

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

FORM 10-Q

(Mark one)

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2000

or

**[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from N/A to N/A

Commission File Number: 333-28037

Golden State Bancorp Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-4642135

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

135 Main Street, San Francisco, CA

(Address of principal executive offices)

94105

(Zip Code)

415-904-1100

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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.
X Yes ___ No

The number of shares outstanding of registrant's \$1.00 par value common stock, as of the close of business on October 31, 2000: 134,238,004 shares.

GOLDEN STATE BANCORP INC.
THIRD QUARTER 2000 REPORT ON FORM 10-Q
TABLE OF CONTENTS

	<u>Page</u>
PART I. <u>FINANCIAL INFORMATION</u>	
Item 1. Consolidated Financial Statements	
Unaudited Consolidated Balance Sheets	
September 30, 2000 and December 31, 1999.....	3
Unaudited Consolidated Statements of Income	
Nine Months Ended September 30, 2000 and 1999.....	4
Unaudited Consolidated Statements of Income	
Three Months Ended September 30, 2000 and 1999.....	5
Unaudited Consolidated Statements of Comprehensive Income	
Nine Months Ended September 30, 2000 and 1999.....	6
Unaudited Consolidated Statements of Comprehensive Income	
Three Months Ended September 30, 2000 and 1999.....	7
Unaudited Consolidated Statements of Stockholders' Equity	
Nine Months Ended September 30, 2000.....	8
Unaudited Consolidated Statements of Cash Flows	
Nine Months Ended September 30, 2000 and 1999.....	9
Notes to Unaudited Consolidated Financial Statements.....	11
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	23
Item 3. Quantitative and Qualitative Disclosures About Market Risk.....	49
PART II. <u>OTHER INFORMATION</u>	
Item 1. Legal Proceedings.....	50
Item 2. Changes in Securities.....	50
Item 3. Defaults Upon Senior Securities.....	50
Item 4. Submission of Matters to a Vote of Security Holders.....	50
Item 5. Other Information.....	50
Item 6. Exhibits and Reports on Form 8-K.....	51
Signatures.....	52

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Balance Sheets
September 30, 2000 and December 31, 1999
(Unaudited)
(dollars in thousands, except per share data)

<u>Assets</u>	September 30, 2000	December 31, 1999
Cash and due from banks	\$ 583,097	\$ 508,959
Interest-bearing deposits in other banks	108	5
Short-term investment securities	<u>73,841</u>	<u>84,061</u>
Cash and cash equivalents	657,046	593,025
Securities available for sale, at fair value	631,957	1,075,766
Securities held to maturity	594,230	185,357
Mortgage-backed securities available for sale, at fair value	10,771,448	13,764,565
Mortgage-backed securities held to maturity	2,997,522	2,149,696
Loans held for sale, net	874,663	729,062
Loans receivable, net	39,047,992	33,953,461
Investment in Federal Home Loan Bank ("FHLB") System	1,338,801	1,167,144
Premises and equipment, net	315,572	324,582
Foreclosed real estate, net	23,089	45,091
Accrued interest receivable	352,089	321,596
Intangible assets (net of accumulated amortization of \$230,745 at September 30, 2000 and \$183,433 at December 31, 1999)	727,198	819,561
Mortgage servicing rights	1,515,806	1,272,393
Other assets	<u>712,998</u>	<u>617,761</u>
Total assets	<u>\$60,560,411</u>	<u>\$57,019,060</u>
<u>Liabilities, Minority Interest and Stockholders' Equity</u>		
Deposits	\$23,200,165	\$23,035,757
Securities sold under agreements to repurchase	5,338,055	5,481,747
Borrowings	28,365,117	25,668,626
Other liabilities	<u>1,227,358</u>	<u>771,147</u>
Total liabilities	<u>58,130,695</u>	<u>54,957,277</u>
Commitments and contingencies	--	--
Minority interest	500,000	500,000
Stockholders' equity:		
Common stock (\$1.00 par value, 250,000,000 shares authorized, 150,615,546 and 134,720,685 shares issued at September 30, 2000 and December 31, 1999, respectively)	150,616	134,721
Issuable shares	132,107	204,681
Additional paid-in capital	1,541,936	1,378,735
Accumulated other comprehensive loss	(202,250)	(275,209)
Retained earnings (substantially restricted)	623,044	371,096
Treasury stock (16,383,058 shares and 12,478,097 shares at September 30, 2000 and December 31, 1999, respectively)	<u>(315,737)</u>	<u>(252,241)</u>
Total stockholders' equity	<u>1,929,716</u>	<u>1,561,783</u>
Total liabilities, minority interest and stockholders' equity	<u>\$60,560,411</u>	<u>\$57,019,060</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Income
Nine Months Ended September 30, 2000 and 1999
(Unaudited)
(dollars in thousands, except per share data)

	Nine Months Ended September 30,	
	2000	1999
Interest income:		
Loans receivable	\$2,085,599	\$1,721,858
Mortgage-backed securities available for sale	625,205	645,539
Mortgage-backed securities held to maturity	149,265	137,810
Loans held for sale	46,405	95,958
Securities available for sale	44,426	57,513
Securities held to maturity	19,628	9,053
Interest-bearing deposits in other banks	4,582	3,851
Dividends on FHLB stock	<u>70,305</u>	<u>43,143</u>
Total interest income	<u>3,045,415</u>	<u>2,714,725</u>
Interest expense:		
Deposits	679,138	667,387
Securities sold under agreements to repurchase	267,622	188,085
Borrowings	<u>1,235,589</u>	<u>967,102</u>
Total interest expense	<u>2,182,349</u>	<u>1,822,574</u>
Net interest income	863,066	892,151
Provision for loan losses	<u>--</u>	<u>10,000</u>
Net interest income after provision for loan losses	<u>863,066</u>	<u>882,151</u>
Noninterest income:		
Loan servicing fees, net	138,744	108,358
Customer banking fees and service charges	147,284	138,820
Gain on sale, settlement and transfer of loans, net	37,608	25,385
(Loss) gain on sale of assets, net	(15,348)	18,296
Other income	<u>22,927</u>	<u>24,135</u>
Total noninterest income	<u>331,215</u>	<u>314,994</u>
Noninterest expense:		
Compensation and employee benefits	324,750	300,489
Occupancy and equipment	119,661	110,224
Professional fees	28,739	39,894
Loan expense	21,145	29,249
Foreclosed real estate operations, net	(4,047)	(5,068)
Amortization of intangible assets	47,312	52,794
Merger and integration costs	--	7,747
Other expense	<u>153,045</u>	<u>168,933</u>
Total noninterest expense	<u>690,605</u>	<u>704,262</u>
Income before income taxes, minority interest and extraordinary items	503,676	492,883
Income tax expense	62,221	105,759
Minority interest: provision in lieu of income tax expense	161,688	122,684
Minority interest: other	<u>21,580</u>	<u>28,338</u>
Income before extraordinary items	258,187	236,102
Extraordinary items – gain on early extinguishment of debt, net of applicable taxes of \$2,083 in 2000	<u>3,014</u>	<u>--</u>
Net income	<u>\$ 261,201</u>	<u>\$ 236,102</u>
Earnings per share:		
Basic		
Income before extraordinary items	\$1.87	\$1.78
Extraordinary items	<u>0.02</u>	<u>--</u>
Net income	<u>\$1.89</u>	<u>\$1.78</u>
Diluted		
Income before extraordinary items	\$1.81	\$1.67
Extraordinary items	<u>0.02</u>	<u>--</u>
Net income	<u>\$1.83</u>	<u>\$1.67</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Income
Three Months Ended September 30, 2000 and 1999
(Unaudited)
(dollars in thousands, except per share data)

	Three Months Ended September 30,	
	2000	1999
Interest income:		
Loans receivable	\$ 742,092	\$587,080
Mortgage-backed securities available for sale	189,661	221,923
Mortgage-backed securities held to maturity	58,428	41,910
Loans held for sale	17,719	28,266
Securities available for sale	11,450	19,399
Securities held to maturity	10,147	2,750
Interest-bearing deposits in other banks	1,198	1,551
Dividends on FHLB stock	25,195	14,959
Total interest income	<u>1,055,890</u>	<u>917,838</u>
Interest expense:		
Deposits	235,992	223,329
Securities sold under agreements to repurchase	94,888	80,475
Borrowings	<u>439,364</u>	<u>326,942</u>
Total interest expense	<u>770,244</u>	<u>630,746</u>
Net interest income	285,646	287,092
Provision for loan losses	--	--
Net interest income after provision for loan losses	<u>285,646</u>	<u>287,092</u>
Noninterest income:		
Loan servicing fees, net	48,152	38,068
Customer banking fees and service charges	48,560	47,453
Gain on sale, settlement and transfer of loans, net	10,546	4,932
Gain on sale of assets, net	688	3,187
Other income	<u>6,651</u>	<u>8,834</u>
Total noninterest income	<u>114,597</u>	<u>102,474</u>
Noninterest expense:		
Compensation and employee benefits	108,367	97,831
Occupancy and equipment	42,746	38,528
Professional fees	10,536	12,625
Loan expense	7,142	7,109
Foreclosed real estate operations, net	(669)	(3,000)
Amortization of intangible assets	15,405	17,626
Other expense	<u>47,430</u>	<u>51,463</u>
Total noninterest expense	<u>230,957</u>	<u>222,182</u>
Income before income taxes and minority interest	169,286	167,384
Income tax expense (benefit)	73,976	(45,353)
Minority interest: provision in lieu of income tax expense	--	122,684
Minority interest: other	<u>6,797</u>	<u>8,431</u>
Net income	<u>\$ 88,513</u>	<u>\$ 81,622</u>
Earnings per share:		
Basic	\$0.63	\$0.63
Diluted	0.62	0.58

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Nine Months Ended September 30, 2000 and 1999
(Unaudited)
(in thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2000</u>	<u>1999</u>
Net income	\$261,201	\$ 236,102
Other comprehensive income (loss), net of tax:		
Unrealized holding gain (loss) on securities available for sale:		
Unrealized holding gain (loss) arising during the period	59,292	(204,906)
Less: reclassification adjustment for loss (gain) included in net income	<u>10,859</u>	<u>(743)</u>
	70,151	(205,649)
Amortization of market adjustment for securities transferred from available for sale to held to maturity	<u>2,808</u>	<u>--</u>
Other comprehensive income (loss)	<u>72,959</u>	<u>(205,649)</u>
Comprehensive income	<u>\$334,160</u>	<u>\$ 30,453</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Three Months Ended September 30, 2000 and 1999
(Unaudited)
(in thousands)

	<u>Three Months Ended September 30,</u>	
	<u>2000</u>	<u>1999</u>
Net income	\$ 88,513	\$ 81,622
Other comprehensive income (loss), net of tax:		
Unrealized holding gain (loss) on securities available for sale:		
Unrealized holding gain (loss) arising during the period	79,028	(43,571)
Less: reclassification adjustment for loss (gain) included in net income	<u>(231)</u>	<u>(549)</u>
	78,797	(44,120)
Amortization of market adjustment for securities transferred from available for sale to held to maturity	<u>2,138</u>	<u>--</u>
Other comprehensive income (loss)	<u>80,935</u>	<u>(44,120)</u>
Comprehensive income	<u>\$169,448</u>	<u>\$ 37,502</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

Nine Months Ended September 30, 2000

(Unaudited)

(dollars in thousands)

	Common Stock		Issuable	Additional	Accumulated	Retained	Common Stock		Total
	Shares	Amount	Shares	Paid-in	Other	Earnings	in Treasury		Stockholders'
				Capital	Comprehensive	(Substantially	Shares	Amount	Equity
					Loss	Restricted)			
Balance at December 31, 1999	134,720,685	\$134,721	\$204,681	\$1,378,735	\$(275,209)	\$371,096	(12,478,097)	\$(252,241)	\$1,561,783
Net income	--	--	--	--	--	261,201	--	--	261,201
Change in net unrealized holding loss on securities available for sale	--	--	--	--	70,151	--	--	--	70,151
Amortization of unrealized holding loss on securities held to maturity	--	--	--	--	2,808	--	--	--	2,808
Adjustment to contribution receivable from GSB Investments and Hunter's Glen in respect of their proportionate ownership of the California Federal Goodwill Litigation Asset	--	--	--	--	--	3,767	--	--	3,767
Issuable shares adjustment for tax refund and related interest	--	--	39,455	(38,066)	--	--	--	--	1,389
Issuable shares (pro-rata 2000 usage of pre-merger NOLs)	--	--	126,283	--	--	--	--	--	126,283
Pro-rata adjustment to pre-merger tax benefits recorded as goodwill	--	--	--	(29,586)	--	--	--	--	(29,586)
Distribution of issuable shares	4,882,904	4,883	(100,000)	95,117	--	--	--	--	--
Cancellation of restricted shares	(2,025)	(2)	--	2	--	--	--	--	--
Impact of restricted common stock	220,327	220	--	2,522	--	--	--	--	2,742
Exercise of stock options and warrants	10,793,655	10,794	--	118,905	--	--	--	--	129,699
Purchase of treasury stock	--	--	--	--	--	--	(3,916,411)	(63,724)	(63,724)
Sale of common stock in treasury	--	--	--	(94)	--	--	11,450	228	134
Dividends on common stock	--	--	--	--	--	(13,020)	--	--	(13,020)
Cash settlement resulting in the extinguishment of issuable shares	--	--	(138,312)	14,401	--	--	--	--	(123,911)
Balance at September 30, 2000	<u>150,615,546</u>	<u>\$150,616</u>	<u>\$132,107</u>	<u>\$1,541,936</u>	<u>\$(202,250)</u>	<u>\$623,044</u>	<u>(16,383,058)</u>	<u>\$(315,737)</u>	<u>\$1,929,716</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2000 and 1999
(Unaudited)
(in thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2000</u>	<u>1999</u>
Cash flows from operating activities:		
Net income	\$ 261,201	\$ 236,102
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	47,312	52,794
(Accretion) amortization of purchase accounting premiums and discounts, net	(27)	8,902
Accretion of discount on borrowings	813	756
Amortization of mortgage servicing rights	149,037	157,782
Provision for loan losses	--	10,000
Loss (gain) on sale of assets, net	15,348	(18,296)
Gain on sale of branches, net	--	(2,343)
Gain on sale of foreclosed real estate, net	(7,591)	(10,494)
Loss on sale, settlement and transfer of loans, net	52,213	147,013
Capitalization of originated mortgage servicing rights	(89,821)	(172,398)
Extraordinary items – gain on early extinguishment of debt, net	(3,014)	--
Depreciation and amortization of premises and equipment	41,351	29,925
Amortization of deferred debt issuance costs	5,511	5,456
FHLB stock dividends	(70,305)	(43,143)
Purchases and originations of loans held for sale	(3,789,358)	(7,217,334)
Net proceeds from the sale of loans held for sale	3,522,307	8,509,343
(Increase) decrease in other assets	(31,236)	206,050
(Increase) decrease in accrued interest receivable	(29,255)	2,040
Increase (decrease) in other liabilities	271,540	(49,713)
Amortization of deferred compensation expense—restricted common stock	1,500	238
Minority interest: provision in lieu of income taxes	161,688	--
Minority interest: other	<u>21,580</u>	<u>28,338</u>
Net cash provided by operating activities	<u>\$ 530,794</u>	<u>\$ 1,881,018</u>

(Continued)

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (continued)
Nine Months Ended September 30, 2000 and 1999
(Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2000	1999
Cash flows from investing activities:		
Downey Acquisition	\$ (379,314)	\$ --
Nevada Purchase	--	458,943
Purchases of securities available for sale	(33,388)	(791,952)
Proceeds from maturities of securities available for sale	35,469	390,328
Purchases of securities held to maturity	(2,849)	(27,527)
Principal payments and proceeds from maturities of securities held to maturity	41,747	64,855
Purchases of mortgage-backed securities available for sale	(58,340)	(4,140,171)
Principal payments on mortgage-backed securities available for sale	1,438,573	3,088,120
Proceeds from sales of mortgage-backed securities available for sale	666,924	193,732
Principal payments on mortgage-backed securities held to maturity	315,554	504,968
Proceeds from sales of loans	62,360	16,820
Net increase in loans receivable	(3,671,238)	(1,168,370)
Purchases of loans receivable	(1,213,023)	(1,218,415)
Purchases of FHLB stock, net	(107,570)	(98,517)
Purchases of premises and equipment	(35,141)	(79,832)
Proceeds from disposal of premises and equipment	2,990	47,002
Proceeds from sales of foreclosed real estate	63,947	114,938
Purchases of mortgage servicing rights	(303,061)	(289,922)
Proceeds from sales of mortgage servicing rights	765	30,616
Net cash used in investing activities	<u>(3,175,595)</u>	<u>(2,904,384)</u>
Cash flows from financing activities:		
Branch sales	--	(69,340)
Net increase (decrease) in deposits	165,605	(1,412,908)
Proceeds from additional borrowings	29,518,911	22,388,086
Principal payments on borrowings	(26,779,900)	(21,751,828)
Net (decrease) increase in securities sold under agreements to repurchase	(143,692)	1,725,530
Bank Preferred Stock Tender Offers	--	(97,621)
Debt Tender Offers	--	(253)
Dividends paid to minority stockholders, net of taxes	(20,191)	(24,153)
Exercise of stock options and warrants	129,699	7,880
Purchases of treasury stock	(63,724)	(168,290)
Sales of treasury stock	134	951
Dividends on common stock	(13,020)	--
Extinguishment of issuable shares	(85,000)	--
Net cash provided by financing activities	<u>2,708,822</u>	<u>598,054</u>
Net change in cash and cash equivalents	64,021	(425,312)
Cash and cash equivalents at beginning of period	<u>593,025</u>	<u>967,950</u>
Cash and cash equivalents at end of period	<u>\$ 657,046</u>	<u>\$ 542,638</u>

See accompanying notes to unaudited consolidated financial statements.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with generally accepted accounting principles for interim financial information and the requirements of Regulation S-X, Article 10 and therefore do not include all disclosures necessary for complete financial statements. In the opinion of management, all adjustments have been made that are necessary for a fair presentation of the financial position and results of operations and cash flows as of and for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2000 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period. Certain amounts for the three and nine-month periods in the prior year have been reclassified to conform to the current period's presentation.

