

WESTCORP /CA/  
Form 10-Q  
November 09, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2004**

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number**  
**33-13646**

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**Westcorp**

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(Exact name of registrant as specified in its charter)

**CALIFORNIA**

---

**51-0308535**

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

**23 Pasteur, Irvine, California**  
**92618-3816**

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(Address of principal executive offices)

**(949) 727-1002**

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(Registrant's telephone number,  
including area code)

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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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

As of October 29, 2004, the registrant had 51,873,467 outstanding shares of common stock, \$1.00 par value. The shares of common stock represent the only class of common stock of the registrant.

The total number of sequentially numbered pages is 37.

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**WESTCORP AND SUBSIDIARIES**

**FORM 10-Q**

**September 30, 2004**

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**Forward-Looking Statements**

This Form 10-Q includes and incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act, as amended, also known as the Exchange Act. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to our future prospects, developments and business strategies. These statements are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control, that could cause actual results to differ materially from those expressed in or implied by these forward-looking statements.

These forward-looking statements are identified by use of terms and phrases such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will, and similar terms and phrases, including reference to assumptions. These statements are contained in the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-Q.

The following factors are among those that may cause actual results to differ materially from the forward-looking statements:

- changes in general economic and business conditions;
- interest rate fluctuations, including hedging activities;
- our financial condition and liquidity, as well as future cash flows and earnings;
- competition;
- our level of operating expenses;
- the effect, interpretation, or application of new or existing laws, regulations and court decisions;
- the availability of sources of funding;
- the level of chargeoffs on the automobile contracts that we originate; and
- significant litigation.

If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those expected, estimated or projected.

We do not undertake to update our forward-looking statements or risk factors to reflect future events or circumstances.

**Available Information**

We provide access to all our filings with the Securities and Exchange Commission on our Web site at <http://www.westcorpinc.com> free of charge on the same day as these reports are electronically filed with the Commission. The information contained in our Web site does not constitute part of this filing.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****WESTCORP AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	<b>(Unaudited) September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
<b>ASSETS</b>		
Cash	\$ 95,150	\$ 50,073
Interest bearing deposits with other financial institutions	3,098	41,009
Other short-term investments	150,000	291,000
	<hr/>	<hr/>
Cash and due from banks	248,248	382,082
Restricted cash	392,531	245,399
Investment securities available for sale	107,374	117,749
Mortgage-backed securities available for sale	2,670,344	2,701,797
Loans receivable	11,935,998	11,138,483
Allowance for credit losses	(312,222)	(301,602)
	<hr/>	<hr/>
Loans receivable, net	11,623,776	10,836,881
Interest receivable	76,428	80,957
Premises and equipment, net	78,424	81,814
Other assets	154,874	169,241
	<hr/>	<hr/>
<b>TOTAL ASSETS</b>	<b>\$15,351,999</b>	<b>\$ 14,615,920</b>
	<hr/>	<hr/>
<b>LIABILITIES</b>		
Deposits	\$ 2,108,668	\$ 1,972,856
Notes payable on automobile secured financing	10,415,151	10,254,641
Securities sold under agreements to repurchase		222,489
Federal Home Loan Bank advances	870,658	328,644
Subordinated debentures	295,053	394,854
Other	219,726	188,517
	<hr/>	<hr/>
<b>TOTAL LIABILITIES</b>	<b>13,909,256</b>	<b>13,362,001</b>

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Minority interest	158,045	131,434
SHAREHOLDERS EQUITY		
Common stock (par value \$1.00 per share; authorized 65,000,000 shares; issued and outstanding 51,873,467 shares at September 30, 2004 and 51,698,398 shares at December 31, 2003)	51,873	51,698
Paid-in capital	714,569	710,001
Retained earnings	558,740	427,527
Accumulated other comprehensive loss, net of tax	(40,484)	(66,741)
	<u>1,284,698</u>	<u>1,122,485</u>
TOTAL SHAREHOLDERS EQUITY		
	<u>\$15,351,999</u>	<u>\$ 14,615,920</u>
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY		

See accompanying notes to consolidated financial statements.

Table of Contents**WESTCORP AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****For the Three Months Ended  
September 30,****For the Nine Months Ended  
September 30,****2004****2003****2004****2003****(Dollars in thousands, except per share amounts)**

Interest income:				
Loans, including fees	\$ 291,796	\$ 293,019	\$ 863,989	\$ 861,169
Mortgage-backed securities	25,828	15,936	72,666	61,950
Investment securities	1,173	823	3,354	2,213
Other	2,441	1,133	5,871	3,004
	<hr/>	<hr/>	<hr/>	<hr/>
<b>TOTAL INTEREST INCOME</b>	<b>321,238</b>	<b>310,911</b>	<b>945,880</b>	<b>928,336</b>
Interest expense:				
Deposits	15,101	15,695	42,291	50,269
Notes payable on automobile secured financing	89,869	101,803	272,678	319,136
Other	10,040	12,550	33,477	37,852
	<hr/>	<hr/>	<hr/>	<hr/>
<b>TOTAL INTEREST EXPENSE</b>	<b>115,010</b>	<b>130,048</b>	<b>348,446</b>	<b>407,257</b>
	<hr/>	<hr/>	<hr/>	<hr/>
<b>NET INTEREST INCOME</b>	<b>206,228</b>	<b>180,863</b>	<b>597,434</b>	<b>521,079</b>
Provision for credit losses	60,337	73,150	174,171	221,071
	<hr/>	<hr/>	<hr/>	<hr/>
<b>NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES</b>	<b>145,891</b>	<b>107,713</b>	<b>423,263</b>	<b>300,008</b>
Noninterest income:				
Automobile lending	26,830	23,516	77,646	67,810
Mortgage banking	97	279	581	1,132
Insurance income	2,264	3,252	5,778	6,187
Other	836	786	2,267	8,187
	<hr/>	<hr/>	<hr/>	<hr/>
<b>TOTAL NONINTEREST INCOME</b>	<b>30,027</b>	<b>27,833</b>	<b>86,272</b>	<b>83,316</b>
Noninterest expenses:				
Salaries and associate benefits	43,541	40,016	130,995	120,950



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Credit and collections	8,056	8,655	24,359	27,004
Data processing	4,053	4,258	12,313	13,690
Occupancy	3,983	4,041	11,710	11,784
Telephone	1,219	1,296	3,519	3,880
Other	14,084	8,479	36,710	30,532
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
TOTAL NONINTEREST EXPENSES	74,936	66,745	219,606	207,840
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
INCOME BEFORE INCOME TAX	100,982	68,801	289,929	175,484
Income tax	40,188	27,343	115,227	69,544
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
INCOME BEFORE MINORITY INTEREST	60,794	41,458	174,702	105,940
Minority interest in earnings of subsidiaries	6,122	12,123	22,251	21,453
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
NET INCOME	\$ 54,672	\$ 29,335	\$ 152,451	\$ 84,487
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Earnings per common share:				
Basic	\$ 1.05	\$ 0.65	\$ 2.94	\$ 2.05
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	\$ 1.04	\$ 0.64	\$ 2.90	\$ 2.03
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Weighted average number of common shares outstanding:				
Basic	51,859,531	45,033,836	51,806,929	41,154,810
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	52,510,834	45,786,913	52,528,983	41,680,576
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Dividends declared	\$ 0.14	\$ 0.13	\$ 0.42	\$ 0.39
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to consolidated financial statements.

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## WESTCORP AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

	Shares	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total
(Dollars in thousands, except share amounts)						
Balance at January 1, 2003	39,200,474	\$39,200	\$350,018	\$325,529	\$(101,550)	\$ 613,197
Net income				123,605		123,605
Unrealized losses on securities available for sale, net of tax (1)					(7,315)	(7,315)
Unrealized losses on cash flow hedges, net of tax (2)					(21,285)	(21,285)
Reclassification adjustment for gains on securities available for sale included in net income, net of tax (3)					(5,058)	(5,058)
Reclassification adjustment for losses on cash flow hedges included in income, net of tax (4)					68,467	68,467
Comprehensive income						158,414
Issuance of common stock	12,371,500	12,372	356,863			369,235
Issuance of subsidiary common stock			702			702
Stock options expensed (5)			669			669
Stock options exercised	126,424	126	1,749			1,875
Cash dividends				(21,607)		(21,607)
	51,698,398	51,698	710,001	427,527	(66,741)	1,122,485

Balance at December 31, 2003						
Net income				152,451		152,451
Unrealized losses on securities available for sale, net of tax (1)					(4,544)	(4,544)
Unrealized losses on cash flow hedges, net of tax (2)					(4,211)	(4,211)
Reclassification adjustment for gains on securities available for sale included in income, net of tax (3)					(1,446)	(1,446)
Reclassification adjustment for losses on cash flow hedges included in income, net of tax (4)					36,458	<u>36,458</u>
Comprehensive income						178,708
Issuance of subsidiary common stock			(40)			(40)
Stock options expensed (5)			1,937			1,937
Stock options exercised	175,069	175	2,671			2,846
Cash dividends				(21,238)		(21,238)
	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Balance at September 30, 2004	<u>51,873,467</u>	<u>\$51,873</u>	<u>\$714,569</u>	<u>\$558,740</u>	<u>\$ (40,484)</u>	<u>\$1,284,698</u>

- (1) The pre-tax amount of unrealized losses on securities available for sale was \$7.6 million for the nine months ended September 30, 2004 compared with \$12.2 million for the year ended December 31, 2003.
- (2) The pre-tax amount of unrealized losses on cash flow hedges was \$7.0 million for the nine months ended September 30, 2004 compared with \$35.5 million for the year ended December 31, 2003.
- (3) The pre-tax amount of unrealized gains on securities available for sale reclassified into earnings was \$2.4 million for the nine months ended September 30, 2004 compared with \$8.4 million for the year ended December 31, 2003.
- (4) The pre-tax amount of unrealized losses on cash flow hedges reclassified into earnings was \$60.8 million for the nine months ended September 30, 2004 compared with \$114 million for the year ended December 31, 2003.
- (5) Amount represents expense related to stock options granted.

See accompanying notes to consolidated financial statements.

