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Saying Yes, WaMu Built Empire on Shaky Loans

By PETER S. GOODMAN and GRETCHEN MORGENSON DEC. 27, 2008

"We hope to do to this industry what Wal-Mart did to theirs, Starbucks did to theirs, Costco did to theirs and Lowe's-Home Depot did to their industry. And I think if we've done our job, five years from now you're not going to call us a bank."

— Kerry K. Killinger, chief executive of Washington Mutual, 2003

SAN DIEGO — As a supervisor at a Washington Mutual mortgage processing center, John D. Parsons was accustomed to seeing baby sitters claiming salaries worthy of college presidents, and schoolteachers with incomes rivaling stockbrokers'. He rarely questioned them. A real estate frenzy was under way and WaMu, as his bank was known, was all about saying yes.

Yet even by WaMu's relaxed standards, one mortgage four years ago raised eyebrows. The borrower was claiming a six-figure income and an unusual profession: mariachi singer.

Mr. Parsons could not verify the singer's income, so he had him photographed in front of his home dressed in his mariachi outfit. The photo went into a WaMu file. Approved.

"I'd lie if I said every piece of documentation was properly signed and dated," said Mr. Parsons, speaking through wire-reinforced glass at a California prison near here, where he is serving 16 months for theft after his fourth arrest — all involving drugs.

While Mr. Parsons, whose incarceration is not related to his work for WaMu, oversaw a team screening mortgage applications, he was snorting methamphetamine daily, he said.

"In our world, it was tolerated," said Sherri Zaback, who worked for Mr. Parsons and recalls seeing drug paraphernalia on his desk. "Everybody said, 'He gets the job done.' "

At WaMu, getting the job done meant lending money to nearly anyone who asked for it — the force behind the bank's meteoric rise and its precipitous collapse this year in the biggest bank failure in American history.

On a financial landscape littered with wreckage, WaMu, a Seattle-based bank that opened branches at a clip worthy of a fast-food chain, stands out as a singularly brazen case of lax lending. By the first half of this year, the value of its bad loans had reached $11.5 billion, nearly tripling from $4.2 billion a year earlier.

Interviews with two dozen former employees, mortgage brokers, real estate agents and appraisers reveal the relentless pressure to churn out loans that produced such results. While that sample may not fully represent a bank with tens of thousands of people, it does reflect the views of employees in WaMu mortgage operations in California, Florida, Illinois and Texas.

Their accounts are consistent with those of 89 other former employees who are confidential witnesses in a class action filed against WaMu in federal court in Seattle by former shareholders.

According to these accounts, pressure to keep lending emanated from the top, where executives profited from the swift expansion — not least, Kerry K. Killinger, who was WaMu's chief executive from 1990 until he was forced out in September.

Between 2001 and 2007, Mr. Killinger received compensation of $88 million, according to the Corporate Library, a research firm. He declined to respond to a list of questions, and his spokesman said he was unavailable for an interview.

During Mr. Killinger's tenure, WaMu pressed sales agents to pump out loans while disregarding borrowers' incomes and assets, according to former employees. The bank set up what insiders described as a system of dubious legality that enabled real estate agents to collect fees of more than $10,000 for bringing in borrowers, sometimes making the agents more beholden to WaMu than they were to their clients.

WaMu gave mortgage brokers handsome commissions for selling the riskiest loans, which carried higher fees, bolstering profits and ultimately the compensation of the bank's executives. WaMu pressured appraisers to provide inflated property values that made loans appear less risky, enabling Wall Street to bundle them more easily for sale to investors.

"It was the Wild West," said Steven M. Knobel, a founder of an appraisal company, Mitchell, Maxwell & Jackson, that did business with WaMu until 2007. "If you were alive, they would give you a loan. Actually, I think if you were dead, they would still give you a loan."

JPMorgan Chase, which bought WaMu for $1.9 billion in September and received $25 billion a few weeks later as part of the taxpayer bailout of the financial services industry, declined to make former WaMu executives available for interviews.

JPMorgan also declined to comment on WaMu's operations before it bought the company. "It is a different era for our customers and for the company," a spokesman said.

For those who placed their faith and money in WaMu, the bank's implosion came as a shock.

"I never had a clue about the amount of off-the-cliff activity that was going on at Washington Mutual, and I was in constant contact with the company," said Vincent Au, president of Avalon Partners, an investment firm. "There were people at WaMu that orchestrated nothing more than a sham or charade. These people broke every fundamental rule of running a company."

'Like a Sweatshop'

Some WaMu employees who worked for the bank during the boom now have regrets.

"It was a disgrace," said Dana Zweibel, a former financial representative at a WaMu branch in Tampa, Fla. "We were giving loans to people that never should have had loans."

If Ms. Zweibel doubted whether customers could pay, supervisors directed her to keep selling, she said.

"We were told from up above that that's not our concern," she said. "Our concern is just to write the loan."