The accompanying unaudited consolidated financial statements include the accounts of Golden State Bancorp Inc. ("Golden State" or the "Company"), which owns all of the common stock of Golden State Holdings Inc. ("GS Holdings," formerly First Nationwide Holdings Inc. ("FN Holdings")), which owns common and preferred stock of California Federal Bank and its subsidiaries ("California Federal" or "Bank"). Unless the context otherwise indicates, "Golden State" or "Company" refers to Golden State Bancorp Inc. as the surviving entity after the consummation of the Golden State Acquisition (as defined herein). On September 11, 1998, Glendale Federal Bank, Federal Savings Bank ("Glendale Federal") merged with and into the Bank pursuant to the Glen Fed Merger. Unless the context otherwise indicates, "California Federal" or "Bank" refers to California Federal Bank as the surviving entity after the consummation of the Glen Fed Merger.

Minority interest represents amounts attributable to (a) the Preferred Stock ("REIT Preferred Stock") of California Federal Preferred Capital Corporation, a wholly owned subsidiary of the Bank, and (b) that portion of stockholders' equity of Auto One Acceptance Corporation ("Auto One"), a subsidiary of the Bank, attributable to 20% of its common stock. In 1999, minority interest also included the Bank Preferred Stock that had not yet been acquired by GS Holdings.

Golden State is a holding company whose only significant asset is its indirect ownership of all of the common and preferred stock of the Bank, and therefore, activities for the consolidated entity are primarily carried out by the Bank and its operating subsidiaries.

All significant intercompany balances and transactions have been eliminated in consolidation. These financial statements should be read in conjunction with the consolidated financial statements of Golden State included in the Company's Annual Report on Form 10-K for the year ended December 31, 1999. All terms used but not defined elsewhere herein have meanings ascribed to them in the Company's Annual Report on Form 10-K.

(2) Acquisitions and Divestitures

Golden State Acquisition

On September 11, 1998, First Nationwide (Parent) Holdings Inc. ("Parent Holdings") and Hunter's Glen/Ford Ltd. ("Hunter's Glen") completed the merger with Golden State, the publicly traded parent company of Glendale Federal, in a tax-free exchange of shares (the "Golden State Merger"), accounted for under the purchase method of accounting. Pursuant to the Golden State Merger agreement, (a) FN Holdings contributed all of its assets (including all of the common stock of California Federal) to GS Holdings (the "FN Holdings Asset Transfer"), (b) Parent Holdings, which then owned all of the common stock of FN Holdings as a result of the extinguishment of the Hunter's Glen minority interest, merged with and into Golden State, which indirectly owned all of the common stock of Glendale Federal, (c) FN Holdings merged with and into Golden State Financial Corporation, which owned all of the common stock of Glendale Federal (the "FN Holdings Merger," and together with the Golden State Merger, the "Holding Company Mergers"), and (d) Glendale Federal merged with and into California Federal (the "Glen Fed Merger"). The FN Holdings Asset Transfer, the Holding Company Mergers and the Glen Fed Merger are referred to collectively as the "Golden State Acquisition."

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

At September 11, 1998, Glendale Federal had total assets of approximately \$18.9 billion and deposits of \$11.3 billion and operated 181 branches and 26 loan offices in California.

The Golden State Acquisition was accounted for as a purchase of Golden State by Parent Holdings and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed in the transaction based on estimates of fair value at the date of purchase. Since the date of purchase, the results of operations related to such assets and liabilities have been included in the Company's consolidated statements of income.

Merger and integration costs associated with the Golden State Acquisition totalled \$7.7 million for the nine months ended September 30, 1999, including severance for terminated California Federal employees, expenses for California Federal branch closures, and conversion and consolidation costs, as well as transition expenses for duplicate personnel, facilities and computer systems during the integration period. No such expenses were incurred during the nine months ended September 30, 2000.

During the third quarter of 1999, the Company recorded fair value and other adjustments to reduce intangible assets in the Golden State Acquisition by \$16.6 million, \$18.1 million and \$12.4 million related to (i) previously accrued severance and contract termination costs (which had not been utilized upon completion of the integration plan), (ii) a "true-up" adjustment of the deferred tax asset and (iii) the purchase price, respectively.

Other Acquisitions and Divestitures

On February 29, 2000, Auto One acquired Downey Auto Finance Corporation, a subsidiary of Downey Savings and Loan Association, F.A., with prime auto loans of approximately \$370 million (the "Downey Acquisition"). Intangible assets of \$7.7 million were recorded in connection with this acquisition.

On April 16, 1999, the Bank acquired twelve retail branches located in Nevada with deposits of approximately \$543 million from Norwest Bank, Nevada, a subsidiary of Norwest Corporation, and Wells Fargo Bank, N.A. (the "Nevada Purchase"). Intangible assets of \$50.7 million were recorded in connection with this acquisition, principally representing the deposit premium paid in the transaction.

During April 1999, First Nationwide Mortgage Corporation ("FNMC") sold servicing rights for approximately 49,000 loans with an unpaid principal balance of approximately \$2.0 billion, recognizing a pre-tax gain of \$16.3 million (the "Servicing Sale").

(3) Reclassification of Securities

On April 30, 2000, the Company reclassified \$1.1 billion and \$497.9 million carrying value of mortgage-backed securities and U.S. government and agency securities, respectively, from securities available for sale to their respective held-to-maturity portfolios. These assets primarily comprise securities which are required as part of the Bank's regulatory liquidity portfolio. The Company has both the positive intent and the ability to hold these securities to maturity. The net unrealized loss related to these securities of \$64.0 million, which is included as a component of equity (accumulated other comprehensive loss), is amortized to interest income over the remaining life of the securities using the interest method. The effect of this amortization on interest income is fully offset by the effect of amortization of the related discount recorded against the respective assets at the time of transfer.

(4) Cash, Cash Equivalents, and Statements of Cash Flows

Cash paid for interest on deposits and other interest-bearing liabilities during the nine months ended September 30, 2000 and 1999 was \$2.2 billion and \$1.7 billion, respectively. Net cash (received) paid for income taxes during the nine months ended September 30, 2000 and 1999 was \$(5.0) million and \$14.6 million, respectively.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

During the nine months ended September 30, 2000, noncash activity consisted of the reclassification of \$1.1 billion and \$497.9 million of mortgage-backed securities and U.S. government and agency securities, respectively, from securities available for sale to their respective held-to-maturity portfolios, transfers of \$113.2 million from loans receivable to mortgage-backed securities upon the securitization of certain of the Bank's single-family loans, transfers of \$54.7 million from loans held for sale (at lower of cost or market) to loans receivable, transfers of \$41.1 million from loans receivable to foreclosed real estate and \$5.4 million of loans made to facilitate sales of real estate owned.

Noncash activity during the nine months ended September 30, 2000 also included the following: (a) a \$211.7 million reduction of the valuation allowance of the Company's deferred tax asset representing pre-merger tax benefits, of which \$161.7 million was retained by the previous owners of FN Holdings; (b) increases of \$2.5 million and \$220 thousand in additional paid-in capital and common stock, respectively, for restricted common stock outstanding under an employee incentive plan; (c) an adjustment to the contribution receivable from GSB Investments and Hunter's Glen in respect of their proportionate ownership of the California Federal Goodwill Litigation asset of \$3.8 million; (d) the distribution of \$100 million in issuable shares; (e) adjustments of \$126.3 million and \$29.6 million to issuable shares and additional paid-in capital, respectively, related to pre-merger tax benefits retained by the previous owners of FN Holdings; (f) an adjustment of \$1.4 million to issuable shares, after taxes, for interest income on a tax refund related to Old California Federal for periods prior to the Golden State Acquisition and (g) a reduction of \$53.3 million in issuable shares, offset by increases of \$38.9 million to other liabilities and \$14.4 million to additional paid-in capital related to the extinguishment of issuable shares.

During the nine months ended September 30, 1999, noncash activity consisted of transfers of \$227.1 million from loans receivable to mortgage-backed securities upon the securitization of certain of the Bank's single-family loans, transfers of \$108.1 million from loans held for sale (at lower of cost or market) to loans receivable, transfers of \$81.0 million from loans receivable to foreclosed real estate and \$8.4 million of loans made to facilitate sales of real estate owned.

Noncash activity during the nine months ended September 30, 1999 also included (a) a reduction of \$18.9 million in previously accrued severance and contract termination costs, (b) an \$18.1 million "true-up" adjustment of the deferred tax asset and \$12.4 million in purchase price adjustments related to the Golden State Acquisition, (c) an increase of \$181 thousand and \$57 thousand in additional paid-in capital and common stock, respectively, reflecting the impact of 56,908 shares of restricted common stock issued during the period, (d) an increase of \$2.0 million in treasury stock reflecting the after-tax effect of a reclassification by the Bank from other assets of the value associated with Litigation Tracking Warrants ("LTWTMs") that have been withdrawn by holders and (e) an increase of \$15.5 million in retained earnings related to an adjustment of the initial dividend of tax benefits due to First Gibraltar and Hunter's Glen upon the Company's deconsolidation from its tax reporting group as a result of the Golden State Acquisition.

(5) Redemption of FN Holdings Notes

On May 15, 1999, GS Holdings redeemed the remaining \$225 thousand aggregate principal amount of the FN Holdings 12¼% Senior Notes for an aggregate redemption price including accrued interest payable, of \$252.6 thousand. The premium paid in connection with such redemption was not material.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

(6) Segment Reporting

Since the Company derives a significant portion of its revenues from interest income, and interest expense is the most significant expense, the segments are reported below using net interest income. Because the Company also evaluates performance based on noninterest income and noninterest expense goals, these measures of segment profit and loss are also presented. The Company does not allocate income taxes to the segments.

	<u>Nine Months Ended September 30,</u>			<u>Three Months Ended September 30,</u>		
	<u>Community</u> <u>Banking</u>	<u>Mortgage</u> <u>Banking</u>	<u>Total</u>	<u>Community</u> <u>Banking</u>	<u>Mortgage</u> <u>Banking</u>	<u>Total</u>
Net interest income: (1)						
2000	\$1,018,899	\$(74,251)	\$944,648	\$343,559	\$(26,339)	\$317,220
1999	1,017,369	(40,562)	976,807	331,236	(16,710)	314,526
Noninterest income: (2)						
2000	\$ 179,336	\$188,763	\$368,099	\$ 62,639	\$ 64,345	\$126,984
1999	187,088	164,678	351,766	67,405	46,701	114,106
Noninterest expense: (3)						
2000	\$ 573,402	\$120,683	\$694,085	\$192,221	\$ 39,896	\$232,117
1999	575,401	132,341	707,742	182,449	40,893	223,342

(1) Includes \$81.6 million and \$84.7 million for the nine months ended September 30, 2000 and 1999, respectively, in earnings credit provided to FNMC by the Bank, primarily for custodial bank account balances generated by FNMC. Also includes \$192.8 million and \$184.9 million for the nine months ended September 30, 2000 and 1999, respectively, in interest income and expense on intercompany loans.

Includes \$31.6 million and \$27.4 million for the three months ended September 30, 2000 and 1999, respectively, in earnings credit provided to FNMC by the Bank, primarily for custodial bank account balances generated by FNMC. Also includes \$70.5 million and \$60.8 million for the three months ended September 30, 2000 and 1999, respectively, in interest income and expense on intercompany loans.

(2) Includes \$36.9 million and \$36.8 million for the nine months ended September 30, 2000 and 1999, respectively, in intercompany servicing fees. Includes \$12.4 million and \$11.6 million for the three months ended September 30, 2000 and 1999, respectively, in intercompany servicing fees.

(3) Includes \$3.5 million for each of the nine-month periods ended September 30, 2000 and 1999, in intercompany noninterest expense. Includes \$1.2 million for each of the three-month periods ended September 30, 2000 and 1999, in intercompany noninterest expense.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

The following reconciles the above table to the amounts shown on the consolidated financial statements for the nine and three months ended September 30, 2000 and 1999 (in thousands):

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2000	1999	2000	1999
Net interest income:				
Total net interest income for reportable segments	\$944,648	\$976,807	\$317,220	\$314,526
Elimination of intersegment net interest income	<u>(81,582)</u>	<u>(84,656)</u>	<u>(31,574)</u>	<u>(27,434)</u>
Total	<u>\$863,066</u>	<u>\$892,151</u>	<u>\$285,646</u>	<u>\$287,092</u>
Noninterest income:				
Total noninterest income for reportable segments	\$368,099	\$351,766	\$126,984	\$114,106
Elimination of intersegment servicing fees	<u>(36,884)</u>	<u>(36,772)</u>	<u>(12,387)</u>	<u>(11,632)</u>
Total	<u>\$331,215</u>	<u>\$314,994</u>	<u>\$114,597</u>	<u>\$102,474</u>
Noninterest expense:				
Total noninterest expense for reportable segments	\$694,085	\$707,742	\$232,117	\$223,342
Elimination of intersegment expense	<u>(3,480)</u>	<u>(3,480)</u>	<u>(1,160)</u>	<u>(1,160)</u>
Total	<u>\$690,605</u>	<u>\$704,262</u>	<u>\$230,957</u>	<u>\$222,182</u>

(7) Accrued Termination and Facilities Costs

In connection with the Golden State Acquisition, the Company recorded liabilities resulting from (a) branch consolidations due to duplicate facilities; (b) employee severance and termination benefits due to a planned reduction in force; and (c) expenses incurred under a contractual obligation to terminate services provided by outside service providers (principally relating to data processing expenses). The merger and integration plan relative to the Golden State Acquisition was in place on September 11, 1998. Certain of these costs were included in the allocation of purchase price and others were recognized in net income. The table below reflects a summary of the activity in the liability for the costs related to such plan since December 31, 1999 (in thousands):

	Branch Consolidations	Severance and Termination Benefits	Contract Termination	Total
Balance at December 31, 1999	\$24,051	\$12,770	\$25	\$36,846
Additional liabilities recorded	2,504	--	--	2,504
Charges to liability account	<u>(9,419)</u>	<u>(204)</u>	<u>--</u>	<u>(9,623)</u>
Balance at September 30, 2000	<u>\$17,136</u>	<u>\$12,566</u>	<u>\$25</u>	<u>\$29,727</u>

(8) Income Taxes

During the nine months ended September 30, 2000, Golden State recorded a net income tax expense of \$62.2 million. Based on favorable resolutions of federal income tax audits of Old California Federal and Glendale Federal, and based on the current status of Mafco's, including the Company's, audits for the years 1991 through 1995, management changed its judgment about the realizability of the Company's deferred tax asset and reduced its valuation allowance by \$211.7 million during the nine-month period ended September 30, 2000. As a result of reducing the valuation allowance, income tax expense was reduced by \$161.7 million and goodwill was reduced by \$50.0 million. Because these tax benefits accrue to the owners of the former FN Holdings under the Golden State Merger agreement, minority interest: provision in lieu of income tax expense was increased by \$161.7 million, an amount equal to the reduction in income tax expense. These adjustments had no impact on net income available to common shareholders and no impact on the expected level of issuable shares.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

Based upon the actual filing of the Mafco Group and Golden State 1998 consolidated federal income tax returns, tax benefits of \$122.7 million were recognized during the third quarter of 1999. The tax benefit is fully offset by an increase in minority interest expense, since under the Golden State Merger agreement, the tax benefits from any NOLs and other tax attributes of Parent Holdings and its subsidiaries are retained by First Gibraltar and Hunter's Glen.

