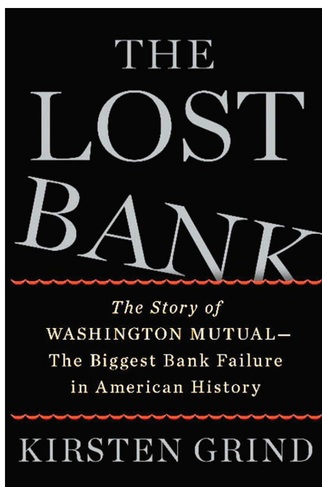
WaMu

Reflections on the lost bank

Through a review of Kristen Grind's book on the history behind the failure of WaMu, Annie Searle, Principal of Annie Searle & Associates and ex WaMu executive, looks at how the intersection of people, process, systems and external events often lead to financial loss without proper risk management



Kristen Grind's book, *The Lost Bank: The Story of Washington Mutual – The Biggest Bank Failure in American History* (Simon & Schuster, 389pp, $27.00) is an important and revealing study with implications beyond its central subject. Rather than focusing on the larger economic meltdown in 2008, Grind's book examines how Washington Mutual's strategy, culture and risk appetite underwent a significant change over 20+ years, as it moved from a regional thrift, to seeing itself as having the potential to become what was called a "category killer."[1] Against the larger story of the bank, Grind describes the metamorphosis of Kerry Killinger, from a smart, ambitious but grounded financial analyst to chairman and CEO of what would become the nation's seventh largest bank.

Grind's book is well researched and footnoted, with hundreds of interviews, close readings of annual reports, lawsuits and the 2010 Senate Investigations Subcommittee hearings on Washington Mutual. Grind provides context for the earlier days of the bank, focusing in particular on the period when lawyer Lou Pepper became CEO and hired a number of smart people, including Killinger, a securities analyst with a small investment firm that Washington Mutual acquired in 1982, who did not at that time have a banking background. Six years later, Pepper and the Washington Mutual board selected Killinger as his successor to run the bank.

The first two chapters of *The Lost Bank* provide historical context for the Pepper years between 1981 and 1988, which stabilised the 1889 savings and loan institution. Grind's description of those years includes reflections from some of the participants of the team that Pepper assembled, as well as from Pepper himself. There are characterizations of some of the folksier "friend of the family" brand elements of that culture – dressing up for Halloween, holiday parties, executives performing skits in the lobby – with less attention paid by Grind to the civic and cultural contributions that Washington Mutual made and of which many former bank employees are still proud.

The bank encouraged its employees to make diverse personal contributions to charitable organisations, by offering various levels of annual match. It regularly underwrote community events in key locations across the country. Washington Mutual "had donated $50 million annually to organizations involved with affordable housing, community building and education, including cash grants to schools in 15 states; $8 million a year has gone to 250 nonprofit and civic groups in the Seattle area alone."[2] Though the bank had begun to grow, the culture of the 1990s and early 2000s aligned with its traditional values of "fair, caring and human". Teamwork was highly valued and Killinger's own "check your ego at the door" was still the mantra.

Kerry Killinger rose from a smart and ambitious financial analyst to become chairman and CEO of WaMu.

Having accomplished large and successful mergers on the retail bank side in the 1990s, it's not surprising that Washington Mutual's values grew from three – "fair, caring and human"– to five – add "dynamic and driven" – when it began to acquire additional home loans companies as part of its growth strategy. Marketing for the retail bank and home loans divisions was handled within each silo, but with a playful emphasis on customer service and ease of use. As if to prove that unstuffy non-bank image, the bank's name contracted, from "Washington Mutual" to "WaMu" in 2007.

Using an operational risk assessment approach, and to amplify Grind's own findings, I have mapped her book to an operational risk failure grid that looks at how the intersection of people, process, systems and external events often lead to financial loss without proper risk management.