The ultimate supervisor at WaMu was Mr. Killinger, who joined the company in 1983 and became chief executive in 1990. He inherited a bank that was founded in 1889 and had survived the Depression and the savings and loan scandal of the 1980s.

An investment analyst by training, he was attuned to Wall Street's hunger for growth. Between late 1996 and early 2002, he transformed WaMu into the nation's sixth-largest bank through a series of acquisitions.

A crucial deal came in 1999, with the purchase of Long Beach Financial, a California lender specializing in subprime mortgages, loans extended to borrowers with troubled credit.

WaMu underscored its eagerness to lend with an advertising campaign introduced during the 2003 Academy Awards: "The Power of Yes." No mere advertising pitch, this was also the mantra inside the bank, underwriters said.

"WaMu came out with that slogan, and that was what we had to live by," Ms. Zaback said. "We joked about it a lot." A file would get marked problematic and then somehow get approved. "We'd say: 'O.K.! The power of yes.' "

Revenue at WaMu's home-lending unit swelled from $707 million in 2002 to almost $2 billion the following year, when the "The Power of Yes" campaign started.

Between 2000 and 2003, WaMu's retail branches grew 70 percent, reaching 2,200 across 38 states, as the bank used an image of cheeky irreverence to attract new customers. In offbeat television ads, casually dressed WaMu employees ridiculed staid bankers in suits.

Branches were pushed to increase lending. "It was just disgusting," said Ms. Zweibel, the Tampa representative. "They wanted you to spend time, while you're running teller transactions and opening checking accounts, selling people loans."

Employees in Tampa who fell short were ordered to drive to a WaMu office in Sarasota, an hour away. There, they sat in a phone bank with 20 other people, calling customers to push home equity loans.

"The regional manager would be over your shoulder, listening to every word," Ms. Zweibel recalled. "They treated us like we were in a sweatshop."

On the other end of the country, at WaMu's San Diego processing office, Ms. Zaback's job was to take loan applications from branches in Southern California and make sure they passed muster. Most of the loans she said she handled merely required borrowers to provide an address and Social Security number, and to state their income and assets.

She ran applications through WaMu's computer system for approval. If she needed more information, she had to consult with a loan officer — which she described as an unpleasant experience. "They would be furious," Ms. Zaback said. "They would put it on you, that they weren't going to get paid if you stood in the way."

On one loan application in 2005, a borrower identified himself as a gardener and listed his monthly income at $12,000, Ms. Zaback recalled. She could not verify his business license, so she took the file to her boss, Mr. Parsons.

He used the mariachi singer as inspiration: a photo of the borrower's truck emblazoned with the name of his landscaping business went into the file. Approved.

Mr. Parsons, who worked for WaMu in San Diego from about 2002 through 2005, said his supervisors constantly praised his performance. “My numbers were through the roof,” he said.

On another occasion, Ms. Zaback asked a loan officer for verification of an applicant’s assets. The officer sent a letter from a bank showing a balance of about $150,000 in the borrower’s account, she recalled. But when Ms. Zaback called the bank to confirm, she was told the balance was only $5,000.

The loan officer yelled at her, Ms. Zaback recalled. “She said, ‘We don’t call the bank to verify.’ ” Ms. Zaback said she told Mr. Parsons that she no longer wanted to work with that loan officer, but he replied: “Too bad.”

Shortly thereafter, Mr. Parsons disappeared from the office. Ms. Zaback later learned of his arrest for burglary and drug possession.

The sheer workload at WaMu ensured that loan reviews were limited. Ms. Zaback’s office had 108 people, and several hundred new files a day. She was required to process at least 10 files daily.

“I’d typically spend a maximum of 35 minutes per file,” she said. “It was just disheartening. Just spit it out and get it done. That’s what they wanted us to do. Garbage in, and garbage out.”

Referral Fees for Loans

WaMu’s boiler room culture flourished in Southern California, where housing prices rose so rapidly during the bubble that creative financing was needed to attract buyers.

To that end, WaMu embraced so-called option ARMs, adjustable rate mortgages that enticed borrowers with a selection of low initial rates and allowed them to decide how much to pay each month. But people who opted for minimum payments were underpaying the interest due and adding to their principal, eventually causing loan payments to balloon.

Customers were often left with the impression that low payments would continue long term, according to former WaMu sales agents.

For WaMu, variable-rate loans — option ARMs, in particular — were especially attractive because they carried higher fees than other loans, and allowed WaMu to book profits on interest payments that borrowers deferred. Because WaMu was selling many of its loans to investors, it did not worry about defaults: by the time loans went bad, they were often in other hands.

WaMu's adjustable-rate mortgages expanded from about one-fourth of new home loans in 2003 to 70 percent by 2006. In 2005 and 2006 — when WaMu pushed option ARMs most aggressively — Mr. Killinger received pay of $19 million and $24 million respectively.

The ARM Loan Niche

WaMu's retail mortgage office in Downey, Calif., specialized in selling option ARMs to Latino customers who spoke little English and depended on advice from real estate brokers, according to a former sales agent who requested anonymity because he was still in the mortgage business.