In addition, the Company recorded an adjustment of \$15.5 million to reduce the initial dividend of tax benefits to First Gibraltar and Hunter's Glen due to its deconsolidation from the Mafco Group, which was recorded as an increase to retained earnings during the third quarter of 1999.

(9) Minority Interest

On April 1, 1999, GS Holdings redeemed all of the remaining 607,299 outstanding shares of the Bank's 10⁵/₈% Preferred Stock not already owned by it for \$105.313 per share for a total redemption price of \$63.9 million. This transaction reduced minority interest on the Company's consolidated balance sheet and resulted in a charge of \$3.2 million to minority interest expense.

On September 1, 1999, GS Holdings redeemed all of the remaining 318,341 shares of the Bank's 11¹/₂% Preferred Stock not already owned by it for \$105.75 per share, for a total redemption price of \$33.7 million. This transaction reduced minority interest by \$31.8 million on the Company's consolidated balance sheet and resulted in a charge of \$1.8 million to minority interest expense.

During the third quarter of 1999, minority interest expense of \$122.7 million was recorded based upon changes to estimated pre-merger tax benefits retained by Parent Holdings. This amount was fully offset by an income tax benefit in the same period. See note 8.

(10) Stockholders' Equity

Common Stock

At September 30, 2000 and December 31, 1999, there were 134,232,488 and 122,242,588 shares, respectively, of Golden State Common Stock issued and outstanding (net of treasury stock). Common stock outstanding included 246,756 and 56,908 restricted shares at September 30, 2000 and December 31, 1999, respectively.

Pursuant to the Golden State Merger agreement, 4,882,904 shares of Golden State common stock, valued at \$100 million, were issued to GSB Investments and Hunter's Glen on May 22, 2000. See "—Issuable Shares."

During the nine months ended September 30, 2000, stock options and warrants totalling 10,793,655 were exercised. See note 11 and "—Warrants."

Issuable Shares

In accordance with the Golden State Merger Agreement, on January 21, 1999, a total of 5,540,319 shares of Golden State Common Stock, valued at \$100 million, were issued (4,432,255 shares to a subsidiary of Mafco Holdings and 1,108,064 shares to Hunter's Glen) as a result of net tax benefits realized by California Federal with respect to its gain from the Florida Branch Sale and the receipt of federal income tax refunds in excess of the amount reflected on the Company's consolidated balance sheets.

Based upon the Company's 1999 taxable income as filed in its federal income tax return, shares valued at \$101.3 million (4,928,901 shares) were contractually issuable during the year ended December 31, 1999 to GSB Investments and Hunter's Glen. The number of shares was based on the use of pre-merger net operating losses and other net deferred tax assets, based upon actual taxable earnings and the average share price during the year. On May 22, 2000, the remaining 147,677 common shares from 1998, valued at \$2.7 million, and a portion of the 1999 contractually issuable shares of Golden State common stock (4,735,227 shares), valued at \$97.3 million, were issued

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

(in total, 3,906,323 shares to a subsidiary of Mafco Holdings and 976,581 shares to Hunter's Glen) as a result of net tax benefits realized by California Federal. The remaining shares allocable to GSB Investments, consisting of 154,939 shares valued at \$3.2 million, were extinguished (as discussed below) and 38,735 shares due to Hunter's Glen, valued at \$0.8 million, are expected to be issued at a future date.

During the fourth quarter of 1999 and the second quarter of 2000, the Company recorded \$4.5 million and \$1.4 million, respectively, in issuable shares related to interest receivable on a federal tax refund related to Old California Federal for periods prior to the Golden State Acquisition. During the nine months ended September 30, 2000, the Company also recorded \$126.3 million of issuable shares related to the Company's pro-rata usage in 2000 of pre-merger tax benefits retained by the previous owners of FN Holdings. Consistent with the Golden State Merger agreement, these amounts are payable to GSB Investments and Hunter's Glen as issuable shares.

On August 22, 2000, the Company paid GSB Investments \$85.0 million resulting in the extinguishment of GSB Investments' right to receive \$100.0 million of issuable shares calculated in accordance with the Golden State Merger agreement. These issuable shares related to tax benefits retained by GSB Investments for pre-merger net operating losses to be utilized in respect of 2000 by the Company. In addition, the Company agreed to pay \$36.0 million to GSB Investments in January 2001 in exchange for the extinguishment of GSB Investments' right to receive \$38.3 million of issuable shares calculated in accordance with the Golden State Merger agreement. These issuable shares relate to 1999 carryover benefits and the federal tax refund and interest received by the Company in April, 2000. A discount of \$1.1 million was recorded on this liability and is being recognized in interest income ratably through January 16, 2001, using the interest method. Expenses totalling \$4.0 million were capitalized during the third quarter of 2000 in connection with this transaction.

Issuable shares are included, as appropriate, in the calculation of basic and diluted earnings per share. See note 13.

Additional Paid-in Capital

During the nine months ended September 30, 2000, the Company recorded reductions to additional paid-in capital of \$38.1 million representing issuable shares for interest on a tax refund and \$29.6 million representing pro-rata adjustments to pre-merger tax benefits retained by the previous owners of FN Holdings. The tax benefits were originally recorded as an adjustment to goodwill related to the Cal Fed Acquisition. See note 8. In addition, additional paid-in capital increased by \$18.4 million during the third quarter of 2000, representing issuable shares extinguished in excess of consideration paid, partially offset by \$4.0 million in capitalized transaction expenses.

Retained Earnings

At September 11, 1998, in connection with the Golden State Acquisition, certain assets were recorded representing the fair value of each of the Goodwill Litigation Assets (as defined herein) that each of the former shareholder groups (pre-merger Golden State and GSB Investments and Hunter's Glen) were contributing to the merged entity. The Golden State Merger agreement contained a mechanism for proportionately allocating these values between the two groups. At September 11, 1998, the fair value of the Glendale Federal Goodwill Litigation Asset (as defined herein) contributed by the former Golden State shareholders was \$56.9 million, and the fair value of the California Federal Goodwill Litigation equalization adjustment due from GSB Investments and Hunter's Glen was \$41.2 million. The \$41.2 million, recorded as a contribution receivable, increased retained earnings during the year ended December 31, 1998 and fluctuates based upon the market value of the LTWTMs. At December 31, 1999, the equalization adjustment was written down to its fair value of \$17.1 million. Since the market value of the LTWTMs, which the Company uses to estimate the fair value of the ultimate goodwill litigation award, increased to \$1.21875 per share at September 30, 2000 from \$0.875 per share at December 31, 1999, the inherent value of the amount to be contributed by GSB Investments and Hunter's Glen also increased, to \$20.9 million, resulting in an increase in retained earnings and the contribution receivable of \$3.8 million during the nine months ended September 30, 2000.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

Treasury Stock

At September 30, 2000, the Company had 16,383,058 shares of its common stock in treasury at an aggregate cost of \$19.27 per share.

During the nine months ended September 30, 2000, the Company repurchased 3,916,411 shares of common stock, at an aggregate purchase price of \$63.7 million, or an average of \$16.27 per share. Also during the nine months ended September 30, 2000, 11,450 shares were issued out of treasury in connection with options exercised by holders related to an acquisition by the former Golden State prior to the Golden State Acquisition.

During the nine months ended September 30, 1999, 73,235 shares were issued out of treasury in connection with options exercised by holders related to an earlier acquisition by the former Golden State prior to the Golden State Acquisition.

Dividends

On September 1, 2000, Golden State paid a dividend of \$0.10 per common share totalling \$13.0 million, to stockholders of record as of July 31, 2000. There were no dividends on common stock during the nine months ended September 30, 1999.

Warrants

During the nine months ended September 30, 2000, 10,753,859 Standby Warrants were exercised at the purchase price of \$12.00 per share and 14,294 expired. In conjunction with the exercise of the Standby Warrants, the holders thereof were issued one share of GSB common stock and one LTW for each Standby Warrant. As the Standby Warrants expired on August 21, 2000, there were no outstanding Standby Warrants at September 30, 2000.

(11) Executive and Stock Compensation

In connection with the Golden State Acquisition, the Bank is administering stock option plans that provided for the granting of options of Golden State Common Stock to employees and directors. Upon the consummation of the merger on September 11, 1998, substantially all options outstanding became exercisable. All pre-merger stock option plans have expired as to the granting of additional options.

In the first quarter of 2000, the Company granted to its employees non-qualified stock options equivalent to 1,333,850 shares of common stock at a weighted average price of \$13.99 per share under the Golden State Bancorp Inc. Omnibus Stock Plan (the "Stock Plan"). In the second quarter of 2000, the Company granted an additional 12,000 non-qualified stock options at a weighted average price of \$16.25 per share. In the third quarter of 2000, the Company granted an additional 5,000 non-qualified options at a weighted average price of \$21.31 per share. These shares generally vest over three years in one-third increments on the anniversary of the grant date. The options generally expire 10 years from the date of grant. No compensation cost was recognized by the Company for these stock options during the nine months ended September 30, 2000, in accordance with the intrinsic value accounting methodology prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, whereby compensation expense to employees is determined based upon the excess, if any, of the market price of the Company's common stock at the measurement date over the exercise price of the award.

During the three months ended September 30, 2000, 36,893 options were exercised and 18,584 options were cancelled or expired under all plans. During the nine months ended September 30, 2000, 51,200 options were exercised and 82,950 options were cancelled or expired under all plans. At September 30, 2000, options to acquire an equivalent of 3,777,782 shares and 1,129,382 LTWTMs remained outstanding under all plans.

During the three and nine months ended September 30, 1999, a total of 149,226 and 506,243 options, respectively, were exercised and 57,500 and 230,000 options, respectively, were cancelled or expired under all plans.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

On January 24, 2000 and July 19, 1999, the Company awarded to certain of its employees 220,327 and 56,908 shares, respectively, of restricted stock under the Golden State Bancorp Inc. Executive Compensation Plan. The market value on the dates of the awards were \$14.00 and \$22.38 per share, respectively. These shares generally vest over two years in one-half increments on the anniversary of the grant date, based upon the continued service of the employee. At September 30, 2000, a total of 246,756 restricted shares was outstanding. The compensation expense related to these awards is recognized on a straight line basis over the vesting period for each tranche of the award with a corresponding increase to additional paid-in capital. During the three and nine months ended September 30, 2000, \$0.4 million and \$1.5 million, respectively, in compensation expense was recognized related to such awards. During the three and nine months ended September 30, 1999, \$0.2 million in compensation expense was recognized related to such awards. These restricted shares have full voting and dividend rights and are included in common shares outstanding and in the calculation of diluted earnings per share. See note 13.

(12) Extraordinary Items

During the first quarter of 2000, the FHLB called and the Bank prepaid \$200 million in FHLB advances, resulting in an extraordinary gain of \$1.2 million, net of income taxes of \$0.8 million, on the early extinguishment of such borrowings.

Also during the first quarter of 2000, the Bank repurchased \$2.5 million outstanding principal amount of the Convertible Subordinated Debentures due 2001, resulting in an extraordinary gain of \$41 thousand, net of income taxes of \$30 thousand, on the early extinguishment of debt.

During the second quarter of 2000, the FHLB called and the Bank prepaid \$200 million in FHLB advances, resulting in an extraordinary gain of \$1.8 million, net of income taxes of \$1.2 million, on the early extinguishment of such borrowings.

(13) Earnings per Share Information

Earnings per share of common stock is based on the weighted average number of common and common equivalent shares outstanding, excluding common shares in treasury, during the periods presented. Information used to calculate basic and diluted earnings per share is as follows (in thousands, except per share data):

	Nine Months Ended September 30,				Three Months Ended September 30,			
	2000		1999		2000		1999	
	Basic EPS	Diluted EPS	Basic EPS	Diluted EPS	Basic EPS	Diluted EPS	Basic EPS	Diluted EPS
Income before extraordinary items	\$258,187	\$258,187	\$236,102	\$236,102	\$ 88,513	\$ 88,513	\$ 81,622	\$ 81,622
Extraordinary items	3,014	3,014	—	—	—	—	—	—
Net income	<u>\$261,201</u>	<u>\$261,201</u>	<u>\$236,102</u>	<u>\$236,102</u>	<u>\$ 88,513</u>	<u>\$ 88,513</u>	<u>\$ 81,622</u>	<u>\$ 81,622</u>
Weighted average common shares outstanding (a)	124,869	124,869	132,137	132,137	129,709	129,709	129,806	129,806
Issuable shares (b)	<u>13,147</u>	<u>13,147</u>	<u>558</u>	<u>558</u>	<u>10,947</u>	<u>10,947</u>	<u>148</u>	<u>148</u>
Total weighted average basic common shares outstanding	<u>138,016</u>	<u>138,016</u>	<u>132,695</u>	<u>132,695</u>	<u>140,656</u>	<u>140,656</u>	<u>129,954</u>	<u>129,954</u>
Effect of dilutive securities:								
Options and warrants (c)	--	2,755	--	5,581	--	2,251	--	5,134
Issuable shares (d)	--	1,489	--	2,749	--	--	--	5,545
Restricted stock (a)	<u>--</u>	<u>97</u>	<u>--</u>	<u>2</u>	<u>--</u>	<u>120</u>	<u>--</u>	<u>6</u>
Total weighted average diluted common shares outstanding (b)	<u>138,016</u>	<u>142,357</u>	<u>132,695</u>	<u>141,027</u>	<u>140,656</u>	<u>143,027</u>	<u>129,954</u>	<u>140,639</u>
Income before extraordinary items	\$ 1.87	\$ 1.81	\$ 1.78	\$ 1.67	\$ 0.63	\$ 0.62	\$ 0.63	\$ 0.58
Extraordinary items	<u>0.02</u>	<u>0.02</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
Earnings per common share	<u>\$ 1.89</u>	<u>\$ 1.83</u>	<u>\$ 1.78</u>	<u>\$ 1.67</u>	<u>\$ 0.63</u>	<u>\$ 0.62</u>	<u>\$ 0.63</u>	<u>\$ 0.58</u>

(Continued)

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

- (a) 2000 and 1999 basic weighted average common shares outstanding exclude the effect of 220,327 shares and the unvested portion of 56,908 shares, respectively, of restricted stock that were awarded to employees of the Company on January 24, 2000 and July 19, 1999, respectively. The effect of all of these shares was included in diluted average shares outstanding. See note 11.
- (b) 2000 total basic and diluted weighted average common shares outstanding include the effect, as appropriate, of: (i) 4,735,227 shares issued on May 22, 2000 to GSB Investments and Hunter's Glen, (ii) 1,218,544 shares issuable to Hunter's Glen, and (iii) 2,754,968 shares related to the extinguishment of issuable shares in August 2000; all based on the use of pre-merger tax benefits during 1999. See note 11; "Issuable Shares" for a discussion on extinguishment of issuable shares.
- 2000 and 1999 total basic and diluted weighted average common shares outstanding include the effect of 5,540,319 shares issued on January 21, 1999 and 147,677 shares issued on May 22, 2000 to GSB Investments and Hunter's Glen for net tax benefits realized by the Bank during 1998.
- 2000 total basic and diluted weighted average common shares outstanding include the effect, as appropriate, of 517,180 shares estimated to be issuable to Hunter's Glen and 1,169,276 shares related to the extinguishment of issuable shares in August 2000; all related to a Federal tax refund and related interest received in 1999 and 2000 associated with Old California Federal for periods prior to the Golden State Acquisition.
- (c) Golden State's weighted average diluted common shares outstanding are not affected by the LTWTMs until they become exercisable because the amount of the proceeds from the Glendale Goodwill Litigation and the number of shares of common stock to be issued cannot be determined until the LTWTMs become exercisable.
- (d) 2000 and 1999 total diluted weighted average shares outstanding include the effect of 5,287,029 shares and 5,544,808 shares, respectively, estimated to be issuable to GSB Investments and Hunter's Glen based on the anticipated use of pre-merger tax benefits. See note 10.

