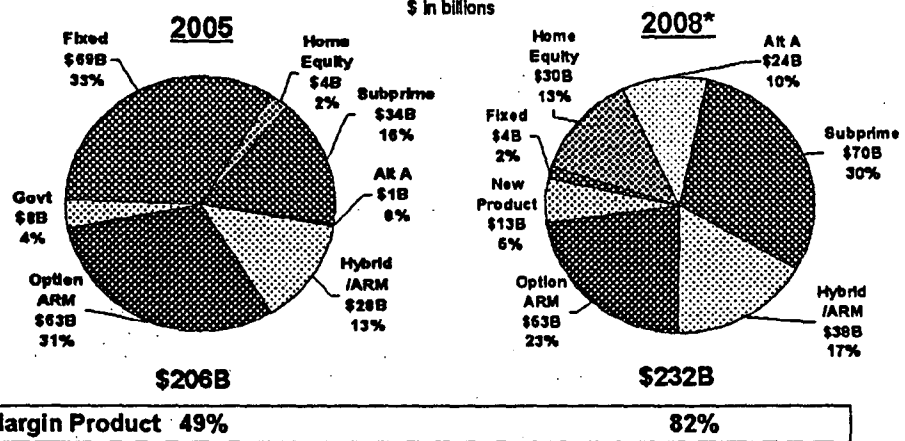
Shift to Higher Margin Products



2005 WaMu Gain on Sale Margin by Product
in bps

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

WaMu Volume by Product
\$ in billions



* Assumes a \$2.3 trillion origination market

Strategic Response

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

Execution

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

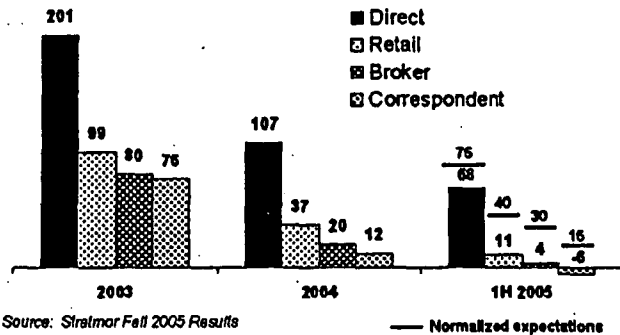
Grow market share in targeted product segments

Shift to Higher Margin Channels



Industry Margin Compression

In bps



2005 Correspondent Product Mix

\$ in billions

Sources of Fixed & Government Volume

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

Correspondent Volume by Product

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

Correspondent channel produces disproportionately more Fixed and Government product

Correspondent Realignment

Correspondent

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

Conduit

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

Execution

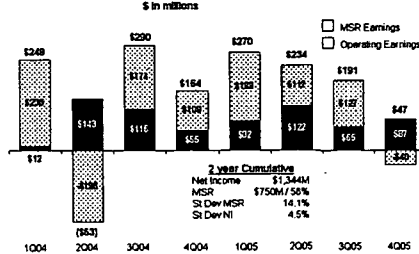
- Focus Conduit on high-margin products
 - Subprime
 - Alt A
 - Home Equity Q2 06
- Reposition Correspondent channel Q3 06
- Leverage Consumer Direct to include Subprime Q3 06

Realign Correspondent to Conduit

Reduce Earnings Volatility



Prime Home Loans Net Income



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

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

MSR Risk Profile (As of February 28, 2006)

Current Risk Profile	Unpaid Principal Balance (\$B)	Market Value (RV) (\$B)	Annual Hedge Cost (\$M)	% Cost to MV
Option ARM/ARM	\$123.5	\$1.5	(\$21)	1.4%
Fixed	\$401.8	\$8.0	(\$14)	5.3%
Government	\$55.0	\$1.0	(\$8)	4.7%
Subprime	\$28.3	\$0.2	(1)	0.5%
Total	\$608.6	\$8.7	(\$39)	4.4%
2006 pro-forma	\$410.6	\$4.4	(\$122)	2.8%

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

Execution

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

Reduce MSR exposure, limit volatility and realign distribution

April 2006 Board Meeting: Home Loans

(Confidential)

