

March 5, 2011
Hon. Mary F. Walrath
United States Bankruptcy Court
District of Delaware
824 Market Street, 5th Floor
Wilmington, DE 19801
Re: In re Washington Mutual, Inc., et al. Case Number 08-12229 (MFW) (Jointly Administered)

US BANKRUPTCY COURT
DISTRICT OF DELAWARE
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Objection to the Modified Disclosure Statement

Dear Judge Walrath,

I am writing on behalf of myself as a shareholder of various Washington Mutual securities (and those similarly situated). I have been tracking the progress of this case since its inception. I hold PIERS units, preferred equity of WMI, and common equity of WMI as well as junior bonds of WMB

I am concerned that certain details provided by the debtor, namely certain details about certain subsidiaries that belong to the debtor, have not been fully disclosed to this court and to the shareholders of WMI. Though I have confidence that counsel for the equity committee has the experience and resources to represent these interests, I feel that it is still important to highlight my concerns about a subsidiary that, outside of the initial bankruptcy filing, has many details that remain undisclosed to this court and to the shareholders of WMI.

The debtor has a duty to report all of the interests they hold, even if those assets prove to have little value to the estate.

What Is The Reinsurance Business?

1) The reinsurance business exists to help mortgage insurance companies and mortgage lenders reduce the risk inherent in providing loans to high-risk borrowers. When a high-risk borrower buys a home (typically with less than a 20% down payment) the homeowner is generally required to pay for private mortgage insurance (PMI), which helps protect the lender in the event of default by the borrower.

2) A private mortgage insurer will often obtain mortgage reinsurance when they have lent to high-risk borrowers. To obtain mortgage reinsurance, the private mortgage insurer will enter into a contract with a mortgage reinsurance company, such as Washington Mutual Mortgage Reinsurance Company (WMMRC). The reinsurance contract between the private mortgage insurer and the mortgage reinsurance company is often built around two types of agreements:

- One where the reinsurer agrees to pay a fixed percentage of any losses experienced by the private mortgage insurer, known as "quota share"
- One where the reinsurer is only liable for amounts that fall within a certain range of the losses experienced by the private mortgage insurer, known as "excess of loss"

3) In exchange for this reinsurance coverage, a private mortgage insurer agrees to pay a portion of the PMI payment to the mortgage reinsurer (in this case, WMMRC). A common example of an "excess of loss" agreement is often referred to as 4/10/40. I will let the debtors describe this (from a November 2008 filing):

"WMMRC is required to pay claims made with respect to the insured loans in a 'book of business' only



after a mortgage insurer's losses exceed 4% of the insured risk. WMMRC then is required to pay all losses on the next 10% risk layer, after which the mortgage insurer bears any remaining loss. In consideration for this risk, WMMRC typically receives 40% of the mortgage insurance premiums paid."

4) For example, a \$100,000 30-year mortgage with a 10% down payment and a requirement for mortgage insurance. The monthly mortgage insurance payment is about \$65 per month. And the mortgage reinsurance payment is 40% of that, or about \$26 per month (or more than \$3100 during the 10-year reinsurance time period).¹ If this mortgage were to fail, in the 4/10/40 agreement, WMMRC would be responsible for 10% of the assumed risk after the first 4%. In this example, WMMRC would very likely end up paying \$10,000, or 10% of the mortgage, should it fail.

5) Mortgage reinsurance is typically not done on individual mortgages, but rather is done from large pools of mortgages with similar risk profiles. For example, if \$10 million in loans are part of an agreement between a primary mortgage insurer and a reinsurance company, and if that agreement is using a 4/10/40, then (similar to the example above) the reinsurance payment on this pool of loans is about \$2,600 per month (or more than \$312,000 during the 10-year reinsurance time period). If all of these mortgages were to fail, in the 4/10/40 agreement, WMMRC would be responsible for 10% of the assumed risk after the first 4%. But if less than 4% of the total number of mortgages within this specific pool failed, then what is the risk to WMMRC?²

6) In order to understand how the reinsurance business works, you must also understand what the actual liabilities are for any given reinsurance pool. In this case, it is important to know what the actual failure percentage rates are for each reinsurance trust owned by WMMRC.

Washington Mutual Mortgage Reinsurance Company (WMMRC) Was A Captive Reinsurance Company

7) WMI owns at least one reinsurance subsidiary: WMMRC³. The debtors described WMMRC in a November 2008 filing (Docket #269) as a captive reinsurance company that was a "a Hawaiian corporation and non-debtor, wholly-owned subsidiary of WMI." They requested from this court permission to provide financial support (\$7.4 million) to the Genworth Trust⁴. The court approved this request. They go on to

¹ There are many ways to calculate mortgage insurance payments and related mortgage reinsurance payments. For example:

² How many mortgages does WMMRC provide reinsurance for? The Blackstone analysis states \$16.6 billion, though this number may be as high as \$22 billion.