Table of Contents**WESTCORP AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****For the Nine Months Ended  
September 30,**

	<b>2004</b>	<b>2003</b>
	<b>(Dollars in thousands)</b>	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 152,451	\$ 84,487
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	174,171	221,071
Depreciation	8,935	10,620
Amortization of losses on cash flow hedges	32,186	43,665
Amortization of premium on mortgage-backed securities	32,012	55,134
Amortization of participation paid to dealers	94,185	81,384
Amortization, other	4,586	1,100
Gain on sales, net	(6,605)	(10,060)
Other	502	(5,688)
Decrease in other assets	2,332	4,570
Increase in other liabilities	31,558	22,301
Other, net	22,251	21,454
	<hr/>	<hr/>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>548,564</b>	<b>530,038</b>
<b>INVESTING ACTIVITIES</b>		
Loans receivable:		
Origination of loans	(5,320,232)	(4,952,333)
Participation paid to dealers	(117,226)	(109,325)
Loan payments and payoffs	4,381,867	3,745,284
Investment securities available for sale:		
Purchases	(69,908)	(119,152)
Proceeds from sale	81,254	1,030
Proceeds from maturities	398	54,475
Mortgage-backed securities available for sale:		
Purchases	(970,806)	(1,672,500)
Proceeds from sale	52,295	105,066
Payments received	910,742	1,476,522
Purchase of premises and equipment	(9,332)	(13,911)
Proceeds from sales of premises and equipment	4,509	2,938
	<hr/>	<hr/>
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(1,056,439)</b>	<b>(1,481,906)</b>

FINANCING ACTIVITIES

Increase in deposits	142,884	5,486
Decrease in securities sold under agreements to repurchase	(218,741)	(30,437)
Proceeds from notes payable on automobile secured financing	4,498,305	4,476,713
Payments on notes payable on automobile secured financing	(4,308,510)	(3,444,685)
(Decrease) increase in borrowings	(351)	3,271
Increase in FHLB advances	542,014	47,401
Payments on issuance of subordinated debentures	(104,683)	(7,315)
Increase in restricted cash	(147,131)	(114,556)
Cash dividends	(21,239)	(15,701)
Payments on cash flow hedges	(11,390)	(34,180)
Proceeds from issuance of common stock	2,846	164,551
Proceeds from issuance of subsidiary common stock	37	68
	<u>          </u>	<u>          </u>
NET CASH PROVIDED BY FINANCING ACTIVITIES	374,041	1,050,616
	<u>          </u>	<u>          </u>
(DECREASE) INCREASE IN CASH AND DUE FROM BANKS	(133,834)	98,748
Cash and due from banks at beginning of year	382,082	84,215
	<u>          </u>	<u>          </u>
CASH AND DUE FROM BANKS AT END OF PERIOD	\$ 248,248	\$ 182,963
	<u>          </u>	<u>          </u>

See accompanying notes to consolidated financial statements.

Table of Contents**WESTCORP AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Note 1 Basis of Presentation**

The accompanying unaudited consolidated financial statements include our accounts and the accounts of our wholly owned subsidiary, Western Financial Bank, also known as the Bank, and its majority owned subsidiary, WFS Financial Inc, also known as WFS. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform with the current year's presentation.

The unaudited consolidated financial statements included herein have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles, also known as GAAP, for complete financial statements.

In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2003 included in our Form 10-K.

**Note 2 Mortgage-Backed Securities Available for Sale**

Mortgage-backed securities available for sale consisted of the following:

	<b>September 30, 2004</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gain</b>	<b>Gross Unrealized Loss</b>	<b>Fair Value</b>
	<b>(Dollars in thousands)</b>			
GNMA certificates	\$2,584,091	\$20,385	\$5,740	\$2,598,736
FNMA participation certificates	31,148	191	151	31,188
FHLMC participation certificates	38,748	184	128	38,804
Other	1,616			1,616
	<u>\$2,655,603</u>	<u>\$20,760</u>	<u>\$6,019</u>	<u>\$2,670,344</u>





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	<b>December 31, 2003</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gain</b>	<b>Gross Unrealized Loss</b>	<b>Fair Value</b>
	<b>(Dollars in thousands)</b>			
GNMA certificates	\$2,613,962	\$28,607	\$4,484	\$2,638,085
FNMA participation certificates	24,967	306		25,273
FHLMC participation certificates	36,734	9	78	36,665
Other	1,774			1,774
	<u>\$2,677,437</u>	<u>\$28,922</u>	<u>\$4,562</u>	<u>\$2,701,797</u>

Our mortgage-backed securities available for sale portfolio was comprised of 61% fixed rate certificates and 39% variable rate certificates at September 30, 2004 compared with 79% fixed rate certificates and 21% variable rate certificates at December 31, 2003.

**Note 3 Net Loans Receivable**

Net loans receivable consisted of the following:

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
Consumer:		
Automobile contracts	\$11,483,904	\$10,657,864
Dealer participation, net of deferred contract fees	190,143	175,263
Other	6,782	6,002
Unearned discounts	(43,742)	(61,300)
	<u>11,637,087</u>	<u>10,777,829</u>
Real estate:		
Mortgage	183,648	237,668
Construction	39,845	16,503
	<u>223,493</u>	<u>254,171</u>
Undisbursed loan proceeds	(31,405)	(17,948)
	<u>192,088</u>	<u>236,223</u>

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Commercial	106,823	124,431
	<u>                    </u>	<u>                    </u>
Allowance for credit losses	11,935,998 (312,222)	11,138,483 (301,602)
	<u>                    </u>	<u>                    </u>
	<u>\$11,623,776</u>	<u>\$10,836,881</u>

Loans managed by us, excluding dealer participation and deferred contract fees, totaled \$11.7 billion and \$11.0 billion as of September 30, 2004 and December 31, 2003, respectively. We owned all of the \$11.7 billion and \$11.0 billion loans managed at September 30, 2004 and December 31, 2003, respectively. Nonperforming loans, or loans on which we have discontinued the accrual of interest income, included in net loans receivable were \$51.4 million and \$53.0 million at September 30, 2004 and December 31, 2003, respectively. Repossessed assets and real estate owned were \$7.0 million and \$10.6 million at September 30, 2004 and December 31, 2003, respectively, and are included in other assets on our Consolidated Statements of Financial Condition.

**Table of Contents****Note 4 Allowance for Credit Losses**

The following table sets forth the activity in the allowance for credit losses:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Dollars in thousands)</b>			
Balance at beginning of period	\$307,293	\$291,459	\$ 301,602	\$ 269,352
Chargeoffs:				
Consumer loans	(76,689)	(88,345)	(232,403)	(258,495)
Commercial loans	(492)		(492)	
Mortgage loans	(37)	(7)	(167)	(344)
	<u>(77,218)</u>	<u>(88,352)</u>	<u>(233,062)</u>	<u>(258,839)</u>
Recoveries:				
Consumer loans	21,792	22,003	69,471	66,593
Commercial loans	18	12	40	61
Mortgage loans		6		40
	<u>21,810</u>	<u>22,021</u>	<u>69,511</u>	<u>66,694</u>
Net chargeoffs	(55,408)	(66,331)	(163,551)	(192,145)
Provision for credit losses	60,337	73,150	174,171	221,071
	<u>60,337</u>	<u>73,150</u>	<u>174,171</u>	<u>221,071</u>
Balance at end of period	<u>\$312,222</u>	<u>\$298,278</u>	<u>\$ 312,222</u>	<u>\$ 298,278</u>
Ratio of net chargeoffs during the period (annualized) to average loans outstanding during the period	1.9%	2.5%	1.9%	2.5%
Ratio of allowance for credit losses to loans at the end of the period	2.6%	2.7%	2.6%	2.7%

**Table of Contents****Note 5 Deposits**

Deposits consisted of the following:

	<b>Weighted Average Rate at September 30, 2004 (1)</b>	<b>Weighted Average Rate for the Nine Months Ended September 30, 2004 Excluding the Effects of Hedging</b>	<b>Effects of Hedging for the Nine Months Ended September 30, 2004</b>	<b>Weighted Average Rate for the Nine Months Ended September 30, 2004 Including the Effects of Hedging</b>
Demand deposit accounts	0.1%	0.1%		0.1%
Passbook accounts	0.1	0.2		0.2
Money market deposit accounts	1.8	1.3	0.1%	1.4
Brokered certificate accounts	1.4	1.7		1.7
Certificate accounts	2.1	1.7	4.6	6.3

(1) Contractual rate.

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
Noninterest bearing deposits	\$ 238,505	\$ 210,405
Demand deposit accounts	862	1,145
Passbook accounts	6,102	7,282
Money market deposit accounts	1,219,918	963,004
Brokered certificate accounts	52,533	62,451
Certificate accounts	590,748	728,569
	<b>\$2,108,668</b>	<b>\$1,972,856</b>

**Note 6 Notes Payable on Automobile Secured Financing**

In connection with our public asset-backed securitization activities, we issued \$1.6 billion and \$4.5 billion of notes secured by automobile contracts for the three and nine months ended September 30, 2004, respectively, compared with \$1.7 billion and \$4.5 billion for the same respective periods in 2003. There were \$10.4 billion of notes payable on automobile secured financing outstanding at September 30, 2004 compared with \$10.3 billion at December 31, 2003.

Interest payments are due either monthly or quarterly, in arrears. Interest expense on all notes payable on automobile secured financing, including interest payments under interest rate swap agreements, totaled \$89.9 million and \$273 million for the three and nine months ended September 30, 2004, respectively, compared with \$102 million and \$319 million for the same respective periods in 2003.

**Table of Contents****Note 7 Accumulated Other Comprehensive Loss, Net of Tax**

The following table summarizes the components of accumulated other comprehensive loss, net of tax:

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
Unrealized gain on marketable securities	\$ 8,782	\$ 14,771
Unrealized loss on interest rate swaps: (1)		
Deposits	(34,054)	(38,297)
Automobile secured financing	(3,947)	(19,539)
Securities sold under agreements to repurchase	_____	(2,248)
	(38,001)	(60,084)
Realized loss on settled cash flow hedges: (1)		
Deposits	(9,123)	(9,539)
Automobile secured financing	(2,142)	(11,889)
	_____	_____
	(11,265)	(21,428)
	_____	_____
Total other accumulated comprehensive loss	<b>\$(40,484)</b>	<b>\$(66,741)</b>

(1) All cash flow hedges are structured to hedge future interest payments on deposits or borrowings.

**Note 8 Comprehensive income**

The following table presents the components of comprehensive income, net of related tax, for the periods indicated:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Dollars in thousands)</b>			
Net income	\$ 54,672	\$29,335	\$152,451	\$ 84,487
Unrealized gains (losses) on securities available for sale, net of tax	15,723	(2,184)	(4,544)	(7,926)
Unrealized (losses) gains on cash flow hedges,	(15,278)	7,276	(4,211)	(30,667)

net of tax				
Reclassification adjustment for gains on securities available for sale included in income, net of tax		(2,983)	(1,446)	(2,987)
Reclassification adjustment for losses on cash flow hedges included in income, net of tax	9,832	20,022	36,458	53,990
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Comprehensive income	\$ 64,949	\$51,466	\$178,708	\$ 96,897
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**Note 9 Dividends**

On August 16, 2004, we declared a cash dividend of \$0.14 per share for shareholders of record as of November 9, 2004 with a payable date of November 23, 2004.