Page 8

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

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

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

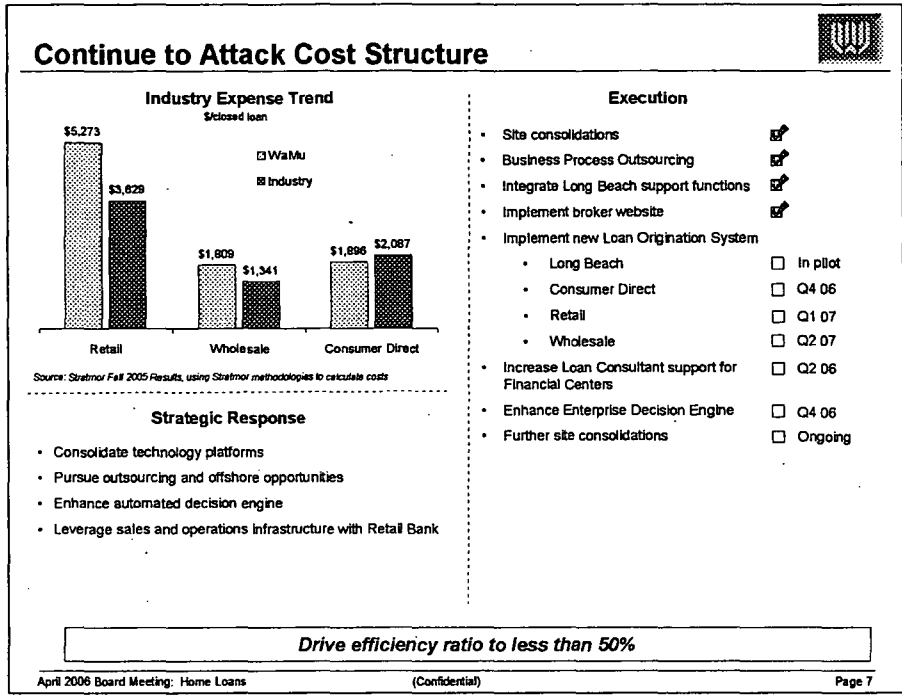
Cease Govt Lending in Retail and Wholesale