³ WMI actually owned at least two reinsurance subsidiaries: WMMRC and Marion Insurance, Inc. The debtors have disclosed very little about Marion Insurance, Inc., but upon information and belief Marion Insurance, Inc. was a wholly owned subsidiary of Washington Mutual, Inc that may have had as much as \$80 million in premiums as of February 2008. Other than a \$17 million transaction with a 3rd party insurance company named Assurant and its inclusion in the original list of assets, the debtors have remained largely silent about their other reinsurance subsidiary, other than to state that Marion Insurance, Inc. was required to enter a cut-off state and that some of its reinsurance contracts were commuted (including to Assurant). The debtors have never disclosed the amount of money in any of the reinsurance trusts related to Marion Insurance, Inc. Nor have the debtors disclosed the amount of risk they were required to assume per any of the agreements in-place between Marion Insurance, Inc. and any of its primary mortgage insurers. Nor have the debtors disclosed if reinsurance contracts were commuted to any company other than Assurant.

⁴ The Genworth Trust (as described by the debtors in the same November 2008 filing) needed \$7.4 million dollars, which was about 10% of the total amount of money in the trust at that time. The debtors also described that the additional reserves were needed "to cover anticipated losses in the coming years" and then went on to state that approximately \$45 million in additional premiums would be collected, that the

describe the each of the six reinsurance trusts and noted that by providing financial support to the Genworth Trust, WMMRC would "preserve almost \$400 million in value for its creditors."

8) From the disclosure statement:

"Pursuant to each Reinsurance Agreement, WMMRC established a trust account with US Bank N.A. (collectively, the "Trusts"), for the benefit of the Mortgage Insurer, to hold premiums collected and to secure WMMRC's obligations to each Mortgage Insurer with respect to the insured loans. WMMRC was historically party to seven trust agreements – one for each Reinsurance Agreement to which it was a party. As of December 31, 2009, the value of the six remaining Trust assets was estimated to be \$460 million."^{5 6}

9) The revenue collected by WMMRC and added to the reinsurance trusts was invested, often in government backed securities that collected a significant amount of interest over time.⁷

The Debtors Took Steps To Ensure The Viability Of WMMRC

10) Since WMMRC is required to maintain an adequate reinsurance reserve for any of its reinsurance trusts, and since the debtors wanted to preserve the value of WMMRC, steps were taken to ensure its viability. From the disclosure statement:

"WMMRC's failure to maintain adequate Reinsurance Reserves could result in the Mortgage Insurers' election to terminate the Reinsurance Agreements on a 'cut-off' basis, in which case WMMRC would no longer be liable for the reinsured loans and would no longer receive reinsurance premiums with respect thereto."

11) Given the amount of revenue available to WMMRC should it remain in a run-off state, it is not surprising to this shareholder that the debtors would take steps to preserve its value. In docket #6747 (something the debtors have referred to as the "Pennsylvania Action"), some more details about the history of revenue generated by WMMRC are described. For example, the annual payments made by private mortgage insurers to WMMRC⁸:

assets in the Genworth Trust would continue to accrue interest, and that the anticipated (final) value of the Genworth Trust was between \$45 and \$65 million.

⁵ Based on the following quotes by the debtors (and stated elsewhere in this letter), the value of the six remaining trusts held by WMMRC increased between November 2008 and December 2009 by more than \$60 million:

- From the November 2008 filing the debtors stated: "... preserve almost \$400 million in value for its creditors."
- From the disclosure statement: "As of December 31, 2009, the value of the six remaining Trust assets was estimated to be \$460 million."

⁶ Seven trust agreements, of which six remain. What happened to the seventh trust agreement?

⁷ Indeed, the Blackstone filing indicates that the amount of interest earned by the reinsurance trusts fluctuates, based on the amount of money in the reinsurance trust at any given time. This amount is often as much as the mortgage reinsurance payments themselves, creating, in a sense, a dual income track for this type of business. One cannot discuss the value of the reinsurance business without disclosing the amounts of interest earned by a reinsurance trust.