**Table of Contents****Note 10 Stock Options**

In May 2001, we adopted the 2001 Westcorp Stock Option Plan, also known as the 2001 Plan, an incentive stock option plan for certain associates and directors. The 2001 Plan replaced the 1991 Stock Option Plan, also known as the 1991 Plan, that expired on April 15, 2001. Those who received options prior to the approval of the 2001 Plan are still subject to the 1991 Plan and may continue to exercise the remaining shares that are outstanding and exercisable. However, any and all shares reserved for the 1991 Plan are no longer available for future grants. As such, no further grants will be made under the expired 1991 Plan.

Options outstanding and exercisable at September 30, 2004 were as follows:

Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$12.00 13.00	168,103	1.25	\$12.63	168,103	\$12.63
13.00 14.00	153,250	2.39	13.25	153,250	13.25
15.00 16.00	1,000	3.11	15.25	750	15.25
17.00 18.00	227,071	3.39	17.32	152,508	17.32
18.00 19.00	701,666	3.81	18.57	243,840	18.53
19.00 20.00	5,000	4.85	19.85	2,500	19.85
20.00 21.00	3,000	5.10	20.41	750	20.41
42.00 43.00	528,500	4.38	42.19		
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
\$12.00 43.00	1,787,590	3.57	\$24.39	721,701	\$15.78
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Stock option activity is summarized as follows:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2003	1,167,438	\$15.91
Granted	444,000	18.78
Exercised	(126,424)	14.84
Forfeited	(24,478)	17.19
	<hr/>	<hr/>



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Outstanding at December 31, 2003	1,460,536	16.86
Granted	540,900	42.19
Exercised	(175,069)	16.26
Forfeited	(38,777)	25.83
	<u>                    </u>	<u>                    </u>
Outstanding at September 30, 2004	1,787,590	\$ 24.39
	<u>                    </u>	<u>                    </u>

Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Our stock options have characteristics significantly different from traded options, and changes in the subjective input assumptions can materially affect the fair value estimate. Although we do not believe that there is a reliable single measure of the fair value of our employee stock options, we use the Binomial option valuation model to determine such value. We believe that this model provides a more reliable measure than the Black-Scholes model. The weighted average fair value of options granted during the nine month period ending September 30, 2004 was \$13.26 compared to \$5.48 for the year ended December 31, 2003.

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Pro forma information regarding net income and earnings per share is required by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123, and has been determined as if we had accounted for our employee stock options under the fair value method of that statement.

Pro forma net income and diluted earnings per share for the respective periods were as follows:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Dollars in thousands, except per share amounts)</b>			
Net income, as reported	\$54,672	\$29,335	\$152,451	\$84,487
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	458	122	1,167	285
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	581	315	1,597	919
Pro forma net income	<u>\$54,549</u>	<u>\$29,142</u>	<u>\$152,021</u>	<u>\$83,853</u>
Earnings per share:				
Basic as reported	<u>\$ 1.05</u>	<u>\$ 0.65</u>	<u>\$ 2.94</u>	<u>\$ 2.05</u>
Basic pro forma	<u>\$ 1.05</u>	<u>\$ 0.65</u>	<u>\$ 2.93</u>	<u>\$ 2.04</u>
Earnings per share:				
Diluted as reported	<u>\$ 1.04</u>	<u>\$ 0.64</u>	<u>\$ 2.90</u>	<u>\$ 2.03</u>
Diluted pro forma	<u>\$ 1.04</u>	<u>\$ 0.64</u>	<u>\$ 2.89</u>	<u>\$ 2.01</u>

**Note 11 Commitments and Contingencies**

We or our subsidiaries are involved as a party to certain legal proceedings incidental to our business, including *Lee, et al. v. WFS Financial Inc*, United States District Court, Middle District of Tennessee at Nashville, No. 3-02-0570 filed June 17, 2002 (a putative class action raising claims under the Equal Credit Opportunity Act) and *Thompson, et al. v.*

*WFS Financial Inc*, California Superior Court, County of Alameda Civil Action No, RG03088926, appeal pending in the Court of Appeal of the State of California, First Appellate District, Division One, No. A104967 (a putative class action raising claims under California's Unfair Competition Law and related claims). WFS has reached a settlement in *Lee, et al. v. WFS Financial Inc* and *Thompson, et al. v. WFS Financial Inc* cases. The settlements will be final after court approval of the settlement in *Lee, et al. v. WFS Financial Inc*. We do not believe that the outcome of these proceedings will have a material effect upon our financial condition, results of operations and cash flows.

Beginning on May 24, 2004 and continuing thereafter, a total of four separate purported class action lawsuits relating to the announcement by Westcorp and WFS that Westcorp was commencing an exchange offer for the outstanding public shares of WFS were filed in the Orange County, California Superior Court against Westcorp, WFS, and individual board members of Westcorp and WFS. On June 24, 2004, the actions were consolidated under the caption *In re WFS Financial Shareholder Litigation*, Case No. 04CC00559. On July 16, 2004, the court granted a motion by plaintiff Alaska Hotel & Restaurant Employees Pension Trust Fund, in Case No.04CC00573, to amend the consolidation order to designate it the lead plaintiff in the litigation. Lead plaintiff filed a consolidated amended complaint on August 9, 2004, and then filed the present corrected consolidated amended complaint on September 15, 2004. All of the defendants have filed demurrers challenging the legal sufficiency of the pending complaint, which are scheduled for hearing. All of the shareholder-related

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actions allege, among other things, that the defendants breached their respective fiduciary duties and seek to enjoin or rescind the transaction and obtain an unspecified sum in damages and costs, including attorneys' fees and expenses. We are vigorously defending this action and do not believe that the outcome of this proceeding will have a material effect upon our financial condition, results of operations and cash flows.

**Note 12 Proposed Acquisition and Merger**

On May 23, 2004, we entered into a definitive agreement pursuant to which we will acquire the outstanding 16% common stock minority interest of WFS not already owned by our wholly owned subsidiary, the Bank. The acquisition is structured as a merger of WFS with and into the Bank. The public holders of WFS shares will receive 1.11 shares of our common stock for each share of WFS common stock held by them in a tax-free exchange. Based on the \$42.60 closing price of our common stock on May 21, 2004, the last business day prior to the execution of the agreement, the transaction has an indicated value of \$47.29 per share of WFS common stock. The transaction is subject to, among other closing conditions, the receipt of regulatory approvals and the approval of a majority of WFS Financial's shareholders, other than shares controlled by Westcorp.

The California Department of Financial Institutions and the Office of Thrift Supervision have approved the Bank's application to convert from a federal savings bank to a California state commercial bank subject to receipt of all other required regulatory approvals. The Federal Deposit Insurance Corporation approved the application to merge WFS into the Bank as part of the acquisition of the minority interest in WFS. The conversion is still contingent upon the approval of our application to become a bank holding company by the Board of Governors of the Federal Reserve. After the conversion, we will be subject to the laws, regulation and oversight of the California Department of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve. The merger is also subject to approval by the majority of WFS' minority shareholders.

We anticipate the merger of WFS with and into the Bank and the conversion of the Bank to a California state commercial bank will be completed sometime in the first quarter of 2005. We believe the combined company will provide greater flexibility in responding to market factors and will enable us to utilize, to a greater extent, the Bank's low cost customer deposits to finance our activities.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

We are a diversified financial services holding company that provides automobile lending services through our second tier subsidiary, WFS Financial Inc, also known as WFS, and retail and commercial banking services through our wholly owned subsidiary, Western Financial Bank, also known as the Bank. The Bank currently owns 84% of the capital stock of WFS.

Our primary sources of revenue are net interest income and noninterest income. Net interest income is the difference between the income earned on interest earning assets and the interest paid on interest bearing liabilities. We generate interest income from our loan portfolio, which consists of consumer, mortgage and commercial loans, and from investments in mortgage-backed securities and other short-term investments. We fund our loan portfolio and investments with deposits, advances from the Federal Home Loan Bank, also known as the FHLB, securities sold under agreements to repurchase, securitizations, other borrowings and equity.

Noninterest income is primarily made up of revenues generated from the servicing of automobile contracts and real estate loans. The primary components of noninterest income include late charges and other miscellaneous servicing fee income. Other components of noninterest income include gains and losses from the sale of investment securities and mortgage-backed securities, insurance income, fees related to the sales of investment products such as mutual funds and annuities, and fee income from depository accounts. The primary components of noninterest expense are salaries, credit and collection expenses, and data processing costs.

**Selected Financial Data**

The following table presents summary unaudited financial data for the three and nine months ended September 30, 2004 and 2003. Since this table is only a summary and does not provide all of the information contained in our financial statements, including the related notes, you should read our Consolidated Financial Statements contained elsewhere herein. Certain amounts from the prior years' Consolidated Financial Statements have been reclassified to conform to the current year presentation.