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

1/8 Basis Point will be implemented in July 2006

Post Sales Dates

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



FTE Outsourcing

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

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

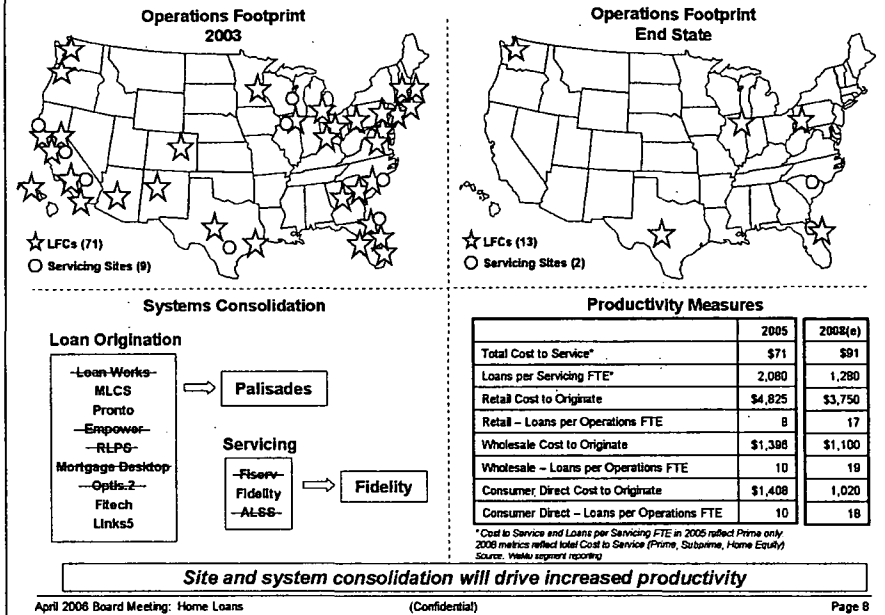
Status of Long Beach pilot

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

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

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

Continue to Attack Cost Structure



Date of Palisades full implementation

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

2008 Servicing breakout (Prime, Subprime, Home Equity)

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

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

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

Risks



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

Summary – Next Steps



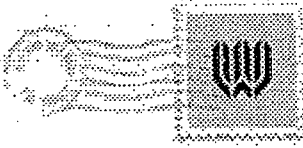
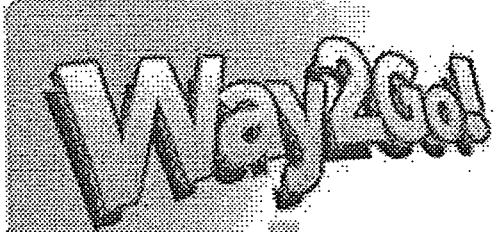
- **Shift from low-margin business to high-margin products**
 - De-emphasize Fixed rate and cease Government
 - Realign Correspondent to Conduit
 - Invest in Direct-to-Consumer platform
- **Reallocate risk from market-based to credit-based assets to reduce earnings volatility**
 - Significantly reduce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

Appendix – Project Plan



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

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



you've been

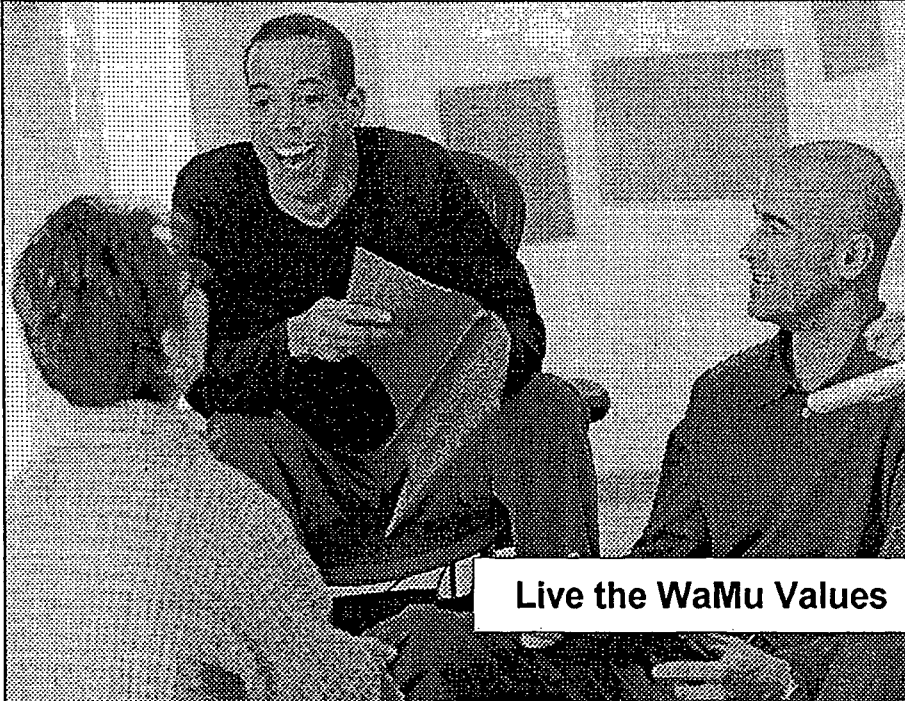
Be Bold!