⁸ Page 8 from the Pennsylvania claim

(). This now-withdrawn claim makes some allegations that are not being alleged by this letter, namely violations of RESPA policies with regard to the origination of mortgages, their mortgage insurer, and the company associated with the reinsurance payments. This letter makes no accusation with regard to fraudulent lending practices; rather

2001 -- \$14,217,000
2002 -- \$73,691,000
2003 -- \$50,163,000
2004 -- \$73,691,000
2005 -- \$77,879,000

12) There is no reason to believe that the trend shown from 2002-2005 didn't hold from 2006-2010, as the typical term for a mortgage reinsurance agreement is 10 years. In fact, the debtors own statements as to the value of the reinsurance trusts shows a \$60 million increase between 2008 and 2009. So it is quite understandable why the debtor would move so quickly to protect WMMRC, as there are hundreds of millions in payments at stake should WMMRC be required to move to a cut-off state. The court gave permission to the debtors to provide any financial assistance, including a \$7.4 million payment and (per the debtors early estimates) additional support up to \$40 million. While the court granted the debtors permission to keep WMMRC viable, did the court give the debtors permission to not disclose when additional financial assistance was necessary?

13) In fact, in the original disclosure statement provided by the debtors, they said this about WMMRC (page 157, Best Interests Tests):

"The recoveries that the Debtors would receive from the expeditious liquidation of WMMRC are likely to be substantially less than the anticipated recovery to be generated if the Debtors retain ownership of WMMRC and reorganize around that entity. While the financial markets have improved since the period immediately following the Petition Date, in the Debtors' business judgment, the liquidation of WMMRC under the current market conditions would result in the Debtors' taking a substantial discount on the value of that asset."

14) In other words, WMMRC will be worth more in the future than it is now. Based on expected surplus amounts in the reinsurance trusts, the debtors expect to be able to pay dividends to shareholders of the reorganized debtor starting as early as 2013.

Washington Mutual Mortgage Reinsurance Company (WMMRC) Is A Reinsurance Company

15) As far as this shareholder can tell, there is no material difference between WMMRC pre- and post-bankruptcy, other than its parent is in Chapter 11 bankruptcy and that WMMRC has (purportedly) not taken on any new reinsurance business. Therefore, WMMRC exists in a run-off state. It still retains much of its pre-bankruptcy reinsurance business. Many of the same contract agreements remain in place. The agreements themselves (whether 4/10/40 or some other agreement) also remain in place. The same payments are being made. And the same obligations (and risks) exist today as they did on 9/25/2008.⁹

16) WMMRC holds a well-diversified national portfolio of insurance loans. Counter-party risk is reduced by using six primary mortgage insurance companies, by diversifying risk across different pools of mortgages and time periods, and by maintaining a AAA-rated investment portfolio.

17) As of December 31, 2009, WMMRC had \$472 million in assets. \$16.6 billion in insured mortgages, \$4.3

this letter simply makes reference to some factual information that is helpful to understanding the financial position of WMMRC during the past 10 years and to help show the viability of WMMRC as a going concern.

⁹ WMMRC has not written any new business since 9/25/2008, but since the business is in a run-off state, ALL of the business written prior to 9/25/2008 is still in effect.

billion in insured risk, and \$1.6 billion in risk exposure, of which \$700 million remained.

18) Using the same 4/10/40 example (as described earlier in this letter), \$16.6 billion in insured mortgages equates to about a \$4.3 million monthly payment and to more than \$50 million per year paid to WMMRC.

The Debtors Disclosure Statement Only Includes Some Details About WMMRC

19) The debtors have not disclosed any details about any of the reinsurance trusts, with the exception of the Genworth Trust.

20) The debtors have omitted certain details about the revenue of WMMRC since 9/26/2008, such as month-by-month revenue, interest earned, and payments received.

21) What details the debtors have disclosed is contained (primarily) in the Blackstone analysis from October 2010. For example, page 56 describes the annual data, starting in 2009. There are \$471 million in total assets, just over \$4 million in receivables, and just under \$4.5 million in accrued interest. Yet, the Blackstone analysis only shows December data.

22) The reinsurance business is a month-to-month business, where the payments and obligations are measured monthly. So why are the months between January and November excluded from the Blackstone analysis? If roughly \$8 million was earned by WMMRC in December 2009 (partly from reinsurance premiums and partly from interest), then is the correct number for 2009 \$8 million x 12 months, or \$96 million?¹⁰

23) With only selected data offered by the debtor, how can this shareholder and this court understand the true value of WMMRC? If only selected data is available, then how can we know that the debtor is working to maximize the estate for the benefit of all creditors and interest holders?

Conclusions

This shareholder understands that there is risk in the mortgage business. A certain pool of mortgages will have a different failure rate from another. Risk changes from year to year (and pool to pool).¹¹ The only significant change between WMMRC pre-petition and post-petition is that its parent filed for Chapter 11; however, the fundamental business model for WMMRC did not change. The six agreements that were in place on 9/26/2008 were also in place on 9/25/2008. The debtors received this court's permission to provide financial assistance to the Genworth Trust (and other trusts, as needed). There has been little (or no) disclosure about the month-to-month operations of WMMRC.