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	(Dollars in thousands, except per share amounts)			
<b>Consolidated Statements of Income Data:</b>				
Interest income	\$ 321,238	\$ 310,911	\$ 945,880	\$ 928,336
Interest expense	115,010	130,048	348,446	407,257
Net interest income	206,228	180,863	597,434	521,079
Provision for credit losses	60,337	73,150	174,171	221,071
	145,891	107,713	423,263	300,008

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Net interest income after provision for credit losses				
Noninterest income	30,027	27,833	86,272	83,316
Noninterest expense	74,936	66,745	219,606	207,840
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income before income tax	100,982	68,801	289,929	175,484
Income tax	40,188	27,343	115,227	69,544
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income before minority interest	60,794	41,458	174,702	105,940
Minority interest in earnings of subsidiaries	6,122	12,123	22,251	21,453
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income	<u>\$ 54,672</u>	<u>\$ 29,335</u>	<u>\$ 152,451</u>	<u>\$ 84,487</u>
Weighted average number of shares and common share equivalents diluted	52,510,834	45,786,913	52,528,983	41,680,576
Earnings per common share diluted	\$ 1.04	\$ 0.64	\$ 2.90	\$ 2.03
Dividends per share	\$ 0.14	\$ 0.13	\$ 0.42	\$ 0.39
Dividend payout ratio	13.4%	20.3%	14.5%	19.2%

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	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
<b>Consolidated Statements of Financial Condition Data:</b>		
Assets:		
Cash and due from banks	\$ 248,248	\$ 382,082
Loans:		
Consumer (1)	11,637,087	10,777,829
Mortgage (2)	192,088	236,223
Commercial	106,823	124,431
Mortgage-backed securities	2,670,344	2,701,797
Investments and time deposits	499,905	363,148
Other assets	309,726	332,012
Less: Allowance for credit losses	312,222	301,602
	<hr/>	<hr/>
Total assets	\$15,351,999	\$14,615,920
	<hr/>	<hr/>
Liabilities:		
Deposits	\$ 2,108,668	\$ 1,972,856
Notes payable on automobile secured financing	10,415,151	10,254,641
FHLB advances and other borrowings	879,354	560,179
Subordinated debentures	295,053	394,854
Other liabilities	211,030	179,471
	<hr/>	<hr/>
Total liabilities	13,909,256	13,362,001
Minority interest in equity of subsidiaries	158,045	131,434
Shareholders' equity	1,284,698	1,122,485
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$15,351,999	\$14,615,920
	<hr/>	<hr/>

<b>At or For the Three Months Ended September 30,</b>		<b>At or For the Nine Months Ended September 30,</b>	
<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>

(Dollars in thousands)

**Other Selected Financial  
Data:**

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Average automobile contracts managed	\$ 11,268,695	\$ 10,284,067	\$ 10,980,339	\$ 9,885,681
Average shareholders equity (3)	\$ 1,300,509	\$ 908,530	\$ 1,253,692	\$ 791,998
Return on average shareholders equity (3)	16.82%	12.92%	16.21%	14.22%
Book value per share (3)	\$ 25.55	\$ 20.89	\$ 25.55	\$ 20.89
Total equity to assets (4)	9.66%	7.54%	9.66%	7.54%
Originations:				
Consumer loans (1)	\$ 1,801,355	\$ 1,684,198	\$ 5,055,659	\$ 4,626,928
Mortgage loans (2)	15,548	2,016	27,003	21,326
Commercial loans	111,853	108,422	237,570	304,078
	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Total loan originations	\$ 1,928,756	\$ 1,794,636	\$ 5,320,232	\$ 4,952,332
	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Interest rate spread	5.06%	4.86%	5.04%	4.94%

(1) Net of unearned discounts.

(2) Net of undisbursed loan proceeds.

(3) Excludes other comprehensive loss.

(4) Excludes other comprehensive loss and includes minority interest.



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### **Critical Accounting Policies**

Management believes critical accounting policies are important to the portrayal of our financial condition and results of operations. Critical accounting policies require difficult and complex judgments because they rely on estimates about the effect of matters that are inherently uncertain due to the impact of changing market conditions. The following is a summary of accounting policies we consider critical.

#### ***Securitization Transactions***

Automobile contracts sold by us to our special purpose entity subsidiaries in connection with securitization transactions are treated as having been sold for bankruptcy purposes. The subsequent transfer of such automobile contracts to the securitization trust is treated as secured financing under Generally Accepted Accounting Principles, also known as GAAP. For GAAP purposes, the contracts are retained on the balance sheet with the securities issued to finance the automobile contracts recorded as notes payable on automobile secured financing. We record interest income on the securitized contracts and interest expense on the notes issued through the securitization transactions.

As servicer of these contracts, we may hold and remit funds collected from the borrowers on behalf of the trustee pursuant to reinvestment contracts that we have entered into or we may deliver funds to the relevant trustee to be held until the distribution dates, depending on the terms of our securitizations.

#### ***Allowance for Credit Losses***

Management determines the amount of the allowance for credit losses based on a review of various analyses. These analyses include trends in chargeoffs by credit tier over various time periods and at various statistical midpoints and high points, the severity of depreciated values of repossessions, trends in the number of days repossessions are held in inventory, trends in the number of contract modifications, trends in delinquency roll rates, trends in deficiency balance collections both internally and from collection agencies, trends in custom credit scores and the effectiveness of our custom credit scores, and trends in the economy generally or in specific geographic locations. Despite these analyses, we recognize that establishing allowance for credit losses is not an exact science and can be highly judgmental in nature.

The analysis of the adequacy of the allowance for credit losses is not only dependent upon effective quantitative and qualitative analyses, but also effective loan review and asset classification. We classify our assets in accordance with regulatory guidance. Our multifamily and commercial loan portfolios are evaluated individually while our single family and consumer portfolios are evaluated in pools. We classify our assets into five categories: Pass, Special Mention, Substandard, Doubtful and Loss. Based upon our asset classifications, we establish general and specific valuation allowances.

General valuation allowances are determined by applying various factors to loan balances that are classified as Pass, Special Mention, Substandard or Doubtful. Specific valuation allowances represent loan amounts that are classified as Loss. Some assets may be split into more than one asset classification due to fair value or net realizable value calculations.

All contracts that are 60 to 89 days delinquent are automatically classified as Special Mention. Real estate loans that are manifesting a weakness in performance are also classified as Special Mention. Any contract that is 90 or more days delinquent is automatically classified as Substandard. Real estate loans that are manifesting a significant weakness in performance are also classified as Substandard. Any multifamily loan that is impaired is classified as Substandard. Any contract where the borrower has filed for bankruptcy or where the vehicle has been repossessed by us and is subject to a redemption period is classified as Substandard, with the difference between the wholesale book

value and loan balance classified as Loss.

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The allowance for credit losses is increased by charging the provision for credit losses and decreased by actual losses on the loans or by reversing the allowance for credit losses through the provision for credit losses based on credit trends or economic conditions.

### ***Derivatives and Hedging Activities***

#### ***Deposits and Securities Sold Under Agreements to Repurchase***

We may enter into cash flow hedges that will protect against potential changes in interest rates affecting interest payments on future deposits gathered by us and future securities sold under agreements to repurchase. The fair value of the interest rate swap agreements is included in deposits and securities sold under agreements to repurchase, respectively, and any change in the fair value is reported as accumulated other comprehensive income (loss), net of tax, on our Consolidated Statements of Financial Condition. Related interest income or expense is settled on a quarterly basis and is recorded in accumulated other comprehensive income (loss) and reclassified into earnings in the period during which cash flows on the hedged items affect income.

#### ***Notes Payable on Automobile Secured Financing***

The contracts originated and held by us are fixed rate and, accordingly, we have exposure to changes in interest rates. To protect against potential changes in interest rates affecting interest payments on future securitization transactions, we may enter into various hedge agreements prior to closing the transaction. The market value of these hedge agreements is designed to respond inversely to changes in interest rates. Because of this inverse relationship, we can effectively lock in a gross interest rate spread at the time of entering into the hedge transaction. Gains and losses on these agreements are recorded in accumulated other comprehensive income (loss), net of tax, on our Consolidated Statements of Financial Condition. Any ineffective portion is recognized in interest expense during that period if the hedge is greater than 100% effective. Following the closing date of the securitization transaction, the gains or losses are amortized on a level yield basis over the duration of the notes issued.

If we issue variable rate notes payable in connection with our securitization activities, we may also enter into interest rate swap agreements in order to hedge our variable interest rate exposure on future interest payments. See

Quantitative and Qualitative Disclosure About Market Risk. The fair value of the interest rate swap agreements is included in notes payable on automobile secured financing, and any change in the fair value is reported as accumulated other comprehensive income (loss), net of tax, on our Consolidated Statements of Financial Condition. Any ineffective portion is recorded in interest expense during that period if the hedge is greater than 100% effective. Related interest income or expense is settled on a monthly or quarterly basis and recognized as an adjustment to interest expense in our Consolidated Statements of Income.

We may also enter into interest rate swap agreements or other derivatives that we choose not to designate as hedges or that do not qualify for hedge accounting under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, also known as SFAS No. 133. These derivatives pertain to variable rate notes issued in conjunction with the securitization of our contracts. Any change in the market value of such derivatives and income or expense recognized on such derivatives is recorded to noninterest income.

### **Proposed Acquisition and Merger**

On May 23, 2004, we entered into a definitive agreement pursuant to which we will acquire the outstanding 16% common stock minority interest of WFS not already owned by our wholly owned subsidiary, the Bank. The acquisition is structured as a merger of WFS with and into the Bank. The public holders of WFS shares will receive 1.11 shares of our common stock for each share of WFS common stock held by them in a tax-free exchange. Based on

the \$42.60 closing price of our common stock on May 21, 2004, the last business day prior to the execution of the agreement, the transaction has an indicated value of \$47.29 per share of WFS common stock. In connection with the merger, the Bank has filed an

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application with the California Department of Financial Institutions to convert its federal thrift charter to a California state bank charter. The merger agreement is conditioned upon the conversion of the charter. The transaction is subject to, among other closing conditions, the receipt of regulatory approvals and the approval of a majority of WFS Financial's shareholders, other than shares controlled by Westcorp.

The California Department of Financial Institutions and the Office of Thrift Supervision have approved the Bank's application to convert from a federal savings bank to a California state commercial bank subject to receipt of all other required regulatory approvals. The Federal Deposit Insurance Corporation approved the application to merge WFS into the Bank as part of the acquisition of the minority interest in WFS. The conversion is still contingent upon the approval of our application to become a bank holding company by the Board of Governors of the Federal Reserve. After the conversion, we will be subject to the laws, regulation and oversight of the California Department of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve. The merger is also subject to approval by the majority of WFS's minority shareholders.

We anticipate the merger of WFS with and into the Bank and the conversion of the Bank to a California state commercial bank will be completed sometime in the first quarter of 2005. We believe the combined company will provide greater flexibility in responding to market factors and will enable us to utilize, to a greater extent, the Bank's low cost customer deposits to finance our activities.

**Results of Operations**

***Net Interest Income***

Net interest income is affected by our interest rate spread, which is the difference between the rate earned on our interest earning assets and the rate paid on our interest bearing liabilities, and the relative amounts of our interest earning assets and interest bearing liabilities. Net interest income totaled \$206 million and \$597 million for the three and nine months ended September 30, 2004, respectively, compared with \$181 million and \$521 million for the same respective periods in 2003. The increase in net interest income was the result of us holding more contracts on balance sheet as well as wider net interest margins.