David Schneider, President

BOLD

28

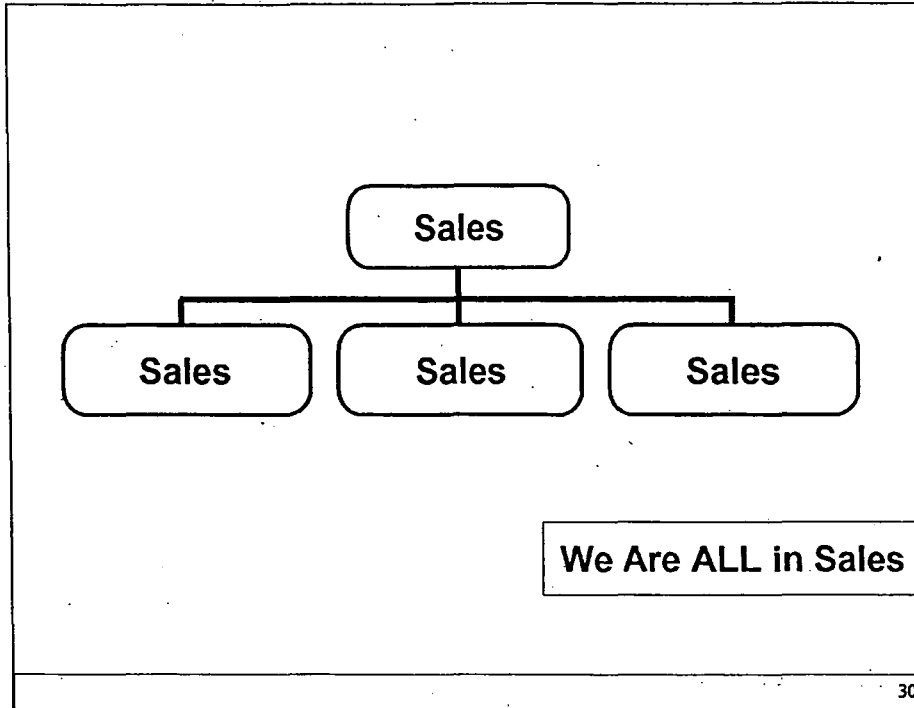
JPM_WM0308868



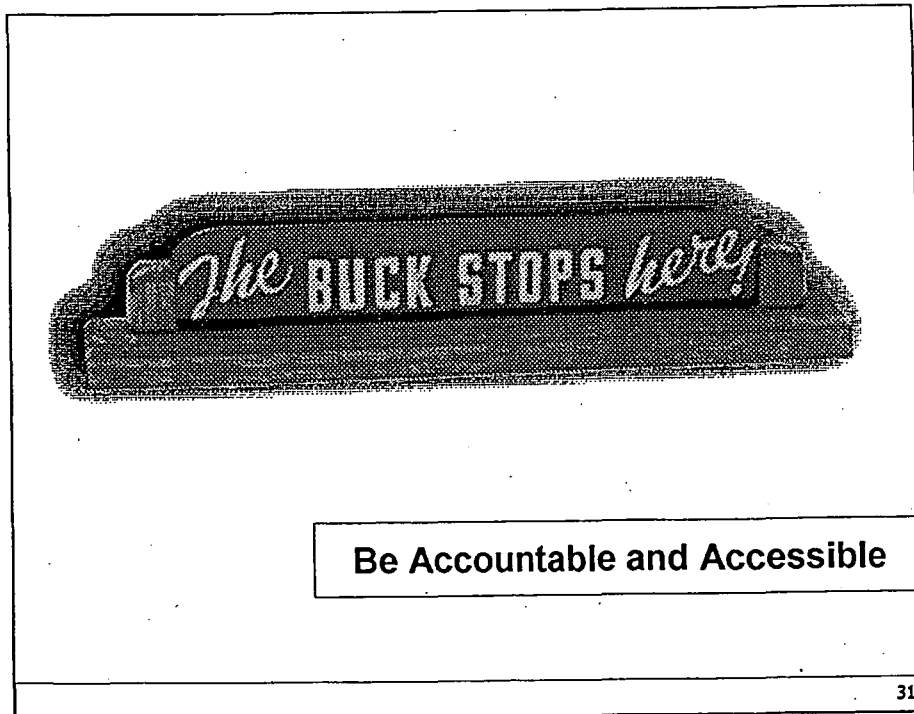
Live the WaMu Values

JPM_WM0308869

Permanent Subcommittee on Investigations
EXHIBIT #4

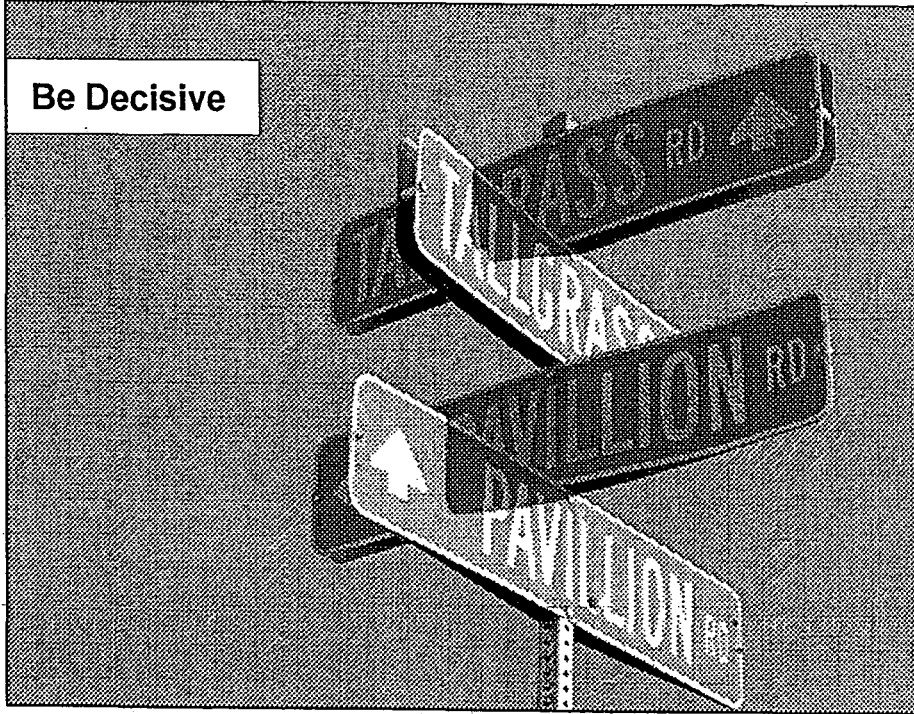


We Are ALL in Sales