Payments to WMMRC are stored in bank accounts and are invested in government-backed securities. Interest is collected. The debtors have available to them a NOL of significant size (more than \$5 BILLION),

¹⁰ Page 56 of the Expert Report of Steven Zelin, Blackstone Advisory Partners, LP, October 26, 2010.

¹¹ The reinsurance business is known for being highly profitable. There are many reinsurance companies and they are all using similar approaches and agreement structures. The debtors have stated that there is "risk that the [WMMRC] trusts could go to zero." This is certainly a possibility. However, it is also possible that the risk to the reinsurance trusts themselves also goes to zero. If zero mortgages fail, then zero payments are made. Only when enough mortgages fail, per each reinsurance agreement, does WMMRC then assume risk. The debtors have not provided evidence to support the notion that enough mortgages have failed or that any payments have been made per the obligations in any agreement between WMMRC and a primary mortgage insurer.

easily large enough to offset most (if not all) of the risk inherent in the WMMRC reinsurance business.¹² Yet the debtors want this shareholder and this court to believe that WMMRC is worth about \$135 million and that any tax benefits related to a NOL--one of unprecedented size--will have little to no effect on the future value of WMMRC.

In order to ensure a fair and equitable reorganization of the debtor, it is hereby requested that the court find that:

- 1) The value of each reinsurance trust that is owned by WMMRC be disclosed to this court and to all shareholders. Including (but not limited to) the amounts received by each trust on a month-to-month basis, the amounts paid by each trust on a month-to-month basis (per each agreement between WMMRC and its primary mortgage insurer), and for all years in which an agreement is active. Specifically: 2004, 2005, 2006, 2007, 2008, 2009, 2010, and 2011. Given that the FDIC did not seize WMMRC, there should be no impediments to providing this data.
- 2) The amounts of all interest earned (on a month-by-month basis) by each reinsurance trust that is owned by WMMRC for the years 2008, 2009, and 2010 must be disclosed.
- 3) The value of the amounts of all premiums paid to WMMRC (on a month-by-month basis) during 2008, 2009, and 2010 must be disclosed.
- 4) The value of the amounts of all losses paid by WMMRC (on a month-by-month basis) during 2008, 2009, and 2010 must be disclosed.
- 5) The value of any amounts withdrawn from any reinsurance trust owned by WMMRC (on a month-by-month basis) during 2008, 2009, 2010, and 2011 must be disclosed.
- 6) The value of each reinsurance trust during 2008, 2009, and 2010 (and on a month-by-month basis) must be disclosed.
- 7) For each reinsurance trust owned by WMMRC, what are the actual failure percentage rates for each agreement between WMMRC and a mortgage insurance provider?
- 8) Require that the debtors file an amended statement of assets, one that includes all assets that belong to WMMRC including (but not limited to) the amounts in each reinsurance trust, all investments made by WMMRC, and all amounts in any bank account owned by WMMRC.
- 9) The court recognizes that assets of significant value have been hidden and/or obscured from visibility to shareholders and to this court and that by hiding this value the debtors have effectively gerrymandered the waterfall for the benefit of certain creditors and to the detriment of interest holders (generally).
- 10) The court assesses the value of the Net Operating Losses (NOLs) with an accurate range of profitability, which may greatly impact the value of the reorganized debtor.
- 10) The court determines an appropriate remedy for the debtor's failure to include the accurate value of this subsidiary as part of the value of the reorganized debtor.

¹² Any discussion of the value of WMMRC and/or the potential value of WMMRC over time should not exist without considering the effect of the \$5+ billion NOL (and possibly more if the debtors' current stock abandonment is not completed) that is available to the reorganized debtor. In addition, any discussion of the value of WMMRC should consider the fact that, while it is in a run-off state currently, after reorganization there won't be any requirements for it to remain in the run-off state.

Any plan of reorganization in bankruptcy must have been proposed in good faith and not by means prohibited by law. Throughout this case, the debtor has sought to hide the disclosure of assets, if only by omission. WMMRC is just one example of that.

The debtor has a fiduciary duty to all parties to this bankruptcy, including shareholders, and that fiduciary duty requires a fair and honest assessment as to the property of the estate. If WMMRC remains property of the estate, shouldn't its value be included in any disclosure statement as an asset of the reorganized debtor?

As a matter of equity and fairness to all creditors and interest holders, a debtor in possession should not be allowed to hide and/or omit details about the assets and liabilities of the estate.

Sincerely,

A handwritten signature in cursive script that reads "Ben Mason".

Ben Mason