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The following table presents information relative to the average balances and interest rates for the periods indicated:

	<b>For the Three Months Ended September 30,</b>					
	<b>2004</b>			<b>2003</b>		
	<b>Average Balance</b>	<b>Interest</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Interest</b>	<b>Yield/ Rate</b>
	(Dollars in thousands)					
Interest earning assets:						
Total investments:						
Mortgage-backed securities	\$ 2,610,918	\$ 25,828	3.96%	\$ 2,516,193	\$ 15,936	2.53%
Other short-term investments	660,922	2,427	1.46	414,078	1,122	1.08
Investment securities	115,445	1,173	4.07	92,888	823	3.54
Interest earning deposits with others	5,668	14	0.98	6,803	11	0.70
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total investments	3,392,953	29,442	3.47	3,029,962	17,892	2.36
Total loans: (1)						
Consumer loans	11,461,360	287,806	9.99	10,463,303	288,138	10.93
Mortgage loans	174,927	2,181	4.99	239,544	3,204	5.35
Commercial loans	116,178	1,628	5.48	116,514	1,491	5.01
Construction loans	13,944	181	5.08	15,061	186	4.84
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total loans	11,766,409	291,796	9.87	10,834,422	293,019	10.73
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total interest earning assets	\$ 15,159,362	321,238	8.43	\$ 13,864,384	310,911	8.90
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Interest bearing liabilities:						
Deposits	\$ 2,083,963	15,101	2.88	\$ 1,968,859	15,695	3.16
Securities sold under agreements to repurchase				203,641	1,032	1.98
FHLB advances and other borrowings	509,385	1,947	1.50	515,980	1,689	1.29
	10,722,274	89,869	3.35	9,763,149	101,803	4.17

Notes payable on automobile secured financing Subordinated debentures	<u>321,990</u>	<u>8,093</u>	<u>10.05</u>	<u>394,804</u>	<u>9,829</u>	<u>9.96</u>
Total interest bearing liabilities	<u>\$ 13,637,612</u>	<u>115,010</u>	<u>3.37</u>	<u>\$ 12,846,433</u>	<u>130,048</u>	<u>4.04</u>
Net interest income and interest rate spread		<u>\$ 206,228</u>	<u>5.06%</u>		<u>\$ 180,863</u>	<u>4.86%</u>
Net yield on average interest earning assets			<u>5.40%</u>			<u>5.18%</u>

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(1) For the purpose of these computations, nonaccruing loans are included in the average loan amounts outstanding.

**Table of Contents****For the Nine Months Ended September 30,**

	2004			2003		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
<b>(Dollars in thousands)</b>						
Interest earning assets:						
Total investments:						
Mortgage-backed securities	\$ 2,593,595	\$ 72,666	3.74%	\$ 2,514,424	\$ 61,950	3.29%
Other short-term investments	638,409	5,840	1.22	321,429	2,949	1.23
Investment securities	123,329	3,354	3.63	69,116	2,213	4.27
Interest earning deposits with others	5,740	31	0.74	8,383	55	0.87
	<u>3,361,073</u>	<u>81,891</u>	<u>3.25</u>	<u>2,913,352</u>	<u>67,167</u>	<u>3.07</u>
Total loans: (1)						
Consumer loans	11,167,879	851,622	10.19	10,056,540	846,270	11.25
Mortgage loans	204,821	7,708	5.02	255,896	10,543	5.49
Commercial loans	106,169	4,371	5.41	111,044	4,020	4.77
Construction loans	7,817	288	4.83	9,595	336	4.63
	<u>11,486,686</u>	<u>863,989</u>	<u>10.05</u>	<u>10,433,075</u>	<u>861,169</u>	<u>11.03</u>
Total interest earning assets	<u>\$ 14,847,759</u>	<u>945,880</u>	<u>8.51</u>	<u>\$ 13,346,427</u>	<u>928,336</u>	<u>9.30</u>
Interest bearing liabilities:						
Deposits	\$ 2,026,245	42,291	2.79	\$ 1,981,146	50,269	3.39
Securities sold under agreements to repurchase	10,894	94	1.13	218,569	3,433	2.07
FHLB advances and other borrowings	614,882	6,015	1.29	444,529	4,775	1.45
Notes payable on automobile secured financing	10,377,881	272,678	3.50	9,426,038	319,136	4.51



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Subordinated debentures	<u>365,619</u>	<u>27,368</u>	<u>9.98</u>	<u>396,742</u>	<u>29,644</u>	<u>9.96</u>
Total interest bearing liabilities	<u>\$13,395,521</u>	<u>348,446</u>	<u>3.47</u>	<u>\$12,467,024</u>	<u>407,257</u>	<u>4.36</u>
Net interest income and interest rate spread		<u>\$597,434</u>	<u>5.04%</u>		<u>\$521,079</u>	<u>4.94%</u>
Net yield on average interest earning assets			<u>5.37%</u>			<u>5.25%</u>

(1) For the purpose of these computations, nonaccruing loans are included in the average loan amounts outstanding.

The total interest rate spread increased 20 basis points for the three months ended September 30, 2004 compared with the three months ended September 30, 2003 due to a decrease of 47 basis points in the yield on interest earning assets combined with a 67 basis point decrease in the cost of funds. The total interest rate spread increased 10 basis points for the nine months ended September 30, 2004 compared with the nine months ended September 30, 2003 due to a decrease of 79 basis points in the yield on interest earning assets combined with an 89 basis point decrease in the cost of funds. The decrease in the yield on interest earning assets and cost of funds in 2004 is primarily due to a lower interest rate environment.

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The following table sets forth the changes in net interest income attributable to changes in volume (change in average portfolio volume multiplied by prior period average rate) and changes in rates (change in weighted average interest rate multiplied by prior period average portfolio balance):

<b>For the Nine Months Ended September 30, 2004 Compared to the Nine Months Ended September 30, 2003 (1)</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
(Dollars in thousands)			
Increase (decrease) in interest income:			
Mortgage-backed securities	\$ 3,563	\$ 7,153	\$ 10,716
Other short-term investments	2,931	(40)	2,891
Investment securities	1,700	(559)	1,141
Interest earning deposits with others	(16)	(8)	(24)
Total loans:			
Consumer loans	117,968	(112,616)	5,352
Mortgage loans	(1,984)	(851)	(2,835)
Commercial loans	(264)	615	351
Construction loans	(70)	22	(48)
	<hr/>	<hr/>	<hr/>
Total interest income	\$ 123,828	\$ (106,284)	\$ 17,544
	<hr/>	<hr/>	<hr/>
Increase (decrease) in interest expense:			
Deposits	\$ 1,800	\$ (9,778)	\$ (7,978)
Securities sold under agreements to repurchase	(2,259)	(1,080)	(3,339)
FHLB advances and other borrowings	2,067	(827)	1,240
Notes payable on automobile secured financing	44,736	(91,194)	(46,458)
Subordinated debentures	(2,336)	60	(2,276)

	_____	_____	_____
Total interest expense	\$ 44,008	\$ (102,819)	\$ (58,811)
	<u>          </u>	<u>          </u>	<u>          </u>
Increase in net interest income			\$ 76,355
			<u>          </u>

- 
- (1) In the analysis of interest changes due to volume and rate, the changes due to the volume/rate variance (the combined effect of change in weighted average interest rate and change in average portfolio balance) have been allocated proportionately based on the absolute value of the volume and rate variances.

***Provision for Credit Losses***

We maintain an allowance for credit losses to cover probable losses that can be reasonably estimated for the loans held on the balance sheet. The level of allowance is based principally on the outstanding balance of loans held on balance sheet and historical loss trends. We believe that the allowance for credit losses is currently adequate to absorb probable losses in our loan portfolio that can be reasonably estimated. The provision for credit losses totaled \$60.3 million and \$174 million for the three and nine months ended September 30, 2004, respectively, compared with \$73.2 million and \$221 million for the same respective periods in 2003. The provision for credit losses declined as a result of improvement in chargeoffs due to an increase in the amount of prime credit contracts held by us and an improving economy.

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***Contract Securitizations***

The following table lists each of our public securitizations. All securitizations prior to 2000-D were paid in full on or before their contractual maturity dates and none of the remaining securitizations have yet reached their contractual maturity dates.

**Securitizations**

- 
- (1) Represents only the note payable amounts outstanding at the period indicated.
  - (2) Represents the difference between the original weighted average annual percentage rate, also known as the APR, and the estimated weighted average securitization rate on the closing date of the securitization.

**Table of Contents*****Noninterest Expense***

Noninterest expense totaled \$74.9 million and \$220 million for the three and nine months ended September 30, 2004, respectively, compared with \$66.7 million and \$208 million for the same respective periods in 2003. Noninterest expense as a percent of total revenues improved to 32% for both the three and nine months ended September 30, 2004, respectively, compared with 32% and 34% for the same respective periods in 2003 as a result of lower collection costs and operating efficiencies.

***Income Taxes***

We file federal and certain state tax returns as part of a consolidated group that includes the Bank and WFS. We file other state tax returns as a separate entity. Tax liabilities from the consolidated returns are allocated in accordance with a tax sharing agreement based on the relative income or loss of each entity on a stand-alone basis. Our effective tax rate was 40% for both the three and nine months ended September 30, 2004 and for the same respective periods in 2003.

**Financial Condition*****Overview***

Total assets increased \$736 million or 5.0% to \$15.4 billion at September 30, 2004 from \$14.6 billion at December 31, 2003. The increase is due primarily to an increase in automobile contracts originated.

***Loan Portfolio***

The following table presents a summary of our automobile contracts purchased:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Dollars in thousands)</b>			
New vehicles	\$ 626,272	\$ 586,648	\$1,795,921	\$1,462,024
Pre-owned vehicles	1,172,834	1,096,754	3,255,200	3,160,047
Total volume	\$1,799,106	\$1,683,402	\$5,051,121	\$4,622,071
Prime	\$1,434,280	\$1,406,674	\$4,096,399	\$3,829,825
Non-prime	364,826	276,728	954,722	792,246
Total volume	\$1,799,106	\$1,683,402	\$5,051,121	\$4,622,071

*Commercial Loan Portfolio*

We had outstanding commercial loan commitments of \$283 million at September 30, 2004 compared with \$225 million at December 31, 2003. We originated \$112 million and \$238 million of commercial loans for the three and nine months ended September 30, 2004, respectively, compared with \$108 million and \$304 million for the same respective periods in 2003. Amounts outstanding at September 30, 2004 and December 31, 2003 were \$107 million and \$124 million, respectively.

**Table of Contents****Asset Quality***Overview*

Nonperforming assets, repossessions, loan delinquency and credit losses are considered by us as key measures of asset quality. Asset quality, in turn, affects our determination of the allowance for credit losses. We also take into consideration general economic conditions in the markets we serve, individual loan reviews, and the level of assets relative to reserves in determining the adequacy of the allowance for credit losses.

*Automobile Contract Quality*

We provide financing in a market where there is a risk of default by borrowers. Chargeoffs directly impact our earnings and cash flows. To minimize the amount of credit losses we incur, we monitor delinquent accounts, promptly repossess and remarket vehicles, and seek to collect on deficiency balances.