The greatest change to organisational processes, especially at the executive level occurred when Killinger divided Washington Mutual into three different units, or silos

PEOPLE

There was no one person who brought down Washington Mutual. It was a culture change that began when the bank incorporated officers accustomed to other corporate values, particularly from acquired organisations. The strategy shifted from acquisition of retail banks that expanded the branch footprint and deposits, to the acquisition of banks with home loans platforms. Grind describes how home loans executive Craig Davis brought in a group of his former subordinates from American Savings Bank who were added to the mix, along with managers and staff kept as a result of this and other acquisitions.[3] Grind notes that at the same time Davis was elevated to head of the home loans group, "he [Killinger] announced bold plans to grab 20 per cent of the nationwide mortgage market share, more than four times the →

Kirsten Grind, author of *The Lost Bank: The Story of Washington Mutual – The Biggest Bank Failure in American History*

amount Washington had held in 2000."[4]

I recall that the theme for the 2000 "State of the Group" annual meeting was "Running with the Big Dogs." Toward that end, Killinger introduced the company's new Human Relations (HR) executive to lead recruiting efforts and to develop an updated compensation plan, with leadership training programs that would further put everyone on the same strategic and cultural page. The drive to modernise technology led to the hiring of an Australian bank CIO, who understood the mortgage market from his time at Countrywide. Grind describes how additional hires were made at the executive level from respectable institutions like General Electric and JPMorgan Chase.[5] Though he may have been pressured earlier by the board of directors and by the leadership development books popular at that time, Killinger took until 2004 to decide upon a COO, perhaps realising he would lose his close oversight of the executive team. As Grind notes, Steve Rotella was ready to leave JP Morgan when it was acquired by Bank One and Jamie Dimon moved into the President & COO position in 2004.[6] When he chose Rotella from JPMorgan Chase in 2004 over the two key executives who had served him well through acquisitions and cleanups, they left the bank. Once Rotella was in place, there was very little left of the original executive team that Lou Pepper had put together. Both Bill Longbrake (CFO then CRO) and Craig Tall (Executive Vice President for Corporate Development) had been moved off the executive team to advisory roles that same year.[7] Now the heads of all the business units, as well as technology, reported to Rotella, a key point I think that could have been examined in more detail in Grind's book.

PROCESS

The single greatest change to organisational processes, especially at the executive level occurred when Killinger "divided Washington Mutual into three different units, or silos, making each silo its own autonomous business. While some of those people remained in leadership positions, the new structure effectively wiped out the cohesion of the team, long a factor in Washington Mutual's success."[8] Each of the three groups maintained their own office and branch infrastructure for some years, as if to reinforce the silos. In building out an enterprise level risk scorecard for the company, the project team found a lack of documentation around business processes

AUTHOR

ANNIE SEARLE

Annie Searle is Principal of Annie Searle & Associates LLC – also known as ASA Risk Consultants – an operational risk consulting and research firm that provides independent risk assessments and roadmaps for critical U.S. infrastructure sectors like banking and finance. More information can be found at www.anniesearle.com.

Prior to founding ASA in 2009, Searle spent ten years at Washington Mutual Bank (WaMu) where for most of those years she was responsible on a company-wide level for business continuity, disaster recovery, technology risk and compliance, technology change management, and (for several years) for vendor and application security. She

was the chair of the Washington Mutual Crisis Management Team, a member of the company's Public Policy Management Committee, and executive sponsor of WaMu's technology innovation program.

She is the author of a wide range of articles, author of *Advice From A Risk Detective: At Home, At Work, Online, And On The Road* (Tautegory Press, October 2011); and editor of a collection of 22 research notes titled *Reflections on Risk* (Tautegory Press, February 2012).

Searle holds Bachelor of Arts and Master of Arts degrees in literature from the University of Iowa. She is an affiliate faculty member at the University of Washington's Information School where she has designed two operational risk courses for the graduate program. She is one of 22 inaugural inductees in 2011 into the Hall of Fame for the International Network of Women in Homeland Security and Emergency Management.

WaMu's head office in Seattle, Washington.

within and across the silos that Grind describes. From my own experience, I know that the only repository companywide that the scorecard project team later found was in the Office of Continuity Assurance, where each business unit had to describe in detail how the work got done so that a workaround plan could be prepared in case of disasters. Unfortunately, the bank had not developed or tested a plan that would handle runs on banks by its depositors of the type that Grind painstakingly documents in Chapter 9 of the book.