(14) Newly Issued Accounting Pronouncements

Accounting for Derivative Instruments and Hedging Activities

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS No. 133"). SFAS No. 133 was amended by Statement of Financial Accounting Standards No. 137, *Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133* ("SFAS No. 137"). SFAS No. 137 mandates that SFAS No. 133 shall be effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on the type of hedge transaction.

Under SFAS No. 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective portion of the hedge. Upon implementation, hedging relationships must be designated anew and documented pursuant to the provisions of this statement.

For fair value hedge transactions in which the Company is hedging changes in the fair value of assets, liabilities or firm commitments, changes in the fair value of the derivative instrument will generally be offset in the income statement by changes in the hedged item's fair value. For cash flow hedge transactions in which the Company is hedging the variability of cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on derivative instruments that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings.

The Company has identified various types of instruments which will qualify as derivatives pursuant to SFAS No. 133. It is expected that the derivative instruments (interest rate floors, principal only swaps and swaptions) used to hedge the change in the fair value of the Company's mortgage servicing rights will be reported as fair value hedges. The derivative instruments (interest rate swaps) used to hedge the change in the cash flows of the Company's Federal Home Loan Bank advances and reverse repurchase agreements will be reported as cash flow hedges.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

During their meeting of October 26 and 27, 2000, the FASB staff issued guidance to the Derivatives Implementation Group ("DIG") of the FASB resolving Issue 11-4, *Definition of a Derivative: When a Loan Commitment Meets the Net Settlement Criteria*. This guidance was issued for DIG review and clarifying comments. This guidance will be posted to the FASB web site in November of 2000 and given a 35-day comment period. The FASB staff guidance indicated that interest rate lock commitments, given to potential borrowers, met the net settlement criteria described in paragraph 9 of SFAS No. 133 and would therefore be considered a derivative instrument. At the end of the 35-day comment period, the FASB staff guidance will become Level D GAAP. In their meeting of October 26 and 27, 2000, the DIG also reviewed Issue 12-4, *Fair Value Hedges: Hedging Mortgage Servicing Right Assets Using Preset Hedge Coverage Ratios*. There was no resolution to this issue at the meeting. The Company is currently assessing the impact of both areas of potential guidance.

On June 15, 2000, the FASB issued Statement of Financial Accounting Standards No. 138 *Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB No. 133* ("SFAS No. 138").

The Board amended SFAS No. 133 by:

- (a) Expanding the normal purchases and normal sales exception,
- (b) Permitting an entity to hedge to a designated benchmark interest rate defined as either (i) the interest rate on direct Treasury obligations of the U.S. government (Treasury rate), or (ii) the London Interbank Offered Rate (LIBOR) swap rate,
- (c) Permitting entities to hedge recognized foreign-currency-denominated assets and liabilities for which a foreign currency transaction gain or loss is recognized in earnings, and
- (d) Permitting certain internal derivatives to qualify for hedge accounting in the affiliate financial statements even though these internal derivatives are offset on a net or aggregate basis, rather than individually, by third party derivative contracts in another member of the consolidated financial group.

In addition, certain decisions arising from the DIG process that required specific amendments to SFAS No. 133 are incorporated in SFAS No. 138.

SFAS No. 133 applies to all entities and amends SFAS No. 107, *Disclosures About Fair Values of Financial Instruments*, to include in Statement 107 the disclosure provisions about concentrations of credit risk from Statement 105. SFAS No. 133 supersedes FASB Statements No. 80, *Accounting for Futures Contracts*, No. 105, *Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, and No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*. SFAS No. 133 also nullifies or modifies the consensuses reached in a number of issues addressed by the Emerging Issues Task Force.

One of the qualifying criteria for hedge accounting under SFAS No. 133 is that the hedging relationship between the hedging instrument and the hedged item must be highly effective in achieving the offset of changes in those fair values or cash flows that are attributable to the hedged risk, both at the inception of the hedge and on an ongoing basis. An assessment of this effectiveness is required at least every three months and whenever financial statements or earnings are reported by the Company.

The high-effectiveness requirement has been interpreted to mean that the cumulative changes in the value of the hedging instrument since hedge inception should be between 80% and 125% of the inverse cumulative change since hedge inception in the fair value or cash flows of the hedged items.

Early application of all of the provisions of SFAS No. 133 is encouraged, but is permitted only as of the beginning of any fiscal quarter that begins after issuance of this statement. SFAS No. 133 should not be applied retroactively to financial statements of prior periods.

GOLDEN STATE BANCORP INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

SFAS No. 133, as amended, will significantly change the accounting treatment of derivative instruments used by the Company. Depending on the underlying risk management strategy, these accounting changes could affect reported net income, assets, liabilities and stockholders' equity. As a result, the Company may choose to reconsider its risk management strategies, since SFAS No. 133 will not reflect the results of many of those strategies in the same manner as current accounting practice. The Company continues to evaluate the potential impact of implementing SFAS No. 133. An accurate assessment of the Company's hedge effectiveness and hence, the net impact of adopting SFAS No. 133, will not be possible until the FASB, which is currently both interpreting and amending SFAS No. 133 with regard to the measurement of hedge effectiveness, concludes its deliberations, and until after the Company has fully implemented hedging strategies in accordance with the FASB's amendments and interpretations.

Accounting for Transfers and Servicing Financial Assets and Extinguishments of Liabilities

On September 29, 2000, the FASB issued Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS No. 140"). SFAS No. 140 replaces SFAS No. 125, which was issued in June of 1996. It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of the provisions of SFAS No. 125 without reconsideration. In general, SFAS No. 140 is effective for transfers of financial assets occurring after March 31, 2001 and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000.

The implementation of SFAS No. 140 is not expected to materially impact the Company's financial results.

(15) Subsequent Event

On October 23, 2000, Golden State declared a dividend of \$0.10 per share on its common stock, payable on December 1, 2000 to shareholders of record as of November 3, 2000.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the Company's expectations, intentions, beliefs or strategies regarding the future. Forward-looking statements include the Company's statements regarding liquidity, provision for loan losses, capital resources and anticipated expense levels in "Management's Discussion and Analysis of Financial Condition and Results of Operations." In addition, in those and other portions of this document, the words "anticipate," "believe," "estimate," "expect," "intend," and other similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. It is important to note that the Company's actual results could differ materially from those described herein as anticipated, believed, estimated or expected. Among the factors that could cause results to differ materially are: (a) changes in levels of market interest rates, (b) changes in the California economy or California real estate values, (c) changes in the level of mortgage loan prepayments, (d) changes in federal banking laws and regulations, (e) actions by the Company's competitors, and (f) the risks described in the "Risk Factors" section included in the Registration Statement on Form S-1 filed by Golden State Holdings Inc. with the Securities and Exchange Commission on September 29, 1998 (File No. 333-64597) and declared effective on November 12, 1998. The Company assumes no obligation to update any such forward-looking statement.

Overview

The principal business of Golden State, through California Federal, consists of operating retail branches that provide deposit products such as demand, transaction and savings accounts, and investment products such as mutual funds, annuities and insurance. In addition, it engages in mortgage banking activities, including originating and purchasing 1-4 unit residential loans for sale to various investors in the secondary market or for retention in its own portfolio, and servicing loans for itself and others. To a lesser extent, the Company originates and/or purchases commercial real estate, commercial and consumer loans for investment. Revenues are derived primarily from interest earned on loans, interest received on government and agency securities and mortgage-backed securities, gains on sales of loans and other investments and fees received in connection with loan servicing, securities brokerage and other customer service transactions. Expenses primarily consist of interest on customer deposit accounts, interest on short-term and long-term borrowings, general and administrative expenses consisting of compensation and benefits, data processing, occupancy and equipment, communications, deposit insurance assessments, advertising and marketing, professional fees and other general and administrative expenses.

Net Income

Golden State reported net income for the nine months ended September 30, 2000 of \$261.2 million, or \$1.83 per diluted share, compared with net income of \$236.1 million, or \$1.67 per diluted share, for the corresponding period in 1999. Net income for the nine months ended September 30, 2000 includes gains on the early extinguishment of debt, net of tax, of \$3.0 million. Net income for the nine months ended September 30, 1999 includes the following nonrecurring items, net of tax: a \$9.4 million gain from the 1999 Servicing Sale, \$5.0 million in minority interest expense related to the redemption of the Bank Preferred Stock and a \$1.4 million gain from the sale of branches.

Golden State reported net income for the three months ended September 30, 2000 of \$88.5 million, or \$0.62 per diluted share, compared with net income of \$81.6 million, or \$0.58 per diluted share, for the corresponding period in 1999. Net income for the three months ended September 30, 1999 includes the following nonrecurring items, net of tax: a \$1.4 million gain from the sale of branches and \$1.8 million in minority interest expense related to the redemption of the Bank's 11½% Preferred Stock.

Financial Condition

During the nine months ended September 30, 2000, consolidated total assets increased \$3.5 billion, to \$60.6 billion from December 31, 1999, and total liabilities increased from \$55.0 billion to \$58.1 billion.

During the nine months ended September 30, 2000, stockholders' equity increased \$368 million to \$1.9 billion. The increase in stockholders' equity is principally the net result of \$261.2 million in net income for the period, \$129.7 million from the exercise of warrants and stock options, \$127.7 million in adjustments to issuable shares, primarily related to a tax refund and pre-merger tax benefits retained by the previous owners of FN Holdings and a \$70.2 million net unrealized gain, after tax, on securities available for sale, partially offset by a \$123.9 million extinguishment of issuable shares, \$63.7 million in purchases of treasury stock, \$29.6 million in adjustments to additional paid-in capital related to pre-merger tax benefits recorded to goodwill and \$13.0 million of common stock dividends.

Golden State's non-performing assets, consisting of non-performing loans, net of purchase accounting adjustments, foreclosed real estate, net, and repossessed assets, decreased to \$134 million at September 30, 2000 compared with \$200 million at December 31, 1999. Total non-performing assets as a percentage of the Bank's total assets decreased to 0.22% at September 30, 2000 from 0.35% at December 31, 1999.

Results of Operations

Nine months ended September 30, 2000 versus nine months ended September 30, 1999

The following table shows the Company's consolidated average balance sheets, with the related interest income, interest expense and the average interest rates for the periods presented. Average balances are calculated on a daily basis.

	Nine Months Ended September 30, 2000		
	Average Balance	Interest	Average Rate
	(dollars in millions)		
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 1,429	\$ 69	6.39%
Mortgage-backed securities available for sale	12,514	625	6.66
Mortgage-backed securities held to maturity	2,640	149	7.54
Loans held for sale, net	832	46	7.44
Loans receivable, net	37,397	2,086	7.44
FHLB stock	<u>1,278</u>	<u>70</u>	7.35
Total interest-earning assets	56,090	<u>3,045</u>	7.24
Noninterest-earning assets	<u>2,965</u>		
Total assets	<u>\$59,055</u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY			
Interest-bearing liabilities:			
Deposits	\$23,044	679	3.94
Securities sold under agreements to repurchase (3)	5,551	268	6.34
Borrowings (3)	<u>27,148</u>	<u>1,235</u>	6.05
Total interest-bearing liabilities	55,743	<u>2,182</u>	5.21
Noninterest-bearing liabilities	1,175		
Minority interest	496		
Stockholders' equity	<u>1,641</u>		
Total liabilities, minority interest and stockholders' equity	<u>\$59,055</u>		
Net interest income		<u>\$ 863</u>	
Interest rate spread			<u>2.03%</u>
Net interest margin			<u>2.07%</u>
Return on average assets			<u>0.59%</u>
Return on average equity			<u>21.23%</u>
Average equity to average assets			<u>2.78%</u>

Nine Months Ended September 30, 1999

	Average <u>Balance</u>	<u>Interest</u> (dollars in millions)	Average <u>Rate</u>
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 1,571	\$ 70	5.98%
Mortgage-backed securities available for sale	13,623	645	6.32
Mortgage-backed securities held to maturity	2,471	138	7.44
Loans held for sale, net	1,939	96	6.60
Loans receivable, net	31,427	1,722	7.31
FHLB stock	<u>1,100</u>	<u>43</u>	5.24
Total interest-earning assets	52,131	<u>2,714</u>	6.94
Noninterest-earning assets	<u>3,820</u>		
Total assets	<u><u>\$55,951</u></u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY			
Interest-bearing liabilities:			
Deposits	\$24,052	667	3.71
Securities sold under agreements to repurchase (3)	4,826	188	5.14
Borrowings (3)	<u>23,469</u>	<u>967</u>	5.51
Total interest-bearing liabilities	52,347	<u>1,822</u>	4.65
Noninterest-bearing liabilities	1,493		
Minority interest	551		
Stockholders' equity	<u>1,560</u>		
Total liabilities, minority interest And stockholders' equity	<u><u>\$55,951</u></u>		
Net interest income		<u>\$ 892</u>	
Interest rate spread			<u>2.29%</u>
Net interest margin			<u>2.27%</u>
Return on average assets			<u>0.56%</u>
Return on average equity			<u>20.19%</u>
Average equity to average assets			<u>2.79%</u>

- (1) Non-performing assets are included in the average balances for the periods indicated.
- (2) Includes securities held to maturity, securities available for sale, interest-bearing deposits in other banks and short-term investment securities.
- (3) Interest and average rate include the impact of interest rate swaps.

The following table shows what portion of the changes in interest income and interest expense were due to changes in rate and volume. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to volume (change in average outstanding balance multiplied by the prior period's rate) and rate (change in average interest rate multiplied by the prior period's volume). Changes attributable to both volume and rate have been allocated proportionately.

	Nine Months Ended September 30, 2000 vs. 1999		
	Increase (Decrease) Due to		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
	(in millions)		
INTEREST INCOME:			
Securities and interest-bearing deposits in banks	\$ (6)	\$ 5	\$ (1)
Mortgage-backed securities available for sale	(59)	39	(20)
Mortgage-backed securities held to maturity	9	2	11
Loans held for sale, net	(64)	14	(50)
Loans receivable, net	333	31	364
FHLB stock	<u>8</u>	<u>19</u>	<u>27</u>
Total	<u>221</u>	<u>110</u>	<u>331</u>
INTEREST EXPENSE:			
Deposits	(26)	38	12
Securities sold under agreements to repurchase	31	49	80
Borrowings	<u>164</u>	<u>104</u>	<u>268</u>
Total	<u>169</u>	<u>191</u>	<u>360</u>
Change in net interest income	\$ 52	\$(81)	\$(29)

The volume variances in total interest income and total interest expense for the nine months ended September 30, 2000 compared to the corresponding period in 1999 are largely due to increased loan volume, partially offset by an increase in borrowings.