We calculate delinquency based on the contractual due date. The improvement in delinquency is primarily the result of improvements in the economy and normal seasonal trends.

The following table sets forth information with respect to the delinquency of our portfolio of contracts:

	<b>September 30, 2004</b>		<b>December 31, 2003</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
	<b>(Dollars in thousands)</b>			
Contracts managed at end of period	<u>\$11,440,352</u>		<u>\$10,596,665</u>	
Period of delinquency				
30-59 days	\$ 183,463	1.60%	\$ 219,937	2.08%
60 days or more (1)	<u>73,126</u>	<u>0.64</u>	<u>87,129</u>	<u>0.82</u>
Total contracts delinquent and delinquencies as a percentage of contracts managed (1)	<u>\$ 256,589</u>	<u>2.24%</u>	<u>\$ 307,066</u>	<u>2.90%</u>

(1) Excludes Chapter 13 bankruptcy accounts greater than 120 days past due of \$45.4 million at September 30, 2004 and \$45.6 million at December 31, 2003.

The following table sets forth information with respect to repossessions in our portfolio of managed contracts:

	<b>September 30, 2004</b>		<b>December 31, 2003</b>	
	<b>Number of Contracts</b>	<b>Amount</b>	<b>Number of Contracts</b>	<b>Amount</b>

	<b>(Dollars in thousands)</b>			
Contracts managed	869,036	\$11,440,352	826,122	\$10,596,665
Repossessed vehicles	885	\$ 6,601	1,522	\$ 10,331
Repossessed vehicles as a percentage of number and amount of contracts outstanding	0.10%	0.06%	0.18%	0.10%



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The following table sets forth information with respect to actual credit loss experience on our portfolio of managed contracts. Net chargeoffs declined as a result of an improving economy.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Average contracts managed during period	\$ 11,268,696	\$ 10,284,067	\$ 10,980,339	\$ 9,885,681
Gross chargeoffs	\$ 76,688	\$ 88,343	\$ 232,395	\$ 258,491
Recoveries	21,791	21,916	69,408	66,451
Net chargeoffs	\$ 54,897	\$ 66,427	\$ 162,987	\$ 192,040
Net chargeoffs as a percentage of average contracts managed during period	1.95%	2.58%	1.98%	2.59%

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The following table sets forth the cumulative static pool losses by month for all outstanding public securitized pools:

**Cumulative Static Pool Loss Curves  
At September 30, 2004**

Period (1)	2000-D	2001-A	2001-B	2001-C	2002-1	2002-2	2002-3	2002-4	2003-1	2003-2	2003-3	2003-4	2004-1	2004-2	2004-3
	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
	0.04%	0.03%	0.03%	0.04%	0.01%	0.00%	0.02%	0.02%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%	0.02%
	0.11%	0.09%	0.10%	0.09%	0.06%	0.03%	0.06%	0.07%	0.04%	0.02%	0.02%	0.03%	0.02%	0.03%	0.05%
	0.24%	0.20%	0.21%	0.20%	0.15%	0.10%	0.14%	0.16%	0.11%	0.06%	0.06%	0.08%	0.06%	0.07%	0.10%
	0.39%	0.33%	0.33%	0.35%	0.29%	0.18%	0.27%	0.26%	0.18%	0.14%	0.13%	0.14%	0.11%	0.15%	0.18%
	0.54%	0.50%	0.50%	0.49%	0.43%	0.32%	0.44%	0.38%	0.29%	0.25%	0.23%	0.21%	0.19%	0.22%	0.25%
	0.74%	0.70%	0.69%	0.65%	0.60%	0.49%	0.57%	0.50%	0.41%	0.36%	0.32%	0.28%	0.27%	0.30%	0.33%
	0.93%	0.84%	0.87%	0.81%	0.84%	0.66%	0.70%	0.61%	0.53%	0.48%	0.40%	0.35%	0.34%	0.37%	0.40%
	1.13%	1.04%	1.05%	0.95%	1.06%	0.82%	0.82%	0.78%	0.66%	0.59%	0.47%	0.44%	0.43%	0.46%	0.49%
	1.34%	1.24%	1.22%	1.07%	1.28%	0.96%	0.96%	0.94%	0.80%	0.70%	0.55%	0.54%	0.53%	0.56%	0.59%
	1.50%	1.45%	1.36%	1.20%	1.48%	1.10%	1.10%	1.08%	0.93%	0.80%	0.62%	0.61%	0.60%	0.63%	0.66%
	1.74%	1.67%	1.53%	1.37%	1.67%	1.26%	1.24%	1.28%	1.06%	0.89%	0.71%	0.70%	0.69%	0.72%	0.75%
	1.95%	1.90%	1.67%	1.55%	1.82%	1.39%	1.38%	1.43%	1.21%	0.98%	0.80%	0.79%	0.78%	0.81%	0.84%
	2.21%	2.09%	1.81%	1.74%	1.99%	1.51%	1.53%	1.59%	1.31%	1.08%	0.88%	0.87%	0.86%	0.89%	0.92%
	2.48%	2.25%	2.00%	1.97%	2.14%	1.68%	1.70%	1.77%	1.40%	1.20%	1.00%	0.99%	0.98%	1.01%	1.04%
	2.71%	2.41%	2.19%	2.16%	2.27%	1.83%	1.88%	1.92%	1.50%	1.31%	1.10%	1.09%	1.08%	1.11%	1.14%
	2.89%	2.54%	2.37%	2.36%	2.45%	1.99%	2.03%	2.05%	1.60%	1.41%	1.20%	1.19%	1.18%	1.21%	1.24%
	3.08%	2.73%	2.60%	2.59%	2.62%	2.16%	2.15%	2.16%	1.70%	1.50%	1.30%	1.29%	1.28%	1.31%	1.34%
	3.22%	2.93%	2.80%	2.78%	2.80%	2.31%	2.28%	2.25%	1.85%	1.65%	1.45%	1.44%	1.43%	1.46%	1.49%
	3.40%	3.11%	3.01%	2.95%	2.99%	2.46%	2.41%	2.37%	1.99%	1.79%	1.59%	1.58%	1.57%	1.60%	1.63%
	3.59%	3.34%	3.19%	3.14%	3.15%	2.60%	2.52%	2.49%	2.19%	1.99%	1.79%	1.78%	1.77%	1.80%	1.83%
	3.78%	3.54%	3.34%	3.29%	3.31%	2.72%	2.62%	2.62%	2.39%	2.19%	1.99%	1.98%	1.97%	2.00%	2.03%
	3.96%	3.72%	3.49%	3.41%	3.45%	2.86%	2.74%	2.73%	2.59%	2.39%	2.19%	2.18%	2.17%	2.20%	2.23%
	4.18%	3.92%	3.62%	3.57%	3.58%	2.95%	2.83%	2.82%	2.79%	2.59%	2.39%	2.38%	2.37%	2.40%	2.43%
	4.41%	4.10%	3.75%	3.73%	3.69%	3.03%	2.96%	2.95%	2.92%	2.72%	2.52%	2.51%	2.50%	2.53%	2.56%
	4.58%	4.23%	3.87%	3.88%	3.80%	3.13%	3.08%	3.07%	3.04%	2.84%	2.64%	2.63%	2.62%	2.65%	2.68%
	4.79%	4.36%	4.00%	4.04%	3.92%	3.22%	3.17%	3.16%	3.13%	2.93%	2.73%	2.72%	2.71%	2.74%	2.77%
	4.96%	4.47%	4.15%	4.20%	4.02%	3.33%	3.28%	3.27%	3.24%	3.04%	2.84%	2.83%	2.82%	2.85%	2.88%
	5.08%	4.56%	4.28%	4.35%	4.12%	3.41%	3.36%	3.35%	3.32%	3.12%	2.92%	2.91%	2.90%	2.93%	2.96%
	5.22%	4.67%	4.40%	4.46%	4.22%	3.51%	3.46%	3.45%	3.42%	3.22%	3.02%	3.01%	3.00%	3.03%	3.06%
	5.34%	4.81%	4.52%	4.57%	4.30%	3.60%	3.55%	3.54%	3.51%	3.31%	3.11%	3.10%	3.09%	3.12%	3.15%
	5.44%	4.92%	4.64%	4.69%	4.42%	3.69%	3.64%	3.63%	3.60%	3.40%	3.20%	3.19%	3.18%	3.21%	3.24%
	5.54%	5.04%	4.73%	4.77%	4.50%	3.78%	3.73%	3.72%	3.69%	3.49%	3.29%	3.28%	3.27%	3.30%	3.33%
	5.66%	5.13%	4.83%	4.85%	4.58%	3.87%	3.82%	3.81%	3.78%	3.58%	3.38%	3.37%	3.36%	3.39%	3.42%
	5.76%	5.24%	4.93%	4.92%	4.65%	3.96%	3.91%	3.90%	3.87%	3.67%	3.47%	3.46%	3.45%	3.48%	3.51%
	5.86%	5.31%	4.99%	5.01%	4.74%	4.05%	4.00%	3.99%	3.96%	3.76%	3.56%	3.55%	3.54%	3.57%	3.60%
	5.97%	5.39%	5.05%	5.09%	4.82%	4.14%	4.09%	4.08%	4.05%	3.85%	3.65%	3.64%	3.63%	3.66%	3.69%
	6.04%	5.45%	5.11%	5.16%	4.89%	4.23%	4.18%	4.17%	4.14%	3.94%	3.74%	3.73%	3.72%	3.75%	3.78%
	6.12%	5.50%	5.17%	5.22%	4.95%	4.32%	4.27%	4.26%	4.23%	4.03%	3.83%	3.82%	3.81%	3.84%	3.87%
	6.19%	5.56%	5.24%	5.29%	5.02%	4.41%	4.36%	4.35%	4.32%	4.12%	3.92%	3.91%	3.90%	3.93%	3.96%

6.25% 5.61% 5.29%  
 6.28% 5.66%  
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ime  
 ix (2)

68% 71% 71% 76% 70% 87% 85% 80% 80% 82% 84% 82% 82% 82% 81

- (1) Represents the number of months since the inception of the securitization.
- (2) Represents the original percentage of prime automobile contracts securitized within each pool.

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*Real Estate Loan Quality*

We had 0.72% of total mortgage loans past due over 60 days at September 30, 2004 compared with 1.25% of total mortgage loans at December 31, 2003. The decrease in total mortgage loans past due over 60 days at September 30, 2004 is due to an improving economy.