SYSTEMS

Though efforts began in 2001 to clean up the bank's multiple business applications and upgrade its hardware platforms, the side effects of multiple acquisitions showed up most clearly in the spaghetti-like schematics of the bank's technology architecture. Streamlining could only be performed if banking units were sure that moving their application would not in any way jeopardise its operation or if the technology costs were too high. I recall that the regulators expressed concerns over home loans financial results because the group was operating, at least at one point, with at least a dozen different lending platforms. In 2000 the Home Loans Group undertook, and later wrote down and off, its own proprietary home loans platform, called Optis, contracting the work to the California firm Accenture. Grind points again to the perils of silos: "Because the Home Loans Group had ownership of the project and it was carried out within that silo of the bank, some WaMu managers and executives didn't know the extent of the problems. Others who offered help were turned away."[9] It was hard to resist the power points – Optis looked like a dream machine that would also put a feather in the cap of the technology group. From at least my perspective, a great deal of what would become the "think big" behavior that later became reckless risk-taking started here. As a 2004 CNN article pointed out, Washington Mutual lost ground to competitors because "Optis worked well for processing mortgage applications, but it failed in the far more important tasks of processing, underwriting and closing the loans."[10]

> **"We hope to do to this industry what Wal-Mart did to theirs, Starbucks to theirs, Costco did to theirs and Lowe's-Home Depot did to their industry"**
>
> **KERRY KILLINGER**

EXTERNAL EVENTS

In a fine irony, Killinger had prophesied the bank's demise in 2003 when he said that "We hope to do to this industry what Wal-Mart did to theirs, Starbucks 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."[11] Five years later, a version of his prophesy came true.

In a letter to friends and family written after Grind's book was published, subsequently reported in the *New York Times*, Killinger lays out what he perceives to be major inaccuracies in *The Lost Bank*. After detailing measures that the board and management took to reduce home loans from 2003 to 2007, and to raise new capital in 2007-2008, Killinger expresses his view that the book "largely misses the point that most sophisticated participants in the financial industry failed to accurately →

predict – the extent of the national housing downturn. Any fair recounting of the financial crisis would note that any errors made in failing to anticipate the severity of the housing collapse were made collectively by the entire financial industry and the government. It is a gross understatement to say that I am greatly saddened that the company is not here today and that it was not provided the many benefits and programs that were so beneficial to large Wall Street banks when the financial crisis reached its peak."[12]

Roger Lowenstein's excellent book, *The End of Wall Street*, provides a full characterisation of that entire environment, as Killinger suggests Grind's does not, but he cannot be much happier with his portrayal in that book. Lowenstein suggests that as early as 2005, "With success coming so easily, WaMu was deaf to the need to monitor its risk" and as early as that same year "…with Killinger, the rising tide of risk tolerance loosened his moorings."[13]

Clearly the leaders at Washington Mutual seemed unable to course correct the growth strategy and dial down their exposure, even though all the key risk indicators were there as early as late 2006. In the long run, we have to ask why the strong bench that had been assembled couldn't see it coming. Several former chief risk officers had raised questions on the housing bubble and on subprime mortgages as early as 2003. Bill Longbrake had been writing and presenting reports to the board of directors for some years that included "a macro view of the economy and the housing market,"[14] Jim Vanasek, who had built a pristine credit history for the company as its chief credit officer succeeded Longbrake as chief risk officer, but retired in 2005 once it was clear that both Killinger and the board of directors were deaf to his arguments.[15] Yet large firms like JPMorgan Chase and Goldman Sachs had begun to significantly reduce their exposure to risk from other banks and to the subprime mortgage business late in 2006. Washington Mutual rejected JPMorgan Chase's offer of $8 per share in March of 2008, thinking the bank had sufficient capital after a new infusion to see it through the bottom of the mortgage crisis. As runs on the bank began to erode its liquidity and

WaMu could not figure out why its calls to suitors were going unanswered. The reason was that the federal regulators had preempted the auction

as various ratings downgrades occurred, executives at Washington Mutual continued to believe that things were going to turn around. Books like Lowenstein's document the chaos in other parts of the economic environment of 2008: Fannie and Freddie and AIG had been propped up or bailed out; Lehman had failed; Bear Stearns was acquired at fire sale prices by JPMorgan Chase and now the FDIC was letting other banks know that Washington Mutual would soon be available for bid. Lowenstein characterises this period in a few sentences: "During the third week of September, the week of the TARP debate, all went silent. WaMu could not figure out why its calls to suitors were going unanswered. The reason was that the federal regulators had preempted the auction."[16] It was too late, despite efforts by Alan Fishman, the East Coast CEO hired that month to replace Killinger. Banks strong enough to consider making the acquisition were waiting to see when the sale would begin. From Grind, describing Sheila Bair's later testimony, "In the FDIC's view, WaMu's closure was a success. Not a dime of the deposit insurance fund had been used in connection with the largest bank failure in US history. The government isn't charged with protecting bank shareholders or employees. Its job is to