Interest Income. Total interest income was \$3.0 billion for the nine months ended September 30, 2000, an increase of \$330.7 million from the nine months ended September 30, 1999. Total interest-earning assets for the nine months ended September 30, 2000 averaged \$56.1 billion, compared to \$52.1 billion for the corresponding period in 1999, primarily as a result of increased loan volume. The yield on total interest-earning assets during the nine months ended September 30, 2000 increased to 7.24% from 6.94% for the nine months ended September 30, 1999, primarily due to a higher percentage of loans to total earning assets and the repricing of variable-rate earning assets.

Golden State earned \$2.1 billion of interest income on loans receivable for the nine months ended September 30, 2000, an increase of \$363.7 million from the nine months ended September 30, 1999. The average balance of loans receivable was \$37.4 billion for the nine months ended September 30, 2000, compared to \$31.4 billion for the same period in 1999. The weighted average rate on loans receivable increased to 7.44% for the nine months ended September 30, 2000 from 7.31% for the nine months ended September 30, 1999. The increase in the average balance reflects an increase in residential loan origination activity and new auto loan production from the Downey Acquisition. The increase in the weighted average rate reflects the repricing of variable-rate loans and an increase in the prime rate on commercial banking loans, partially offset by lower rates on new purchases of prime auto loans, including those purchased in the Downey Acquisition.

Golden State earned \$46.4 million of interest income on loans held for sale for the nine months ended September 30, 2000, a decrease of \$49.6 million from the nine months ended September 30, 1999. The average balance of loans held for sale was \$832 million for the nine months ended September 30, 2000, a decrease of \$1.1 billion from the comparable period in 1999, primarily attributed to a reduction in fixed-rate originations due to higher interest rates, coupled with longer holding periods for loans held for sale during the nine months ended September 30, 1999. The weighted average rate on loans held for sale increased to 7.44% for the nine months ended

September 30, 2000 from 6.60% for the nine months ended September 30, 1999, primarily due to higher market interest rates.

Interest income on mortgage-backed securities available for sale was \$625.2 million for the nine months ended September 30, 2000, a decrease of \$20.3 million from the nine months ended September 30, 1999. The average portfolio balance decreased \$1.1 billion, to \$12.5 billion, for the nine months ended September 30, 2000 compared to the same period in 1999. The weighted average yield on these assets increased from 6.32% for the nine months ended September 30, 1999 to 6.66% for the nine months ended September 30, 2000. The decrease in the volume and the increase in the weighted average yield is primarily due to the reclassification of \$1.1 billion in mortgage-backed securities to the held-to-maturity portfolio, run-off of existing portfolios and the sale of approximately \$688 million in mortgage-backed securities during the second and third quarters of 2000, partially offset by the impact of purchases during the fourth quarter of 1999.

Interest income on mortgage-backed securities held to maturity was \$149.3 million for the nine months ended September 30, 2000, an increase of \$11.5 million from the nine months ended September 30, 1999. The average portfolio balance increased \$169 million, to \$2.6 billion, for the nine months ended September 30, 2000 compared to the same period in 1999, primarily attributed to the reclassification of \$1.1 billion in mortgage-backed securities from the available-for-sale portfolio, partially offset by the run-off of existing portfolios. The run-off in these securities was replaced with the origination and purchase of whole loans instead of additional mortgage-backed securities. The weighted average rates for the nine months ended September 30, 2000 and 1999 were 7.54% and 7.44%, respectively.

Interest income on securities and interest-bearing deposits in other banks was \$68.6 million for the nine months ended September 30, 2000, a decrease of \$1.8 million from the nine months ended September 30, 1999. The average portfolio balance was \$1.4 billion and \$1.6 billion for the nine months ended September 30, 2000 and 1999, respectively. The higher weighted average rate of 6.39% for the nine months ended September 30, 2000 compared to 5.98% for the nine months ended September 30, 1999 reflects \$2.4 million in interest income on a federal income tax refund related to Old California Federal for periods prior to the Golden State Acquisition for which there is no corresponding asset.

Dividends on FHLB stock were \$70.3 million for the nine months ended September 30, 2000, an increase of \$27.2 million from the nine months ended September 30, 1999. The average balance outstanding during the nine months ended September 30, 2000 and 1999 was \$1.3 billion and \$1.1 billion, respectively. The weighted average dividend on FHLB stock increased to 7.35% for the nine months ended September 30, 2000 from 5.24% for the nine months ended September 30, 1999. The increase in the average balance and weighted average yield is due to an increase in the amount of such stock owned by the Company as a result of an increase in borrowings under FHLB advances and an increase in the dividend rate on FHLB stock.

Interest Expense. Total interest expense was \$2.2 billion for the nine months ended September 30, 2000, an increase of \$359.8 million from the nine months ended September 30, 1999. The increase is primarily the result of additional borrowings under FHLB advances and securities sold under agreements to repurchase used to fund loans and offset the reduction in deposit balances.

Interest expense on deposits, including brokered deposits, was \$679.1 million for the nine months ended September 30, 2000, an increase of \$11.8 million from the nine months ended September 30, 1999. The average balance of deposits outstanding decreased from \$24.1 billion for the nine months ended September 30, 1999 to \$23.0 billion for the nine months ended September 30, 2000. The decrease in the average balance includes declines in the average balance of certificates of deposit, money market and passbook savings, offset in part by an increase in the average balance of customer checking accounts and custodial accounts. These changes reflect the Company's focus during 2000 on consumer checking account growth. The overall weighted average cost of deposits increased to 3.94% for the nine months ended September 30, 2000 from 3.71% for the nine months ended September 30, 1999, primarily due to rising market interest rates.

Interest expense on securities sold under agreements to repurchase totalled \$267.6 million for the nine months ended September 30, 2000, an increase of \$79.5 million from the nine months ended September 30, 1999. The average balance of such borrowings for the nine months ended September 30, 2000 and 1999 was \$5.6 billion and \$4.8 billion, respectively. The increase is primarily attributed to the funding of loans and the purchase of mortgage-backed securities in the fourth quarter of 1999, as well as deposit run-off. The weighted average interest rate on these instruments increased to 6.34% for the nine months ended September 30, 2000 from 5.14% for the nine months ended September 30, 1999, primarily due to an increase in market rates on new borrowings in 2000 compared to 1999.

Interest expense on borrowings totalled \$1.2 billion for the nine months ended September 30, 2000, an increase of \$268.5 million from the nine months ended September 30, 1999. The average balance outstanding for the nine months ended September 30, 2000 and 1999 was \$27.1 billion and \$23.5 billion, respectively. The weighted average interest rate on these instruments increased to 6.05% for the nine months ended September 30, 2000 from 5.51% for the nine months ended September 30, 1999, primarily due to higher prevailing market rates in 2000. The higher volume reflects the increase in FHLB advances used to fund loans and the purchase of mortgage-backed securities in the fourth quarter of 1999.

Net Interest Income. Net interest income was \$863.1 million for the nine months ended September 30, 2000, a decrease of \$29.1 million from the nine months ended September 30, 1999. The interest rate spread declined to 2.03% for the nine months ended September 30, 2000 from 2.29% for the nine months ended September 30, 1999, primarily as a result of maturities and repayments of lower rate interest-bearing liabilities being replaced with interest-bearing liabilities having comparatively higher rates. The effect of higher rates on liabilities was partially offset by higher yielding assets replenishing asset run-off in a rising rate environment and the repricing of variable-rate assets.

Noninterest Income. Total noninterest income, consisting primarily of loan servicing fees, customer banking fees and gains on sales of assets, was \$331.2 million for the nine months ended September 30, 2000, representing an increase of \$16.2 million from the nine months ended September 30, 1999.

Loan servicing fees, net of amortization of mortgage servicing rights, were \$138.7 million for the nine months ended September 30, 2000, compared to \$108.4 million for the nine months ended September 30, 1999. The single-family residential loan servicing portfolio, excluding loans serviced for the Bank, increased from \$72.3 billion at September 30, 1999 to \$83.0 billion at September 30, 2000. Incremental loan servicing fees were partially offset by amortization of MSRs. MSR amortization for the nine months ended September 30, 2000 decreased by \$8.7 million from the nine months ended September 30, 1999 due to a reduction in the estimated prepayment rate, partially offset by a higher MSR basis. Loan servicing fees benefited from the slowdown in mortgage loan prepayments in 2000, with an average prepayment rate on loans serviced for others of 8.5% during the first nine months of 2000, compared to 19.3% in the comparable period in 1999.

Customer banking fees were \$147.3 million for the nine months ended September 30, 2000 compared to \$138.8 million for the nine months ended September 30, 1999. The increase is primarily attributed to increased emphasis by management on transaction account growth and higher fee income on mutual fund, annuity and other security sales through Cal Fed Investments.

Gain on sale, settlement and transfer of loans, net totalled \$37.6 million for the nine months ended September 30, 2000, an increase of \$12.2 million from the nine months ended September 30, 1999. During the second quarter of 2000, the Company recorded a \$14.5 million reduction in its recourse liability. This liability is a life-of-asset accrual. Given the paydowns which have occurred on the underlying loans and the improving credit and real estate market conditions present, the Company determined that the liability balance exceeded its estimate of the required accrual for the remaining life of the recourse assets by \$14.5 million. Gains attributed to early payoffs and settlement of commercial loans with unamortized discounts were \$5.9 million lower in the nine months ended September 30, 2000 compared to the same period in 1999. During the nine months ended September 30, 2000, California Federal sold \$3.7 billion in single-family mortgage loans originated for sale with servicing rights retained as part of its ongoing mortgage banking operations compared to \$8.7 billion of such sales for the corresponding period in 1999, while the gains on such sales increased \$3.7 million between the two periods.

Net loss on sale of assets totalled \$15.3 million for the nine months ended September 30, 2000, compared to a net gain of \$18.3 million for the nine months ended September 30, 1999. The loss during 2000 is primarily attributed to an \$18.7 million loss from the sale of approximately \$500 million of mortgage-backed securities with an average yield of 6.64% during the second quarter and a \$0.9 million loss from the sale of \$187.6 million of mortgage-backed securities with an average yield of 6.59% during the third quarter, partially offset by a \$1.3 million gain from the sale of interest rate swaps with a notional amount of \$284.0 million in August 2000. It is expected that these sales will benefit both the net interest margin and the Company's interest rate sensitivity in future periods. The \$18.3 million gain reported in 1999 primarily relates to the \$16.3 million gain on the Servicing Sale.

Other noninterest income was \$22.9 million for the nine months ended September 30, 2000, a decrease of \$1.2 million from the nine months ended September 30, 1999, primarily attributed to the sale of the Eureka and Ukiah branches in the third quarter of 1999.

Noninterest Expense. Total noninterest expense was \$690.6 million for the nine months ended September 30, 2000, a decrease of \$13.7 million compared to the nine months ended September 30, 1999. The variance between the two periods is primarily attributed to continued expense reduction efforts by the Company and the completion of merger and integration efforts in the first half of 1999. Noninterest expense for the nine months ended September 30, 2000 included decreases of \$15.9 million in other noninterest expense, \$11.2 million in professional fees, \$8.1 million in loan expense, \$7.7 million in specific merger and integration costs incurred in 1999 in connection with the Golden State Acquisition and \$5.5 million in amortization of intangible assets. These decreases were partially offset by increases of \$24.3 million in compensation expense and \$9.4 million in occupancy and equipment expense.

Compensation and employee benefits expense was \$324.8 million for the nine months ended September 30, 2000, an increase of \$24.3 million from the nine months ended September 30, 1999. The increase is primarily attributed to normal salary increases and higher employment levels in expanding lines of business, including the impact of additional employees from the Downey Acquisition.

Occupancy and equipment expense was \$119.7 million for the nine months ended September 30, 2000, an increase of \$9.4 million from the nine months ended September 30, 1999, primarily attributed to increased depreciation expense related to a change in the depreciable lives of personal computers.

Professional fees were \$28.7 million for the nine months ended September 30, 2000, a decrease of \$11.2 million from the nine months ended September 30, 1999, primarily due to legal and consulting fee expenses incurred in 1999 related to goodwill litigation and the Y2K project.

Loan expense was \$21.1 million for the nine months ended September 30, 2000, a decrease of \$8.1 million from the nine months ended September 30, 1999, primarily due to a decrease in pass-through interest expense on loans attributed to a decrease in payoffs during 2000. Repayment rates on loans serviced for others averaged 12.2% during the first nine months of 2000, a significant decline from the 23.5% average experienced during the same period of 1999.

Merger and integration costs were \$7.7 million for the nine months ended September 30, 1999, representing transition expenses, which include severance, conversion and consolidation costs incurred in connection with the Golden State Acquisition. Such costs were not incurred during the first nine months of 2000.

Amortization of intangible assets was \$47.3 million for the nine months ended September 30, 2000, a decrease of \$5.5 million from the nine months ended September 30, 1999, primarily attributed to a lower goodwill base due to a \$50.0 million reduction in goodwill in the first quarter of 2000, resulting from a reduction in the valuation allowance against the Company's deferred tax asset (see "– Provision for Income Tax"), and a \$38.2 million reduction in goodwill resulting from an income tax refund received during the fourth quarter of 1999 related to Old California Federal. This decrease was partially offset by amortization expense related to the \$7.7 million and \$50.7 million in goodwill recorded in connection with the Downey Acquisition and the Nevada Purchase, respectively.

Other noninterest expense was \$153.0 million in 2000 compared to \$168.9 million in 1999. The decline in operating expenses is primarily attributed to management's continued expense reduction efforts.

Provision for Income Tax. During the nine months ended September 30, 2000, Golden State recorded gross income tax expense of \$223.9 million, which was offset by a tax benefit of \$161.7 million, for net income tax expense of \$62.2 million. Based on favorable resolutions of federal income tax audits of Old California Federal and Glendale Federal, and the current status of Mafco's, including the Company's, audits for the years 1991 through 1995, management changed its judgment about the realizability of the Company's deferred tax asset and reduced its valuation allowance by \$211.7 million during the nine-month period ended September 30, 2000. As a result of reducing the valuation allowance, income tax expense was reduced by \$161.7 million and goodwill was reduced by \$50.0 million. Because these tax benefits accrue to the previous owners of FN Holdings under the Golden State Merger agreement, minority interest: provision in lieu of income tax expense was increased by \$161.7 million, an amount equal to the reduction in income tax expense. These adjustments had no impact on net income available to common shareholders.

During the nine months ended September 30, 1999, Golden State recorded gross income tax expense of \$228.4 million, which was offset by a tax benefit of \$122.7 million, for a net income tax expense of \$105.8 million. A provision in lieu of income taxes was recorded for the \$122.7 million of pre-merger tax benefits, in the form of net operating losses and other items, which are retained by the previous owners of FN Holdings. The benefit adjustment resulted from the 1998 tax filings in the third quarter of 1999.

Golden State's effective gross federal tax rate was 38% during the nine months ended September 30, 2000 and 1999, while its federal statutory tax rate was 35% during both periods. The difference between the effective and statutory rates was primarily the result of nondeductible goodwill amortization. Golden State's effective state tax rate was 6% and 8% during the nine months ended September 30, 2000 and 1999, respectively. The effective state tax rate declined during 2000 as a result of changes in management's estimates of the expected state tax liability of the Company.

Minority Interest. Minority interest expense for the nine months ended September 30, 2000 includes a \$161.7 million provision in lieu of income taxes, representing pre-merger tax benefits retained by the previous owners of FN Holdings related to the first quarter reduction of the valuation allowance on the Bank's deferred tax asset (see note 8 of the Company's Notes to Unaudited Consolidated Financial Statements). Minority interest expense for the nine months ended September 30, 2000 also includes \$1.4 million due to the previous owners of FN Holdings, representing after-tax interest income on a tax refund related to Old California Federal for periods prior to the Golden State Acquisition. Dividends on the REIT Preferred Stock totalling \$34.2 million were also recorded during the nine months ended September 30, 2000. Minority interest expense relative to the REIT Preferred Stock is reflected net of related income tax benefit of \$14.0 million, which will inure to the Company as a result of the deductibility of such dividends for income tax purposes.