*Nonperforming Assets*

Nonperforming loans, also known as NPLs, are defined as all nonaccrual loans. This includes mortgage loans 90 days or more past due, impaired loans where full collection of principal and interest is not reasonably assured and Chapter 13 bankruptcy accounts that are contractually past due over 120 days. For those accounts that are in Chapter 13 bankruptcy and are contractually past due over 120 days, all accrued interest is reversed and income is recognized on a cash basis. When a loan is designated as nonaccrual, all previously accrued but unpaid interest is reversed. Interest on NPLs excluded from interest income was \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2004, respectively, compared with \$0.9 million and \$2.5 million for the same respective periods in 2003.

Nonperforming assets, also known as NPAs, consist of NPLs, repossessed automobiles and real estate owned, also known as REO. Repossessed automobiles and REO are carried at lower of cost or fair value. NPAs decreased \$5.2 million to \$58.4 million at September 30, 2004 compared with \$63.6 million at December 31, 2003. The decrease in the NPAs was primarily due to a \$3.7 million decrease in repossessed automobiles. NPAs represented 0.4% of total assets at both September 30, 2004 and December 31, 2003. There were no impaired loans at September 30, 2004 and December 31, 2003.

*Allowance for Credit Losses*

Our allowance for credit losses was \$312 million at September 30, 2004 compared to \$302 million at December 31, 2003. Net chargeoffs totaled \$55.4 million and \$164 million for the three and nine months ended September 30, 2004, respectively, compared with \$66.3 million and \$192 million for the same respective periods in 2003. The increase in the allowance for credit losses was the result of a higher level of automobile contracts held on balance sheet. The allowance for credit losses as a percentage of owned loans outstanding was 2.6% at September 30, 2004 compared with 2.7% at December 31, 2003. Based on the analysis we performed related to the allowance for credit losses as described under Critical Accounting Policies, we believe that our allowance for credit losses is currently adequate to cover probable losses in our loan portfolio that can be reasonably estimated.

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The following table presents summarized data relative to the allowance for credit and real estate owned losses at the dates indicated:

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
Total loans (1)	\$11,935,998	\$11,138,483
Allowance for credit losses	312,222	301,602
Allowance for real estate owned losses	100	100
Loans past due 60 days or more (2)	74,678	91,381
Nonperforming loans (3)	51,355	53,026
Nonperforming assets (4)	58,363	63,600
Allowance for credit losses as a percent of:		
Total loans (1)	2.6%	2.7%
Loans past due 60 days or more	418.1%	330.0%
Nonperforming loans	608.0%	568.8%
Total allowance for credit losses and REO losses as a percent of nonperforming assets	535.1%	474.4%
Nonperforming loans as a percent of total loans	0.4%	0.5%
Nonperforming assets as a percent of total assets	0.4%	0.4%

- (1) Loans net of unearned interest and undisbursed loan proceeds.
- (2) Excludes nonaccrual Chapter 13 bankruptcy accounts.
- (3) All nonperforming loans are on nonaccrual.
- (4) Nonperforming loans, repossessed automobiles and real estate owned, net of allowance.

**Deposits**

We attract both short-term and long-term deposits from the general public, commercial enterprises and institutions by offering a variety of accounts and rates. We offer regular passbook accounts, demand deposit accounts, money market accounts, certificate of deposit accounts and individual retirement accounts. Our retail banking division gathers deposits from 20 retail branch locations throughout Southern California. Our commercial banking division gathers deposits by establishing commercial relationships with businesses located throughout Southern California.

The following table sets forth the amount of our deposits by type at the dates indicated:

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
No minimum term:		
Demand deposit accounts	\$ 862	\$ 1,145
Passbook accounts	6,102	7,282
Money market accounts	1,219,918	963,004

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Noninterest bearing deposits	238,505	210,405
	<u>          </u>	<u>          </u>
Core deposits	1,465,387	1,181,836
Certificate accounts:		
Certificates (30 days to five years)	523,905	646,868
Individual retirement accounts	66,843	81,701
Brokered deposits	52,533	62,451
	<u>          </u>	<u>          </u>
	<u>\$2,108,668</u>	<u>\$1,972,856</u>

The variety of deposits we offer has allowed us to remain competitive in obtaining funds and provided us the flexibility to respond to changes in customer demand and competitive pressures. Generally, as other financial institutions, we have become more subject to short-term fluctuations in deposit flows as customers have become more interest rate conscious. Our ability to attract and maintain deposits and control our cost of funds has been, and will continue to be, significantly affected by market conditions.

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### **Capital Resources and Liquidity**

#### ***Overview***

We require substantial capital resources and cash to support our business. Our ability to maintain positive cash flows from operations is the result of our consistent managed growth, favorable loss experience and our efficient operations.

#### ***Principal Sources of Cash***

*Automobile Contract Securitizations* Securitizations totaled \$1.6 billion and \$4.5 billion for the three and nine months ended September 30, 2004, respectively, compared with \$1.7 billion and \$4.5 billion for the same respective periods in 2003.

*Collections of Principal and Interest from Loans and MBS and Release of Cash from Spread Accounts* The collection of principal and interest from contracts originated and securitized and the release of cash from spread accounts is another significant source of funds for us. Principal and interest collections on loans and MBS totaled \$1.2 billion and \$4.0 billion for the three and nine months ended September 30, 2004, respectively, compared with \$1.8 billion and \$5.2 billion for the same respective periods in 2003. The decrease in the principal and interest collections is due to principal and interest on our senior/subordinated securitizations being held at the trustee in collection and spread accounts until certain predetermined levels are reached.

*Deposits* Deposits were \$2.1 billion at September 30, 2004 and \$2.0 billion at December 31, 2003.

*Other Borrowings* Other borrowings, which include securities sold under agreements to repurchase and FHLB advances, increased to \$871 million at September 30, 2004 from \$551 million at December 31, 2003.

*Subordinated Debentures* In 1997 and 2002, we issued \$150 million of 8.875% and \$300 million of 9.625% subordinated capital debentures due in 2007 and 2012, respectively. At September 30, 2004 there was \$300 million outstanding on the subordinated debenture due in 2012, excluding discounts and issue costs. On August 1, 2004, we redeemed the outstanding balance of our \$150 million, 8.875% subordinated debentures due 2007 at par plus accrued but unpaid interest to the redemption date.

#### ***Principal Uses of Cash***

*Acquisition of Loans and Investment Securities* Loan originations totaled \$1.9 billion and \$5.3 billion for the three and nine months ended September 30, 2004, respectively, compared with \$1.8 billion and \$5.0 billion for the same respective periods in 2003. We purchased \$252 million and \$1.0 billion of mortgage-backed securities and other investment securities during the three and nine months ended September 30, 2004, respectively, compared with \$743 million and \$1.8 billion for the same respective periods in 2003.

*Payments of Principal and Interest on Securitizations* Payments of principal and interest to noteholders and certificateholders totaled \$1.7 billion and \$4.6 billion for the three and nine months ended September 30, 2004, respectively, compared with \$1.3 billion and \$3.7 billion for the same respective periods in 2003.

*Amounts Paid to Dealers* Participation paid by us to dealers was \$42.3 million and \$117 million for the three and nine months ended September 30, 2004, respectively, compared with \$39.6 million and \$109 million for the same respective periods in 2003.

*Operating Our Business* Noninterest expenses totaled \$74.9 million and \$220 million for the three and nine months ended September 30, 2004, respectively, compared with \$66.7 million and \$208 million for the same

respective periods in 2003.



**Table of Contents****Capital Requirements**

The Bank is a federally chartered savings bank. As such, it is subject to certain minimum capital requirements imposed by the Financial Institutions Reform, Recovery and Enforcement Act, also known as FIRREA and the Federal Deposit Insurance Corporation Improvement Act, also known as FDICIA. FDICIA separates all financial institutions into one of five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. In order to be considered well capitalized, an institution must have a total risk-based capital ratio of 10.0% or greater, a tier 1 or core risk-based capital ratio of 6.0% or greater, a leverage ratio of 5.0% or greater and not be subject to any Office of Thrift Supervision order. The Bank currently meets all of the requirements of a well capitalized institution.

The following table summarizes the Bank's actual capital and required capital as of September 30, 2004 and December 31, 2003:

	<b>Tangible Capital</b>	<b>Core Capital</b>	<b>Tier 1 Risk-Based Capital</b>	<b>Risk-Based Capital</b>
	<b>(Dollars in thousands)</b>			
<b>September 30, 2004</b>				
Actual Capital:				
Amount	\$1,033,691	\$1,033,691	\$1,030,680	\$1,449,391
Capital ratio	8.10%	8.10%	10.56%	14.85%
FIRREA minimum required capital:				
Amount	\$ 191,365	\$ 382,729	N/A	\$ 780,695
Capital ratio	1.50%	3.00%	N/A	8.00%
Excess	\$ 842,326	\$ 650,962	N/A	\$ 668,696
FDICIA well capitalized required capital:				
Amount	N/A	\$ 637,882	\$ 585,521	\$ 975,869
Capital ratio	N/A	5.00%	6.00%	10.00%
Excess	N/A	\$ 395,809	\$ 445,159	\$ 473,523
<b>December 31, 2003</b>				
Actual Capital:				
Amount	\$ 884,536	\$ 884,536	\$ 881,517	\$1,357,744
Capital ratio	7.06%	7.06%	9.20%	14.17%
FIRREA minimum required capital:				
Amount	\$ 187,923	\$ 375,845	N/A	\$ 766,665
Capital ratio	1.50%	3.00%	N/A	8.00%
Excess	\$ 696,613	\$ 508,691	N/A	\$ 591,079
FDICIA well capitalized required capital:				
Amount	N/A	\$ 626,409	\$ 574,999	\$ 958,332
Capital ratio	N/A	5.00%	6.00%	10.00%
Excess	N/A	\$ 258,127	\$ 306,518	\$ 399,412



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The following table reconciles the Bank's capital in accordance with GAAP to the Bank's tangible, core and risk-based capital:

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(Dollars in thousands)</b>	
Bank shareholder's equity - GAAP basis	\$ 835,191	\$ 685,045
Plus: Net unrealized losses	40,602	68,203
Plus: Minority interest in equity of subsidiaries	158,045	131,434
Less: Non-permissible activities	(147)	(146)
	<hr/>	<hr/>
Total tangible and core capital	1,033,691	884,536
Adjustments for risk-based capital:		
Subordinated debentures (1)	295,599	355,370
General loan valuation allowance (2)	123,112	120,857
Low-level recourse deduction	(3,011)	(3,019)
	<hr/>	<hr/>
Risk-based capital	<b>\$1,449,391</b>	<b>\$1,357,744</b>

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(1) Excludes capitalized discounts and issue costs.