Jamie Dimon was more adept of forming close relationships with government officials than WaMu, to its detriment.

protect customers."[17]

Shareholders who have never worked in a financial institution will read Grind's book at one level, while those of us who were there will be hanging on the edges of our seats beginning with Chapter 7, "Scenes from the Great Depression," which begins with the 2008 annual meeting for shareholders. From this point on, Grind takes us inside the action, where in Chapter 9, "The Final Hours," we are shown Washington Mutual's net deposit balances day by day from September 8 onwards. In the epilogue to the book, where Grind amplifies on how little noticed was the failure of Washington Mutual in the larger context of the economic collapse, she notes of Killinger's Congressional testimony in 2010 that "former executives and managers of WaMu watched the congressional grilling, thinking nothing unusual of Killinger's responses. It was entirely possible, they believed, that Killinger didn't know what was happening. He had continued to believe that the risks the bank took could be managed. He couldn't see how his strategy decisions, made at the highest level of the company, had created a poisonous lending culture at the bottom."[18]

Certainly the executive team felt that there was sufficient liquidity to weather the September run on the bank even as it tried to entertain potential buyers. They might have been right, especially with a new CEO who had the right Wall Street and Washington D.C. connections – except that Washington Mutual had never developed the so-called fifth line of business[19] that would provide it with strong government support at such a critical time. Both the OTS and the FDIC regulated Washington Mutual, with the OTS consistently backing off the FDIC. The infighting and highly divergent views of the two regulators on the health of the bank should have been sufficient tip to prepare and mobilise an actionable public sector strategy. While the bank did have a relatively small government relations team in Washington D.C., it was focused primarily on Capitol Hill. A Washington Mutual senior liaison that functioned at the level of Secretary Paulson and his direct reports at Treasury and who enjoyed their confidence as well as the confidence of Sheila Bair might have made all the difference in the final decision-making. But this is not the type of strategy or relationship that can be built overnight. As it was, Bair characterised Washington Mutual's failure as "barely a blip given everything else that was going on."[20] In a culture of inflated confidence around growth, especially in the years 2000-2007, it might be hard to believe that Washington Bank would ever need the government at its back to survive. JPMorgan Chase's Jamie Dimon had early on cultivated those close relationships with high government officials that Washington Mutual had not managed. As Grind's book makes clear, by the time Washington Mutual's new CEO, Alan Fishman, got to Washington D.C. to make the rounds among all the agencies and departments, the decision on the bank's future had already been made. In *Last Man Standing*, Jamie Dimon discusses the two fire sale acquisitions that JPMorgan Chase made back to back in 2008, when the government turned to him as a trusted partner, "the nation's bank," in the midst of the economic meltdown that drove fear through the markets and the regulators alike: "Bear was never a home run, but WaMu will prove to be a great thing for the company over the long run."[21] TRU

Notes

1 Kristen Grind, The Lost Bank: The Story of Washington Mutual – The Biggest Bank Failure in American History (New York: Simon & Schuster, 2012), p. 91.
2 PBS Newshour, "Amid Financial Crisis, WaMu Collapse Hits Hard in Seattle," October 15, 2008.
3 Grind, pp. 67-68.
4 Grind, p. 67.
5 Grind, pp. 98-99.
6 Grind, p. 105.
7 Grind, pp. 97-98.
8 Ibid.
9 Grind, p. 100-101.
10 Shawn Tully, What Went Wrong at WaMu," CNNMoney, August 9, 2004.
11 Peter S. Goodman and Gretchen Morgenson, "Saying Yes to Anyone, WaMu Built Empire on Shaky Loans," New York Times, December 28, 2008.
12 William Alden, Washington Mutual's Former Chief Takes Issue With Book's Portrayl," New York Times, June 21, 2012.
13 Roger Lowenstein, The End of Wall Street (Penguin: New York, 2010, 2011), pages 33 and 36.
14 Grind, p.162.
15 Grind, pp. 149-150.
16 Lowenstein, p 239.
17 Grind, p. 315.
18 Grind, p. 330.
19 JPMorgan Chase has been said to have a "seventh line of business" which is public sector lobbying and advocacy both at the Treasury Department and Congressional level
20 Grind, p. 314.
21 Duff McDonald, Last Man Standing (New York: Simon & Schuster, 2009), p.307.