According to that agent, WaMu turned real estate agents into a pipeline for loan applications by enabling them to collect "referral fees" for clients who became WaMu borrowers.

Buyers were typically oblivious to agents' fees, the agent said, and agents rarely explained the loan terms.

"Their Realtor was their trusted friend," the agent said. "The Realtors would sell them on a minimum payment, and that was an outright lie."

According to the agent, the strategy was the brainchild of Thomas Ramirez, who oversaw a sales team of about 20 agents at the Downey branch during the first half of this decade, and now works for Wells Fargo.

Mr. Ramirez confirmed that he and his team enabled real estate agents to collect commissions, but he maintained that the fees were fully disclosed.

"I don't think the bank would have let us do the program if it was bad," Mr. Ramirez said.

Mr. Ramirez's team sold nearly $1 billion worth of loans in 2004, he said. His performance made him a perennial member of WaMu's President's Club, which brought big bonuses and recognition at an awards ceremony typically hosted by Mr. Killinger in tropical venues like Hawaii.

Mr. Ramirez's success prompted WaMu to populate a neighboring building in Downey with loan processors, underwriters and appraisers who worked for him. The fees proved so enticing that real estate agents arrived in Downey from all over Southern California, bearing six and seven loan applications at a time, the former agent said.

WaMu banned referral fees in 2006, fearing they could be construed as illegal payments from the bank to agents. But the bank allowed Mr. Ramirez's team to continue using the referral fees, the agent said.

Forced Out With Millions

By 2005, the word was out that WaMu would accept applications with a mere statement of the borrower's income and assets — often with no documentation required — so long as credit scores were adequate, according to Ms. Zaback and other underwriters.

"We had a flier that said, 'A thin file is a good file,' " recalled Michele Culbertson, a wholesale sales agent with WaMu.

Martine Lado, an agent in the Irvine, Calif., office, said she coached brokers to leave parts of applications blank to avoid prompting verification if the borrower's job or income was sketchy.

"We were looking for people who understood how to do loans at WaMu," Ms. Lado said.

Top producers became heroes. Craig Clark, called the "king of the option ARM" by colleagues, closed loans totaling about $1 billion in 2005, according to four of his former coworkers, a tally he amassed in part by challenging anyone who doubted him.

"He was a bulldozer when it came to getting his stuff done," said Lisa Alvarez, who worked in the Irvine office from 2003 to 2006.

Christine Crocker, who managed WaMu's wholesale underwriting division in Irvine, recalled one mortgage to an elderly couple from a broker on Mr. Clark's team.

With a fixed income of about $3,200 a month, the couple needed a fixed-rate loan. But their broker earned a commission of three percentage points by arranging an option ARM for them, and did so by listing their income as $7,000 a month. Soon, their payment jumped from roughly $1,000 a month to about $3,000, causing them to fall behind.

Mr. Clark, who now works for JPMorgan, referred calls to a company spokesman, who provided no further details.

In 2006, WaMu slowed option ARM lending. But earlier, ill-considered loans had already begun hurting its results. In 2007, it recorded a $67 million loss and shut down its subprime lending unit.

By the time shareholders joined WaMu for its annual meeting in Seattle last April, WaMu had posted a first-quarter loss of $1.14 billion and increased its loan loss reserve to $3.5 billion. Its stock had lost more than half its value in the previous two months. Anger was in the air.

Some shareholders were irate that Mr. Killinger and other executives were excluding mortgage losses from the computation of their bonuses. Others were enraged that WaMu turned down an $8-a-share takeover bid from JPMorgan.

"Calm down and have a little faith," Mr. Killinger told the crowd. "We will get through this."

WaMu asked shareholders to approve a $7 billion investment by Texas Pacific Group, a private equity firm, and other unnamed investors. David Bonderman, a founder of Texas Pacific and a former WaMu director, declined to comment.

Hostile shareholders argued that the deal would dilute their holdings, but Mr. Killinger forced it through, saying WaMu desperately needed new capital.

Weeks later, with WaMu in tatters, directors stripped Mr. Killinger of his board chairmanship. And the bank began including mortgage losses when calculating executive bonuses.

In September, Mr. Killinger was forced to retire. Later that month, with WaMu buckling under roughly $180 billion in mortgage-related loans, regulators seized the bank and sold it to JPMorgan for $1.9 billion, a fraction of the $40 billion valuation the stock market gave WaMu at its peak.

Billions that investors had plowed into WaMu were wiped out, as were prospects for many of the bank's 50,000 employees. But Mr. Killinger still had his millions, rankling laid-off workers and shareholders alike.

"Kerry has made over $100 million over his tenure based on the aggressiveness that sunk the company," said Mr. Au, the money manager. "How does he justify taking that money?"

In June, Mr. Au sent an e-mail message to the company asking executives to return some of their pay. He says he has not heard back.

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