(2) Limited to 1.25% of risk-weighted assets.

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**Item 3. Quantitative and Qualitative Disclosure About Market Risk**

Fluctuations in interest rates and early prepayment of contracts are the primary market risks facing us. Our Credit and Pricing Committee is responsible for setting credit and pricing policies and for monitoring credit quality. Our Asset/Liability Committee is responsible for the management of interest rate and prepayment risks. Asset/liability management is the process of measuring and controlling interest rate risk through matching the maturity and repricing characteristics of interest earning assets with those of interest bearing liabilities.

The Asset/Liability Committee closely monitors interest rate and prepayment risks and recommends policies for managing such risks. The primary measurement tool for evaluating this risk is the use of interest rate shock analysis. This analysis simulates the effects of an instantaneous and sustained change in interest rates (in increments of 100 basis points) on our assets and liabilities and measures the resulting increase or decrease to our net portfolio value, also known as NPV. NPV is the discounted value of the future cash flows (or paths of cash flows in the presence of options based on volatility assumptions and an arbitrage free Monte Carlo simulation method to achieve the current market price) of all assets minus all liabilities whose value is affected by interest rate changes plus the book value of non-interest rate sensitive assets minus the book value of non-interest rate sensitive liabilities. It should be noted that shock analysis is objective but not entirely realistic in that it assumes an instantaneous and isolated set of events. The NPV ratio is the ratio of the NPV to the market value of our assets as calculated above. In general, an increase in interest rates would more adversely affect our NPV than would a decrease in interest rates.

Another important measurement of our interest rate risk is gap analysis. Gap is defined as the difference between the amount of interest sensitive assets that reprice versus the amount of interest sensitive liabilities that also reprice within a defined period of time. We have more interest sensitive liabilities rather than assets repricing in shorter term maturity buckets and more interest sensitive assets rather than liabilities repricing in longer term maturity buckets.

The Asset/Liability Committee monitors our hedging activities to ensure that the value of hedges, their correlation to the contracts being hedged and the amounts being hedged continue to provide effective protection against interest rate risk. The amount and timing of hedging transactions are determined by our senior management based upon the monitoring activities of the Asset/Liability Committee. As a result of our approach to interest rate risk management and our hedging strategies, we do not anticipate that changes in interest rates will materially affect our results of operations or liquidity, although we can provide no assurance in this regard. There were no material changes in market risks in the current quarter.

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The following table summarizes our maturity GAP position:

**Interest Rate Sensitivity Analysis at September 30, 2004**

	<b>Within 3 Months</b>	<b>3 Months to 1 Year</b>	<b>1 Year to 3 Years</b>	<b>3 Years to 5 Years</b>	<b>After 5 Years</b>	<b>Total</b>
(Dollars in thousands)						
Interest earning assets:						
Investment securities	\$ 57,305		\$ 50,069			\$ 107,374
Other investments	545,629					545,629
Mortgage-backed securities	683,153	\$1,145,691	554,724	\$ 166,526	\$ 120,250	2,670,344
Total investments	1,286,087	1,145,691	604,793	166,526	120,250	3,323,347
Consumer loans (1)	817,615	3,208,741	5,487,367	2,043,162	80,202	11,637,087
Mortgage loans:						
Adjustable rate (2)	162,382	4,798				167,180
Fixed rate (2)	1,068	2,559	3,811	1,684	1,246	10,368
Construction loans (2)	14,540					14,540
Commercial loans (2)	106,781	42				106,823
Total interest earning assets	2,388,473	4,361,831	6,095,971	2,211,372	201,698	15,259,345
Interest bearing liabilities:						
Deposits:						
Passbook accounts	6,102					6,102
Demand deposit and money market accounts	1,220,780					1,220,780
Certificate accounts (3)	237,286	391,014	14,320	661		643,281
Notes payable on automobile secured financing (3)	2,508,615	2,854,311	4,258,083	794,142		10,415,151
FHLB advances (3)	868,107				2,551	870,658
Subordinated debentures (3)					295,053	295,053
Other borrowings (3)	8,695					8,695

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Total interest bearing liabilities	<u>4,849,585</u>	<u>3,245,325</u>	<u>4,272,403</u>	<u>794,803</u>	<u>297,604</u>	<u>13,459,720</u>
Excess interest earning/bearing assets (liabilities)	(2,461,112)	1,116,506	1,823,568	1,416,569	(95,906)	1,799,625
Effect of hedging activities (4)	<u>1,431,520</u>	<u>(157,587)</u>	<u>(640,208)</u>	<u>(433,725)</u>	<u>(200,000)</u>	
Hedged (deficit) excess	<u>\$ (1,029,592)</u>	<u>\$ 958,919</u>	<u>\$ 1,183,360</u>	<u>\$ 982,844</u>	<u>\$ (295,906)</u>	<u>\$ 1,799,625</u>
Cumulative (deficit) excess	<u>\$ (1,029,592)</u>	<u>\$ (70,673)</u>	<u>\$ 1,112,687</u>	<u>\$ 2,095,531</u>	<u>\$ 1,799,625</u>	<u>\$ 1,799,625</u>
Cumulative (deficit) excess as a percentage of total interest earning assets	<u>(6.75)%</u>	<u>(0.46)%</u>	<u>7.29%</u>	<u>13.73%</u>	<u>11.79%</u>	<u>11.79%</u>

(1) Based on contractual maturities adjusted by our historical prepayment rate.

(2) Based on interest rate repricing adjusted for projected prepayments.

(3) Based on contractual maturity.

(4) Includes effect of interest rate swaps designated against deposits.

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**Item 4. Controls and Procedures**

Disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operations of our disclosure controls and procedures within 90 days of the filing date of this quarterly report. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective. There has been no significant change in our internal controls or in other factors that could significantly affect the controls and procedures subsequent to the date of their evaluation.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We or our subsidiaries are involved as a party to certain legal proceedings incidental to our business, including *Lee, et al. v. WFS Financial Inc*, United States District Court, Middle District of Tennessee at Nashville, No. 3-02-0570 filed June 17, 2002 (a putative class action raising claims under the Equal Credit Opportunity Act) and *Thompson, et al. v. WFS Financial Inc*, California Superior Court, County of Alameda Civil Action No, RG03088926, appeal pending in the Court of Appeal of the State of California, First Appellate District, Division One, No. A104967 (a putative class action raising claims under California's Unfair Competition Law and related claims). WFS has reached a settlement in *Lee, et al. v. WFS Financial Inc* and *Thompson, et al. v. WFS Financial Inc* cases. The settlements will be final after court approval of the settlement in *Lee, et al. v. WFS Financial Inc*. We do not believe that the outcome of these proceedings will have a material effect upon our financial condition, results of operations and cash flows.

Beginning on May 24, 2004 and continuing thereafter, a total of four separate purported class action lawsuits relating to the announcement by Westcorp and WFS that Westcorp was commencing an exchange offer for the outstanding public shares of WFS were filed in the Orange County, California Superior Court against Westcorp, WFS, and individual board members of Westcorp and WFS. On June 24, 2004, the actions were consolidated under the caption *In re WFS Financial Shareholder Litigation*, Case No. 04CC00559. On July 16, 2004, the court granted a motion by plaintiff Alaska Hotel & Restaurant Employees Pension Trust Fund, in Case No.04CC00573, to amend the consolidation order to designate it the lead plaintiff in the litigation. Lead plaintiff filed a consolidated amended complaint on August 9, 2004, and then filed the present corrected consolidated amended complaint on September 15, 2004. All of the defendants have filed demurrers challenging the legal sufficiency of the pending complaint, which are scheduled for hearing. All of the shareholder-related actions allege, among other things, that the defendants breached their respective fiduciary duties and seek to enjoin or rescind the transaction and obtain an unspecified sum in damages and costs, including attorneys' fees and expenses. We are vigorously defending this action and do not believe that the outcome of this proceeding will have a material effect upon our financial condition, results of operations and cash flows.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

None



**Item 5. Other Information**

None

**Table of Contents****Item 6. Exhibits and Reports on Form 8-K****(a) Exhibits**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
2.1	Agreement and Plan of Merger and Reorganization, dated as of May 23, 2004, among Westcorp, Western Financial Bank and WFS Financial Inc (1)
3.1	Articles of Incorporation (2)
3.1.1	Certificate of Amendment of the Articles of Incorporation of Westcorp as filed May 14, 2001 (3)
3.1.2	Certificate of Amendment of the Articles of Incorporation of Westcorp as filed May 19, 2004 (1)
3.2	Bylaws (2)
4.1	Indenture dated as of July 1, 1997 issued by Western Financial Bank, formerly Western Financial Savings Bank, F.S.B., with respect to \$150,000,000 in aggregate principal amount of 8.875% Subordinated Capital Debentures due 2007 (4)
4.2	Indenture dated as of May 1, 2002 issued by Western Financial Bank, formerly Western Financial Savings Bank, F.S.B., with respect to \$300,000,000 in aggregate principal amount of 9.625% Subordinated Capital Debentures due 2012 (5)
31.1	Section 302 Certification of CEO
31.2	Section 302 Certification of CFO
32.1	Section 906 Certification of CEO
32.2	Section 906 Certification of CFO

- (1) Exhibit previously filed with Westcorp Registration Statement on Form S-4 (File No. 333-117424), filed July 16, 2004, incorporated herein by reference under Exhibit Number indicated.
- (2) Exhibits previously filed with Westcorp Registration Statement on Form S-4 (File No. 33-34286), filed April 11, 1990 incorporated herein by reference under the Exhibit Number indicated.
- (3) Exhibit previously filed with Annual Report on Form 10-K of Westcorp for the year ended December 31, 2003 as filed on or about March 12, 2004 incorporated herein by reference.
- (4) Exhibit previously filed with Annual Report on Form 10-K of Westcorp for the year ended December 31, 1997 as filed on or about March 29, 1998 incorporated herein by reference.
- (5) Exhibit previously filed with Annual Report on Form 10-K of Westcorp for the year ended December 31, 2002 as filed on or about March 29, 2003 incorporated herein by reference.

**(b) Reports on Form 8-K**

Westcorp press release on July 21, 2004

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Westcorp**

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(Registrant)

Date: November 8, 2004

By: /s/ ERNEST S. RADY

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Ernest S. Rady  
Chairman of the Board and Chief Executive  
Officer

Date: November 8, 2004

By: /s/ LEE A. WHATCOTT

---

Lee A. Whatcott  
Executive Vice President, Chief Financial Officer  
and Chief Operating Officer (Principal Financial  
and Accounting Officer)

**Table of Contents****Exhibit Index**

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