Minority interest for the nine months ended September 30, 1999 included a \$122.7 million provision in lieu of income taxes, representing pre-merger tax benefits retained by the previous owners of FN Holdings and \$5.0 million in net premiums paid in connection with the redemption of the Bank Preferred Stock. Minority interest expense also included dividends on the Bank Preferred Stock that had not yet been acquired by GS Holdings and the REIT Preferred Stock totalling \$1.8 million and \$34.2 million, respectively. Minority interest expense relative to the REIT Preferred Stock is reflected net of related income tax benefit of \$14.4 million which will inure to the Company as a result of the deductibility of such dividends for income tax purposes. Minority interest expense for the nine months ended September 30, 1999 also included a \$1.7 million benefit reversal representing that portion of Auto One's loss attributable to the 20% interest in the common stock of Auto One that was issued as part of the GSAC Acquisition.

Results of Operations

Three months ended September 30, 2000 versus three months ended September 30, 1999

The following table shows the Company's consolidated average balance sheets, with the related interest income, interest expense and the average interest rates for the periods presented. Average balances are calculated on a daily basis.

	Three Months Ended September 30, 2000		
	Average Balance	Interest	Average Rate
	(dollars in millions)		
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 1,429	\$ 23	6.36%
Mortgage-backed securities available for sale	11,278	190	6.73
Mortgage-backed securities held to maturity	3,096	58	7.55
Loans held for sale, net	926	18	7.65
Loans receivable, net	39,084	742	7.59
FHLB stock	<u>1,334</u>	<u>25</u>	7.51
Total interest-earning assets	57,147	<u>1,056</u>	7.39
Noninterest-earning assets	<u>3,258</u>		
Total assets	<u>\$60,405</u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY			
Interest-bearing liabilities:			
Deposits	\$23,307	236	4.03
Securities sold under agreements to repurchase (3)	5,444	95	6.83
Borrowings (3)	<u>27,976</u>	<u>439</u>	6.23
Total interest-bearing liabilities	56,727	<u>770</u>	5.39
Noninterest-bearing liabilities	1,381		
Minority interest	495		
Stockholders' equity	<u>1,802</u>		
Total liabilities, minority interest and stockholders' equity	<u>\$60,405</u>		
Net interest income		<u>\$ 286</u>	
Interest rate spread			<u>2.00%</u>
Net interest margin			<u>2.04%</u>
Return on average assets			<u>0.59%</u>
Return on average equity			<u>19.65%</u>
Average equity to average assets			<u>2.98%</u>

Three Months Ended September 30, 1999

	Average <u>Balance</u>	<u>Interest</u> (dollars in millions)	Average <u>Rate</u>
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 1,623	\$ 24	5.84%
Mortgage-backed securities available for sale	13,918	222	6.38
Mortgage-backed securities held to maturity	2,303	42	7.28
Loans held for sale, net	1,635	28	6.91
Loans receivable, net	32,390	587	7.25
FHLB stock	<u>1,137</u>	<u>15</u>	5.22
Total interest-earning assets	53,006	<u>918</u>	6.92
Noninterest-earning assets	<u>3,310</u>		
Total assets	<u><u>\$56,316</u></u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY			
Interest-bearing liabilities:			
Deposits	\$24,011	223	3.69
Securities sold under agreements to repurchase (3)	5,840	80	5.39
Borrowings (3)	<u>23,292</u>	<u>328</u>	5.57
Total interest-bearing liabilities	53,143	<u>631</u>	4.71
Noninterest-bearing liabilities	1,205		
Minority interest	518		
Stockholders' equity	<u>1,450</u>		
Total liabilities, minority interest and stockholders' equity	<u><u>\$56,316</u></u>		
Net interest income		<u>\$287</u>	
Interest rate spread			<u>2.21%</u>
Net interest margin			<u>2.20%</u>
Return on average assets			<u>0.58%</u>
Return on average equity			<u>22.51%</u>
Average equity to average assets			<u>2.58%</u>

- (1) Non-performing assets are included in the average balances for the periods indicated.
- (2) Includes securities held to maturity, securities available for sale, interest-bearing deposits in other banks and short-term investment securities.
- (3) Interest and average rate include the impact of interest rate swaps.

The following table shows what portion of the changes in interest income and interest expense were due to changes in rate and volume. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to volume (change in average outstanding balance multiplied by the prior period's rate) and rate (change in average interest rate multiplied by the prior period's volume). Changes attributable to both volume and rate have been allocated proportionately.

	Three Months Ended September 30, 2000 vs. 1999		
	Increase (Decrease) Due to		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
(in millions)			
INTEREST INCOME:			
Securities and interest-bearing deposits in banks	\$ (3)	\$ 2	\$ (1)
Mortgage-backed securities available for sale	(45)	13	(32)
Mortgage-backed securities held to maturity	14	2	16
Loans held for sale, net	(13)	3	(10)
Loans receivable, net	126	29	155
FHLB stock	<u>3</u>	<u>7</u>	<u>10</u>
Total	<u>82</u>	<u>56</u>	<u>138</u>
INTEREST EXPENSE:			
Deposits	(7)	20	13
Securities sold under agreements to repurchase	(4)	19	15
Borrowings	<u>70</u>	<u>41</u>	<u>111</u>
Total	<u>59</u>	<u>80</u>	<u>139</u>
Change in net interest income	<u>\$ 23</u>	<u>\$(24)</u>	<u>\$ (1)</u>

The volume variances in total interest income and total interest expense for the three months ended September 30, 2000 compared to the corresponding period in 1999 are largely due to increased loan volume and purchases of mortgage-backed securities in the fourth quarter of 1999, partially offset by an increase in borrowings and the sale of mortgage-backed securities in 2000.

Interest Income. Total interest income was \$1.1 billion for the three months ended September 30, 2000, an increase of \$138.1 million from the three months ended September 30, 1999. Total interest-earning assets for the three months ended September 30, 2000 averaged \$57.1 billion, compared to \$53.0 billion for the corresponding period in 1999, primarily as a result of increased loan volume. The yield on total interest-earning assets during the three months ended September 30, 2000 increased to 7.39% from 6.92% for the three months ended September 30, 1999, primarily due to a higher percentage of loans to total earning assets and the repricing of variable-rate earning assets.

Golden State earned \$742.1 million of interest income on loans receivable for the three months ended September 30, 2000, an increase of \$155.0 million from the three months ended September 30, 1999. The average balance of loans receivable was \$39.1 billion for the three months ended September 30, 2000, compared to \$32.4 billion for the same period in 1999. The weighted average rate on loans receivable increased to 7.59% for the three months ended September 30, 2000 from 7.25% for the three months ended September 30, 1999. The increase in the average balance reflects an increase in the residential loan origination activity and new auto loan production from the Downey acquisition. The increase in the weighted average rate reflects the repricing of variable-rate loans and an increase in the prime rate on commercial banking loans, partially offset by lower rates on new purchases of prime auto loans, including those purchased in the Downey Acquisition.

Golden State earned \$17.7 million of interest income on loans held for sale for the three months ended September 30, 2000, a decrease of \$10.5 million from the three months ended September 30, 1999. The average balance of loans held for sale was \$926 million for the three months ended September 30, 2000, a decrease of \$709 million from the comparable period in 1999, primarily attributed to a reduction in fixed-rate originations due to higher interest rates, coupled with longer holding periods for loans held for sale during the three months ended September 30, 1999. The weighted average rate on loans held for sale increased to 7.65% for the three months

ended September 30, 2000 from 6.91% for the three months ended September 30, 1999, primarily due to higher market interest rates.

Interest income on mortgage-backed securities available for sale was \$189.7 million for the three months ended September 30, 2000, a decrease of \$32.3 million from the three months ended September 30, 1999. The average portfolio balance decreased \$2.6 billion, to \$11.3 billion, for the three months ended September 30, 2000 compared to the same period in 1999. The weighted average yield on these assets increased from 6.38% for the three months ended September 30, 1999 to 6.73% for the three months ended September 30, 2000. The decrease in the volume and the increase in the weighted average yield are primarily due to the reclassification of \$1.1 billion in mortgage-backed securities to the held-to-maturity portfolio, run-off of existing portfolios and the sale of approximately \$688 million of mortgage-backed securities during the nine months ended September 30, 2000, partially offset by the impact of purchases during the fourth quarter of 1999.

Interest income on mortgage-backed securities held to maturity was \$58.4 million for the three months ended September 30, 2000, an increase of \$16.5 million from the three months ended September 30, 1999. The average portfolio balance increased \$793 million, to \$3.1 billion, for the three months ended September 30, 2000 compared to the same period in 1999, primarily attributed to the reclassification of \$1.1 billion in mortgage-backed securities from the available-for-sale portfolio, partially offset by the run-off of existing portfolios. The run-off in these securities was replaced with the origination and purchase of whole loans instead of additional mortgage-backed securities. The weighted average rates for the three months ended September 30, 2000 and 1999 were 7.55% and 7.28%, respectively.

Interest income on securities and interest-bearing deposits in other banks was \$22.8 million for the three months ended September 30, 2000, a decrease of \$0.9 million from the three months ended September 30, 1999. The average portfolio balance was \$1.4 billion and \$1.6 billion for the three months ended September 30, 2000 and 1999, respectively. The higher weighted average rate of 6.36% for the three months ended September 30, 2000 compared to 5.84% for the three months ended September 30, 1999 reflects rising market interest rates.

Dividends on FHLB stock were \$25.2 million for the three months ended September 30, 2000, an increase of \$10.2 million from the three months ended September 30, 1999. The average balance outstanding during the three months ended September 30, 2000 and 1999 was \$1.3 billion and \$1.1 billion, respectively. The weighted average dividend on FHLB stock increased to 7.51% for the three months ended September 30, 2000 from 5.22% for the three months ended September 30, 1999. The increase in the average balance and weighted average yield is due to an increase in the amount of such stock owned by the Company as a result of an increase in borrowings under FHLB advances and an increase in the dividend rate on FHLB stock.

Interest Expense. Total interest expense was \$770.2 million for the three months ended September 30, 2000, an increase of \$139.5 million from the three months ended September 30, 1999. The increase is primarily the result of additional borrowings under FHLB advances used to fund loans and offset the reduction in deposit balances.

Interest expense on deposits, including brokered deposits, was \$236.0 million for the three months ended September 30, 2000, an increase of \$12.7 million from the three months ended September 30, 1999. The average balance of deposits outstanding decreased from \$24.0 billion for the three months ended September 30, 1999 to \$23.3 billion for the three months ended September 30, 2000. The decrease in the average balance includes declines in the average balance of certificates of deposit, money market and passbook savings, offset in part by an increase in the average balance of customer checking accounts and custodial accounts. These changes reflect the Company's focus during 2000 on consumer checking account growth. The overall weighted average cost of deposits increased to 4.03% for the three months ended September 30, 2000 from 3.69% for the three months ended September 30, 1999, primarily due to rising market interest rates.

Interest expense on securities sold under agreements to repurchase totalled \$94.9 million for the three months ended September 30, 2000, an increase of \$14.4 million from the three months ended September 30, 1999. The average balance of such borrowings for the three months ended September 30, 2000 and 1999 was \$5.4 billion and \$5.8 billion, respectively. The decrease is primarily attributed to a decline in the purchase of mortgage-backed securities during the three months ended September 30, 2000 compared to the same period in 1999. The weighted

average interest rate on these instruments increased to 6.83% for the three months ended September 30, 2000 from 5.39% for the three months ended September 30, 1999, primarily due to an increase in market rates on new borrowings in 2000 compared to 1999.

Interest expense on borrowings totalled \$439.4 million for the three months ended September 30, 2000, an increase of \$112.4 million from the three months ended September 30, 1999. The average balance outstanding for the three months ended September 30, 2000 and 1999 was \$28.0 billion and \$23.3 billion, respectively. The weighted average interest rate on these instruments increased to 6.23% for the three months ended September 30, 2000 from 5.57% for the three months ended September 30, 1999, primarily due to higher prevailing market rates in 2000. The higher volume reflects the increase in FHLB advances used to fund loans and the purchase of mortgage-backed securities in the fourth quarter of 1999.

Net Interest Income. Net interest income was \$285.6 million for the three months ended September 30, 2000, a decrease of \$1.4 million from the three months ended September 30, 1999. The interest rate spread declined to 2.00% for the three months ended September 30, 2000 from 2.21% for the three months ended September 30, 1999, primarily as a result of maturities and repayments of lower rate interest-bearing liabilities being replaced with interest-bearing liabilities having comparatively higher rates. The effect of higher rates on liabilities was partially offset by higher yielding assets replenishing asset run-off in a rising rate environment and the repricing of variable-rate assets.

Noninterest Income. Total noninterest income, consisting primarily of loan servicing fees, customer banking fees and gains on sales of assets, was \$114.6 million for the three months ended September 30, 2000, representing an increase of \$12.1 million from the three months ended September 30, 1999.

Loan servicing fees, net of amortization of mortgage servicing rights, were \$48.2 million for the three months ended September 30, 2000, compared to \$38.1 million for the three months ended September 30, 1999. The single-family residential loan servicing portfolio, excluding loans serviced for the Bank, increased from \$72.3 billion at September 30, 1999 to \$83.0 billion at September 30, 2000. Incremental loan servicing fees were partially offset by amortization of MSR. MSR amortization for the quarter decreased by \$1.0 million from the three months ended September 30, 1999 due to a reduction in the estimated prepayment rate, partially offset by a higher MSR basis. Loan servicing fees benefited from the slowdown in mortgage loan prepayments in 2000, with an average prepayment rate on loans serviced for others of 9.1% in the third quarter of 2000, compared to 13.3% in the comparable period in 1999.

Customer banking fees were \$48.6 million for the three months ended September 30, 2000 compared to \$47.5 million for the three months ended September 30, 1999. The increase is primarily attributed to increased emphasis by management on transaction account growth and higher fee income on mutual fund, annuity and other security sales through Cal Fed Investments.

Gain on sale, settlement and transfer of loans, net totalled \$10.5 million for the three months ended September 30, 2000, an increase of \$5.6 million from the three months ended September 30, 1999. During the three months ended September 30, 2000, California Federal sold \$1.4 billion in single-family mortgage loans originated for sale with servicing rights retained as part of its ongoing mortgage banking operations compared to \$2.9 billion of such sales for the corresponding period in 1999, while the gain on such sales increased \$5.3 million between the two periods. Gains attributed to early payoffs and settlement of commercial loans with unamortized discounts were \$0.3 million higher in the three months ended September 30, 2000 compared to the same period in 1999.

Net gain on sale of assets totalled \$0.7 million for the three months ended September 30, 2000, compared to \$3.2 million for the three months ended September 30, 1999. The gain during 2000 is primarily attributed to a \$1.3 million gain from the sale of interest rate swaps with a notional amount of \$284.0 million, partially offset by a \$0.9 million loss from the sale of \$187.6 million of mortgage-backed securities with an average yield of 6.59%. See “– Nine Months Ended September 30, 2000 versus Nine Months Ended September 30, 1999 – Noninterest Income.”

Other noninterest income was \$6.7 million for the three months ended September 30, 2000, a decrease of \$2.2 million from the three months ended September 30, 1999, primarily attributed to the sale of the Eureka and Ukiah branches in the third quarter of 1999.

Noninterest Expense. Total noninterest expense was \$231.0 million for the three months ended September 30, 2000, an increase of \$8.8 million compared to the three months ended September 30, 1999. The variance between the two periods is primarily attributed to normal inflation rates and investments in expanding lines of business. Noninterest expense for the three months ended September 30, 2000 included increases of \$10.5 million in compensation expense, \$4.2 million in occupancy and equipment, and \$2.3 million related to lower gains from foreclosed real estate operations. These increases were partially offset by decreases of \$4.0 million in other noninterest expense, \$2.2 million in amortization of intangible assets and \$2.1 million in professional fees.