Be Accountable and Accessible

Be Decisive

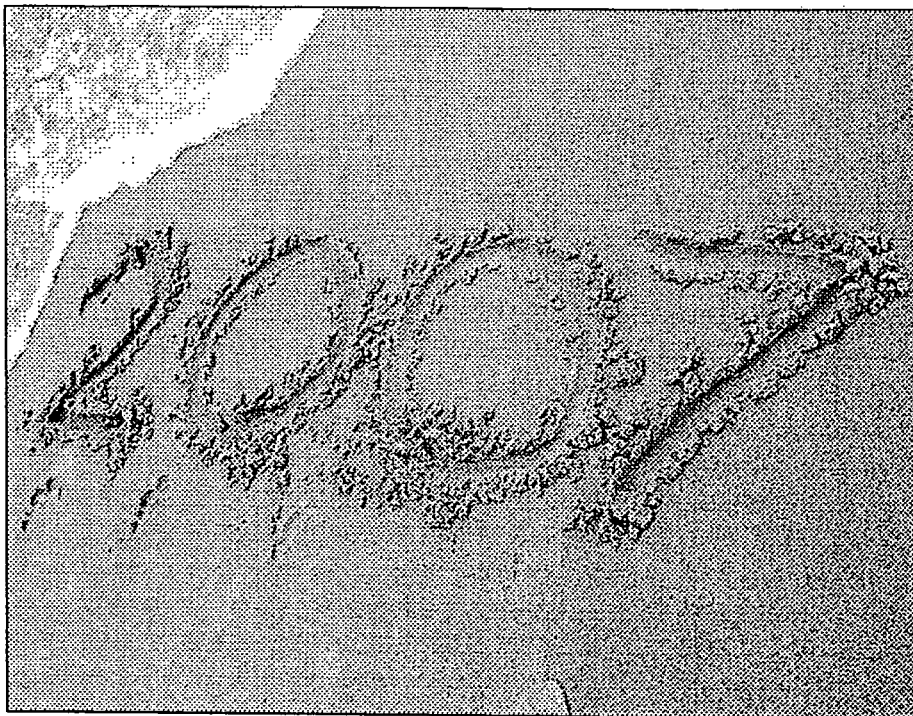


JPM_WM0308872

Have Fun



JPM_WM0308873



JPM_WM0308874

2007 Focus Areas

Growth

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

35

JPM_WM0308875

Q & A



36

JPM_WM03088876

be
BOLD

37

JPM_WM03088877