Compensation and employee benefits expense was \$108.4 million for the three months ended September 30, 2000, an increase of \$10.5 million from the three months ended September 30, 1999. The increase is primarily attributed to normal salary increases and higher employment levels in expanding lines of business, including the impact of additional employees from the Downey Acquisition.

Occupancy and equipment expense was \$42.7 million and \$38.5 million for the three months ended September 30, 2000 and 1999, respectively. This increase reflects an increase in depreciation expense related to a change in the depreciable lives of personal computers.

Professional fees were \$10.5 million for the three months ended September 30, 2000, a decrease of \$2.1 million from the three months ended September 30, 1999, primarily due to expenses incurred in 1999 attributed to the Y2K project and goodwill litigation.

Amortization of intangible assets was \$15.4 million for the three months ended September 30, 2000, a decrease of \$2.2 million from the three months ended September 30, 1999, primarily attributed to a lower goodwill base due to a \$50.0 million reduction in goodwill in the first quarter of 2000, resulting from a reduction in the valuation allowance against the Company's deferred tax asset, and a \$38.2 million reduction resulting from an income tax refund received during the fourth quarter of 1999 related to Old California Federal. These decreases were partially offset by amortization expense related to the \$7.7 million in goodwill recorded in connection with the Downey Acquisition.

Other noninterest expense was \$47.4 million in 2000 compared to \$51.5 million in 1999. The decline in operating expenses is primarily attributed to management's continued expense reduction efforts.

Provision for Income Tax. During the three months ended September 30, 2000, Golden State recorded income tax expense of \$74.0 million. During the three months ended September 30, 1999, Golden State recorded gross income tax expense of \$77.3 million, which was offset by a tax benefit of \$122.7 million, for a net income tax benefit \$45.4 million. A provision in lieu of income taxes was recorded for the \$122.7 million of pre-merger tax benefits, in the form of net operating losses and other items, which are retained by the previous owners of FN Holdings. The benefit adjustment resulted from the 1998 tax filings in the third quarter of 1999.

Golden State's effective gross federal tax rate was 38% during the three months ended September 30, 2000 and 1999, while its federal statutory tax rate was 35% during both periods. The difference between the effective and statutory rates was primarily the result of nondeductible goodwill amortization. Golden State's effective state tax rate was 6% and 8% during the three months ended September 30, 2000 and 1999, respectively. The effective state tax rate declined during 2000 as a result of changes in management's estimates of the expected state tax liability of the Company.

Minority Interest. Minority interest expense for the three months ended September 30, 2000 includes dividends on the REIT Preferred Stock totalling \$11.4 million. Minority interest expense relative to the REIT Preferred Stock is reflected net of related income tax benefit of \$4.6 million, which will inure to the Company as a result of the deductibility of such dividends for income tax purposes.

Minority interest for the three months ended September 30, 1999 included a \$122.7 million provision in lieu of income taxes, representing pre-merger tax benefits retained by the previous owners of FN Holdings and \$1.8 million in net premiums paid in connection with the redemption of the Bank Preferred Stock. Dividends on the REIT Preferred Stock totalling \$11.4 million were also recorded during the three months ended September 30, 1999. Minority interest expense relative to the REIT Preferred Stock is reflected net of related income tax benefit of \$4.8 million which will inure to the Company as a result of the deductibility of such dividends for income tax purposes.

Provision for Loan Losses

The adequacy of the allowance for loan losses is periodically evaluated by management to maintain the allowance at a level that is sufficient to absorb expected loan losses. The allowance for loan losses is increased by provisions for loan losses as well as by balances acquired through acquisitions and is decreased by charge-offs (net of recoveries). The Company charges current earnings with a provision for estimated credit losses on loans receivable. The provision considers both specifically identified problem loans as well as credit risks not specifically identified in the loan portfolio. See “— Problem and Potential Problem Assets” for a discussion of the methodology used in determining the adequacy of the allowance for loan losses. The Company recorded no provision for loan losses during the nine months ended September 30, 2000. The Company recorded provisions for loan losses of \$10 million for the nine months ended September 30, 1999; no provision for loan losses was recorded during the third quarter of 1999.

The decrease in the provision for loan losses during the nine-month period ended September 30, 2000 compared to the same period in 1999 reflects management’s evaluation of the adequacy of the allowance based on, among other things, past loan loss experience and known and inherent risks in the portfolio, evidenced in part by the continued decline in the Company’s level of non-performing assets. In addition, management’s periodic evaluation of the adequacy of the allowance for loan losses considers potential adverse situations that have occurred but are not yet known that may affect the borrower’s ability to repay, the estimated value of underlying collateral and economic conditions.

Activity in the allowance for loan losses is as follows (in thousands):

	<u>Nine Months Ended September 30,</u>		<u>Three Months Ended September 30,</u>	
	<u>2000</u>	<u>1999</u>	<u>2000</u>	<u>1999</u>
Balance – beginning of period	\$554,893	\$588,533	\$536,114	\$578,369
Provision for loan losses	--	10,000	--	--
Charge-offs	(27,251)	(30,919)	(6,954)	(9,436)
Recoveries	2,432	3,839	914	1,850
Reclassification	--	(670)	--	--
Balance – end of period	<u>\$530,074</u>	<u>\$570,783</u>	<u>\$530,074</u>	<u>\$570,783</u>

Although management believes that the allowance for loan losses is adequate, it will continue to review its loan portfolio to determine the extent to which any changes in economic conditions or loss experience may require further provisions in the future.

Problem and Potential Problem Assets

The Company considers a loan impaired when, based upon current information and events, it is “probable” that it will be unable to collect all amounts due (*i.e.*, both principal and interest) according to the contractual terms of the loan agreement. Any insignificant delay or insignificant shortfall in amount of payments will not cause a loan to be considered impaired. In determining impairment, the Company considers large non-homogeneous loans including nonaccrual loans, troubled debt restructurings, and performing loans that exhibit, among other characteristics, high LTV ratios, low debt-coverage ratios or other indications that the borrowers are experiencing increased levels of financial difficulty. Loans collectively reviewed for impairment by the Company include all single-family loans, business banking loans under \$100,000 and performing multi-family and commercial real estate loans under \$500,000, excluding loans which have entered the work-out process.

The measurement of impairment may be based on (a) the present value of the expected future cash flows of the impaired loan discounted at the loan's original effective interest rate, (b) the observable market price of the impaired loan, or (c) the fair value of the collateral of a collateral-dependent loan. The Company bases the measurement of collateral-dependent impaired loans on the fair value of the loan's collateral, less disposal costs. The amount, if any, by which the recorded investment of the loan exceeds the measure of the impaired loan's value is recognized by recording a valuation allowance. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

Cash receipts on impaired loans not performing according to contractual terms are generally used to reduce the carrying value of the loan, unless the Company believes it will recover the remaining principal balance of the loan. Impairment losses are included in the allowance for loan losses. Upon disposition of an impaired loan, loss of principal, if any, is recorded through a charge-off to the allowance for loan losses.

At September 30, 2000, loans that were considered to be impaired totalled \$101.4 million (of which \$13.0 million were on nonaccrual status). The average recorded investment in impaired loans during the nine and three-month periods ended September 30, 2000 was approximately \$96.5 million and \$94.8 million, respectively. For the nine and three-month periods ended September 30, 2000, Golden State recognized interest income on those impaired loans of \$6.5 million and \$2.3 million, respectively, which included \$0.5 million and \$0.2 million, respectively, of interest income recognized using the cash basis method of income recognition.

The following table presents the Company's non-performing loans, foreclosed real estate, repossessed assets, troubled debt restructurings and impaired loans as of the dates indicated. These categories are not mutually exclusive; certain loans are included in more than one classification. Purchased sub-prime auto loans are reflected as non-performing, impaired or restructured using each individual loan's contractual unpaid principal balance.

September 30, 2000			
	<u>Non-performing</u>	<u>Impaired</u>	<u>Restructured</u>
	(in millions)		
Real Estate:			
1-4 unit residential	\$ 83	\$ 1	\$ 1
5+ unit residential	3	27	--
Commercial and other	3	43	--
Land	--	--	--
Construction	--	--	--
Total real estate	89	71	1
Non-real estate	15	30	--
Total loans	104 (a)	<u>\$101</u> (b)	<u>\$1</u>
Foreclosed real estate, net	23		
Repossessed assets	7		
Total non-performing assets	<u>\$134</u>		

December 31, 1999			
	<u>Non-performing</u>	<u>Impaired</u>	<u>Restructured</u>
	(in millions)		
Real Estate:			
1-4 unit residential	\$126	\$ --	\$ 2
5+ unit residential	6	34	5
Commercial and other	8	67	18
Land	--	2	--
Construction	--	--	--
Total real estate	140	103	25
Non-real estate	11	21	--
Total loans	151 (a)	<u>\$124</u> (b)	<u>\$25</u>
Foreclosed real estate, net	45		
Repossessed assets	4		
Total non-performing assets	<u>\$200</u>		

(a) Includes loans securitized with recourse on non-performing status of \$2.0 million at December 31, 1999. There are no loans securitized with recourse on non-performing status at September 30, 2000.

(b) Includes \$12.4 million and \$18.9 million of non-performing loans at September 30, 2000 and December 31, 1999, respectively. Also includes \$13.3 million and \$13.7 million of loans classified as troubled debt restructurings at September 30, 2000 and December 31, 1999, respectively.

There were no accruing loans contractually past due 90 days or more at September 30, 2000 or December 31, 1999.

The Company's non-performing assets, consisting of nonaccrual loans, repossessed assets and foreclosed real estate, net, decreased to \$134 million at September 30, 2000, from \$200 million at December 31, 1999. Non-performing assets as a percentage of the Bank's total assets decreased to 0.22% at September 30, 2000, from 0.35% at December 31, 1999.

The Company places a high degree of emphasis on the management of its asset portfolio. The Company has three distinct asset management functions: performing loan asset management, problem loan asset management and credit review. Each of these three functions is charged with the responsibility of reducing the risk profile within the commercial, multi-family and other asset portfolios by applying asset management and risk evaluation techniques that are consistent with the Company's portfolio management strategy and regulatory requirements. In addition to these asset management functions, the Company has a specialized credit risk management group that is charged with the development of credit policies and performing credit risk analyses for all asset portfolios.

The following table presents non-performing real estate assets by geographic region of the country as of September 30, 2000:

	Non-performing Real Estate <u>Loans, Net (2)</u>	Foreclosed Real Estate, <u>Net (2)</u> (dollars in millions)	Total Non-performing Real Estate <u>Assets</u>	<u>Geographic Concentration</u>
Region:				
California	\$56	\$11	\$ 67	60%
Northeast (1)	9	3	12	10
Other regions	<u>24</u>	<u>9</u>	<u>33</u>	<u>30</u>
Total	<u>\$89</u>	<u>\$23</u>	<u>\$112</u>	<u>100%</u>

(1) Consists of Connecticut, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Delaware, Maine, Vermont and Maryland.

(2) Net of purchase accounting adjustments.

At September 30, 2000, the Company had one non-performing asset over \$2 million with a balance of \$2.3 million. At September 30, 2000, the Company had 3,432 non-performing assets below \$2 million in size, including 1,003 non-performing 1-4 unit residential assets.

An allowance is maintained to absorb losses inherent in the loan portfolio. The adequacy of the allowance is periodically evaluated and is based on past loan loss experience, known and inherent risks in the loan portfolio, adverse situations that have occurred but are not yet known that may affect the borrower's ability to repay, the estimated value of underlying collateral and economic conditions. Management's methodology for assessing the adequacy of the allowance includes the evaluation of the following three key elements: the formula allowance, specific allowances for identified problem loans and the unallocated allowance.

The formula allowance is determined by applying loss factors against all non-impaired loans. Loss factors may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. Loss factors are calculated based on migration models that estimate the probability that loans will become delinquent and ultimately result in foreclosure over a period of between one and 2.5 years, depending on the loan type, and the rates of loss that have been experienced on foreclosed loans. The foreclosure migration and loss severity rates are then averaged over the past eight years in order to capture experience across a period that management believes approximates a business cycle. A contingency factor is then added to provide for the modeling risk associated with imprecision in estimating inherent loan losses.

The specific allowances are established against individual loans, including impaired loans. Specific allowances are established against individual residential 1-4 mortgage loans, commercial loans and commercial real estate loans for which management has performed analyses and concluded that, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Generally, management believes that collectibility is improbable if a loan is severely delinquent or if it has been determined that borrower cash flow is inadequate for debt repayment. The amount of specific allowance is determined by an estimation of collateral deficiency, including consideration of costs that will likely be incurred through the disposal of any repossessed collateral. In other words, management estimates the fair value of

collateral, net of the cost of disposition of the collateral, and the fair value is compared to the net book value of the loan. If the net book value exceeds the fair value, a specific allowance is established in an amount equal to the excess. Loans evaluated for specific allowance are excluded from the formula allowance analysis so as not to double-count loss exposure.

The unallocated allowance is established for inherent losses which may not have been identified through the more objective processes used to derive the formula and specific portions of the allowance. The unallocated portion is necessarily more subjective and requires a high degree of management judgment and experience. Management has identified several factors that impact the potential for credit losses that are not considered in either the formula or the specific allowance segments. These factors consist of industry and geographic loan concentrations, changes in the composition of loan portfolios through acquisitions and new business strategies, changes in underwriting processes, and trends in problem loan and loss recovery rates. Each factor is analyzed and assigned a range of values. At this time, management has chosen an unallocated allowance amount at the mid-point of the range for each factor.

At September 30, 2000, the allowance for loan losses was \$530 million, consisting of a \$377 million formula allowance, a \$23 million specific allowance and a \$130 million unallocated allowance.

Although the loan loss allowance has been allocated by type of loan for internal valuation purposes, \$507 million of the allowance is general in nature and is available to support any losses which may occur, regardless of type, in the Company's loan portfolio. A summary of the activity in the total allowance for loan losses by loan type is as follows:

	<u>1 – 4 Unit Residential</u>	<u>5+ Unit Residential and Commercial Real Estate</u>	<u>Consumer and Other</u>	<u>Total</u>
	(in millions)			
Balance – December 31, 1999	\$235	\$276	\$44	\$555
Provision for loan losses	--	(1)	1	--
Charge-offs	(2)	(4)	(7)	(13)
Recoveries	<u>--</u>	<u>--</u>	<u>1</u>	<u>1</u>
Balance – March 31, 2000	233	271	39	543
Provision for loan losses	--	(1)	1	--
Charge-offs	(2)	(2)	(4)	(8)
Recoveries	<u>--</u>	<u>--</u>	<u>1</u>	<u>1</u>
Balance – June 30, 2000	231	268	37	536
Provision for loan losses	--	(3)	3	--
Charge-offs	(1)	--	(6)	(7)
Recoveries	--	--	1	1
Reclassifications	<u>--</u>	<u>(80)</u>	<u>80</u>	<u>--</u>
Balance – September 30, 2000	<u>\$230</u>	<u>\$185</u>	<u>\$115</u>	<u>\$530</u>

Asset and Liability Management

Banks and savings associations are subject to interest rate risk to the degree that their interest-bearing liabilities, consisting principally of deposits, securities sold under agreements to repurchase and FHLB advances, mature or reprice more or less frequently, or on a different basis, than their interest-earning assets. A key element of the banking business is the monitoring and management of liquidity risk and interest rate risk. The process of planning and controlling asset and liability mixes, volumes and maturities to influence the net interest spread is referred to as asset and liability management. The objective of the Company's asset and liability management is to maximize its net interest income over changing interest rate cycles within the constraints imposed by prudent lending and investing practices, liquidity needs and capital planning.

Golden State, through the Bank, actively pursues investment and funding strategies intended to minimize the sensitivity of its earnings to interest rate fluctuations. The Company measures the interest rate sensitivity of its balance sheet through gap and duration analysis, as well as net interest income and market value simulation. After taking into consideration both the variability of rates and the maturities of various instruments, it evaluates strategies which may reduce the sensitivity of its earnings to interest rate and market value fluctuations. An important decision is the selection of interest-bearing liabilities and the generation of interest-earning assets which best match relative to interest rate changes. In order to reduce interest rate risk by increasing the percentage of interest sensitive assets, the Company has continued its emphasis on the origination of adjustable rate mortgage ("ARM") products for its portfolio. Where possible, the Company seeks to originate real estate and other loans that reprice frequently. At September 30, 2000, approximately 77% of the Company's loan portfolio consisted of ARMs.

One of the most important sources of the Bank's net income is net interest income, which is the difference between the combined yield earned on interest-earning assets and the combined rate paid on interest-bearing liabilities. Net interest income is also dependent on the relative balances of interest-earning assets and interest-bearing liabilities.

ARMs have, from time to time, been offered with low initial interest rates as marketing inducements. In addition, most ARMs are subject to periodic interest rate adjustment caps or floors. In a period of rising interest rates, ARMs could reach a periodic adjustment cap while still at a rate significantly below their contractual margin over existing market rates. Since repricing liabilities are typically not subject to such interest rate adjustment constraints, the Company's net interest margin would most likely be negatively impacted in this situation. Certain ARMs now offered by the Company have a fixed monthly payment for a given period, with any changes as a result of market interest rates reflected in the unpaid principal balance through negative amortization.

A traditional measure of interest rate risk within the savings industry is the interest rate sensitivity gap, which is the sum of all interest-earning assets minus the sum of all interest-bearing liabilities to be repriced within the same period. A gap is considered positive when the amount of interest rate sensitive assets exceed interest rate sensitive liabilities, while the opposite results in a negative gap. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, and a positive gap would tend to result in an increase in net interest income. During a period of falling rates, the opposite would tend to occur.

The following table sets forth the projected maturities based upon contractual maturities as adjusted for projected prepayments and “repricing mechanisms” (provisions for changes in the interest rates of assets and liabilities). Prepayment rates are assumed in each period on substantially all of the Company’s loan portfolio based upon expected loan prepayments. Repricing mechanisms on the Company’s assets are subject to limitations, such as caps on the amount that interest rates and payments on its loans may adjust. Accordingly, such assets may not respond in the same manner or to the same extent to changes in interest rates as the Company’s liabilities. In addition, the interest rate sensitivity of the assets and liabilities illustrated in the table would vary substantially if different assumptions were used or if actual experience differed from the assumptions set forth. The Company’s estimated interest rate sensitivity gap at September 30, 2000 was as follows:

	Maturity/Rate Sensitivity				
	Within 1 Year	1 – 5 Years	Over 5 Years	Noninterest Bearing	Total
	(dollars in millions)				
INTEREST-EARNING ASSETS:					
Interest-bearing deposits in other banks and short-term investment securities (1) (2)	\$ 74	\$ --	\$ --	\$ --	\$ 74
Securities held to maturity (1)	67	153	374	--	594
Securities available for sale (3)	632	--	--	--	632
Mortgage-backed securities available for sale (3)	10,771	--	--	--	10,771
Mortgage-backed securities held to maturity (1) (4)	1,960	392	644	--	2,996
Loans held for sale, net (3)	875	--	--	--	875
Loans receivable, net (1) (5)	21,279	13,444	4,745	--	39,468
Investment in FHLB	<u>1,339</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,339</u>
Total interest-earning assets	36,997	13,989	5,763	--	56,749
Noninterest-earning assets	<u>--</u>	<u>--</u>	<u>--</u>	<u>3,811</u>	<u>3,811</u>
	<u>\$36,997</u>	<u>\$ 13,989</u>	<u>\$5,763</u>	<u>\$3,811</u>	<u>\$60,560</u>
INTEREST-BEARING LIABILITIES:					
Deposits (6)	\$21,604	\$ 1,589	\$ 7	\$ --	\$23,200
Securities sold under agreements to repurchase (1)	5,138	200	--	--	5,338
FHLB advances (1)	13,422	12,698	--	--	26,120
Other borrowings (1)	<u>752</u>	<u>1,401</u>	<u>92</u>	<u>--</u>	<u>2,245</u>
Total interest-bearing liabilities	40,916	15,888	99	--	56,903
Noninterest-bearing liabilities	--	--	--	1,227	1,227
Minority interest	--	--	--	500	500
Stockholders' equity	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,930</u>	<u>1,930</u>
	<u>\$40,916</u>	<u>\$ 15,888</u>	<u>\$ 99</u>	<u>\$3,657</u>	<u>\$60,560</u>
Gap before interest rate swap agreements	\$ (3,919)	\$ (1,899)	\$5,664		\$ (154)
Interest rate swap agreements	<u>3,550</u>	<u>(2,800)</u>	<u>(750)</u>		<u>--</u>
Gap	<u>\$ (369)</u>	<u>\$ (4,699)</u>	<u>\$4,914</u>		<u>\$ (154)</u>
Cumulative gap	<u>\$ (369)</u>	<u>\$ (5,068)</u>	<u>\$ (154)</u>		<u>\$ (154)</u>
Gap as a percentage of total assets	<u>(0.61)%</u>	<u>(7.76)%</u>	<u>8.12%</u>		<u>(0.25)%</u>
Cumulative gap as a percentage of total assets	<u>(0.61)%</u>	<u>(8.37)%</u>	<u>(0.25)%</u>		<u>(0.25)%</u>

(Continued)

-
- (1) Based upon (a) contractual maturity, (b) instrument repricing date, if applicable, and (c) projected repayments and prepayments of principal, if applicable. Prepayments were estimated generally by using the prepayment rates forecast by various large brokerage firms as of September 30, 2000. The actual maturity and rate sensitivity of these assets could vary substantially if future prepayments differ from prepayment estimates.
 - (2) Consists of \$74 million of short-term investment securities and less than \$0.1 million of interest-bearing deposits in other banks.
 - (3) As securities and mortgage-backed securities available for sale and loans held for sale may be sold within one year, they are considered to be maturing within one year.
 - (4) Excludes underlying non-performing loans of \$1 million.
 - (5) Excludes allowance for loan losses of \$530 million and non-performing loans of \$102 million, net of \$8 million related to specific allowances.
 - (6) Fixed rate deposits and deposits with fixed pricing intervals are reflected as maturing in the year of contractual maturity or first repricing date. Money market deposit accounts, demand deposit accounts and passbook accounts are reflected as maturing within one year.

At September 30, 2000, Golden State's cumulative gap totalled \$(154) million. At December 31, 1999, Golden State's cumulative gap totalled (\$688) million.

The Company utilizes computer modeling, under various interest rate scenarios, to provide a dynamic view of the effects of the changes in rates, spreads, and yield curve shifts on net interest income. However, the maturity/rate sensitivity analysis is a static view of the balance sheet with assets and liabilities grouped into certain defined time periods, and only partially depicts the dynamics of the Company's sensitivity to interest rate changes. Therefore, this analysis may not fully describe the complexity of relationships between product features and pricing, market rates and future management of the balance sheet mix.

The Company's risk management policies are established by the Asset/Liability Management Committee ("ALCO") of the Bank. ALCO meets monthly to formulate the Bank's investment and risk management strategies. The basic responsibilities of ALCO include management of net interest income and market value of portfolio equity to measure the stability of earnings, management of liquidity to provide adequate funding, and the establishment of asset product priorities by formulating performance evaluation criteria, risk evaluation techniques and a system to standardize the analysis and reporting of originations, competitive trends, profitability and risk. On a quarterly basis, the Board of Directors of the Bank is apprised of ALCO strategies adopted and their impact on operations, and, at least annually, the Board of Directors of the Bank reviews the Bank's interest rate risk management policy statements.

Liquidity

The standard measure of liquidity in the savings industry is the ratio of cash and short-term U.S. Government securities and other specified securities to deposits and borrowings due within one year. The OTS established a minimum liquidity requirement for the Bank of 4.00%. California Federal has been in compliance with the liquidity regulations during the nine months ended September 30, 2000 and the year ended December 31, 1999.

The major source of funding for Golden State on an unconsolidated basis is distributions from its subsidiary, GS Holdings, which receives substantially all of its funding from distributions of the Bank's earnings and tax sharing payments. Net income generated by the Bank is used to meet its cash flow needs, including paying dividends on its preferred stock owned by GS Holdings, and may be distributed, subject to certain restrictions, to GS Holdings. In turn, GS Holdings uses distributions received from the Bank primarily to meet debt service requirements, pay any expenses it may incur, and make distributions to Golden State, subject to certain restrictions. For more information on dividend restrictions for the Bank and GS Holdings, refer to "Business – Regulation and Supervision" and note 25 of the "Notes to Consolidated Financial Statements" in the Company's 1999 Form 10-K.

On a consolidated basis, a major source of the Company's funding is expected to be the Bank's retail deposit branch network, which management believes will be sufficient to meet its long-term liquidity needs. The ability of the Company to retain and attract new deposits is dependent upon the variety and effectiveness of its customer account products, customer service and convenience, and rates paid to customers. The Company also obtains funds from the repayment and maturities of loans and mortgage-backed securities, while additional funds can be obtained from a variety of other sources, including customer and brokered deposits, loan sales, securities sold under agreements to repurchase, FHLB advances, and other secured and unsecured borrowings. It is anticipated that FHLB advances and securities sold under agreements to repurchase will continue to be important sources of funding, and management expects there to be adequate collateral for such funding requirements.

Interest on the GS Holdings Notes approximates \$142.5 million per year. Although GS Holdings expects that distributions and tax sharing payments from the Bank will be sufficient to make required interest and principal payments, there can be no assurance that earnings from the Bank will be sufficient to make such distributions to GS Holdings. In addition, there can be no assurance that such distributions will be permitted by the terms of any debt instruments of GS Holdings' subsidiaries then in effect, by the terms of any class of preferred stock issued by the Bank or its subsidiaries, including the REIT Preferred Stock, or under applicable federal thrift laws.

The Company anticipates that cash and cash equivalents on hand, the cash flows from assets as well as other sources of funds will provide adequate liquidity for its operating, investing and financing needs and the Bank's regulatory liquidity requirements for the foreseeable future. In addition to cash and cash equivalents of \$657.0 million at September 30, 2000, the Company has substantial additional borrowing capacity with the FHLB and other sources.

The consolidated Company's primary uses of funds are the origination or purchase of loans, the purchase of mortgage-backed securities, the funding of maturing certificates of deposit, demand deposit withdrawals, the repayment of borrowings and dividends to common shareholders. Certificates of deposit scheduled to mature during the twelve months ending September 30, 2001 aggregate \$10.0 billion. The Company may renew these certificates, attract new replacement deposits, replace such funds with other borrowings, or it may elect to reduce the size of the balance sheet. In addition, at September 30, 2000, Golden State had FHLB advances, securities sold under agreements to repurchase and other borrowings aggregating \$19.3 billion maturing or repricing within twelve months. The Company may elect to pay off such debt or to replace such borrowings with additional FHLB advances, securities sold under agreements to repurchase or other borrowings at prevailing rates.

As presented in the accompanying unaudited consolidated statements of cash flows, the sources of liquidity vary between periods. The primary sources of funds during the nine months ended September 30, 2000 were \$29.5 billion in proceeds from additional borrowings, \$3.5 billion in proceeds from sales of loans held for sale, \$1.8 billion in principal payments on mortgage-backed securities available for sale and held to maturity, and \$667 million in proceeds from sales of mortgage-backed securities available for sale. The primary uses of funds were \$26.8 billion in principal payments on borrowings, a \$3.7 billion net increase in loans receivable, \$3.8 billion in purchases and originations of loans held for sale, \$1.2 billion in purchases of loans receivable and \$379.3 million for the Downey Acquisition.

Mortgage Banking Operations

During the nine months ended September 30, 2000 and 1999, the Company, through the Bank's wholly owned mortgage bank subsidiary, FNMC, acquired mortgage-servicing rights on loan portfolios of \$13.5 billion and \$12.9 billion, respectively. The 1-4 unit residential loans serviced for others (including loans sub-serviced for others and excluding loans serviced for the Bank) totalled \$83.0 billion at September 30, 2000, an increase of \$10.1 billion and \$10.7 billion from December 31, 1999 and September 30, 1999, respectively. During the nine months ended September 30, 2000 and 1999, the Bank, through FNMC, originated \$10.3 billion and \$12.9 billion, respectively, and sold (generally with servicing retained) \$3.7 billion and \$8.7 billion, respectively, of 1-4 unit residential loans. Gross revenues from mortgage loan servicing activities for the nine months ended September 30, 2000 totalled \$234.0 million, an increase of \$28.0 million from the nine months ended September 30, 1999. Gross loan servicing fees for the nine months ended September 30, 2000 were reduced by \$146.8 million of amortization of servicing rights to arrive at net loan servicing fees of \$87.2 million.

A decline in long-term interest rates generally results in an acceleration of mortgage loan prepayments. Higher than anticipated levels of prepayments generally cause the accelerated amortization of mortgage servicing rights (“MSRs”), and generally will result in a reduction in the market value of MSRs and in the Company’s servicing fee income. To reduce the sensitivity of its earnings to interest rate and market value fluctuations, the Company hedged the change in value of its MSRs based on changes in interest rates (“MSR Hedge”).

The Company owned several derivative instruments at September 30, 2000 which were used to hedge against prepayment risk in its mortgage servicing portfolio. These derivative instruments included Constant Maturity Swap interest rate floor contracts, swaptions and principal only swaps. The estimated fair value of all derivatives used to hedge prepayment risk was \$50.8 million at September 30, 2000. The interest rate floor contracts had a notional amount of \$1.5 billion, strike rates between 5.70% and 7.13%, mature in the years 2002 and 2003, and had an estimated fair value of \$24.4 million at September 30, 2000. Premiums paid to counterparties in exchange for cash payments when the 10-year Constant Maturity Swap rate falls below the strike rate are recorded as part of the MSR asset on the balance sheet. The swaption contracts had a notional amount of \$1.4 billion, strike rates between 6.50% and 7.88%, expire in the years 2002 and 2003, and had an estimated fair value of \$34.7 million at September 30, 2000. Premiums paid to counterparties in exchange for the right to enter into an interest rate swap are recorded as part of the MSR asset on the balance sheet. Principal only swap agreements had notional amounts of \$195.5 million and an estimated fair value of \$(8.3) million at September 30, 2000.

The following is a summary of activity in MSRs (including non-residential MSRs) and the MSR Hedge for the nine months ended September 30, 2000 (in millions):

	<u>MSRs</u>	<u>MSR Hedge</u>	<u>Total MSR Balance</u>
Balance at December 31, 1999	\$1,232	\$ 40	\$1,272
Additions – purchases	288	--	288
Originated servicing	90	--	90
Swaption sales	(5)	(13)	(18)
Servicing Sale/Transfer	(1)	--	(1)
Floor sales	(4)	(7)	(11)
Premiums paid	--	42	42
Payments made to counterparties, net	3	--	3
Amortization	<u>(138)</u>	<u>(11)</u>	<u>(149)</u>
Balance at September 30, 2000	<u>\$1,465</u>	<u>\$ 51</u>	<u>\$1,516</u>

Capitalized MSRs are amortized in proportion to, and over the period of, estimated net servicing income. SFAS No. 125 requires enterprises to measure the impairment of MSRs based on the difference between the carrying amount of the MSRs and their current fair value. At September 30, 2000 and December 31, 1999, no allowance for impairment of the MSRs was necessary.

Capital Resources

OTS capital regulations require savings associations to satisfy three minimum capital requirements: tangible capital, core (leverage) capital, and risk-based capital.

Tangible capital. Tangible capital is the sum of common stockholders’ equity (including retained earnings), noncumulative perpetual preferred stock and minority interest in equity accounts of fully consolidated subsidiaries, less disallowed intangibles. Tangible capital must be at least 1.5% of adjusted total assets.

Core capital. Core capital generally is the sum of tangible capital plus certain other qualifying intangibles. Under the leverage requirement, a savings association is required to maintain core capital equal to a minimum of 4% of adjusted total assets.

Risk-based capital. Risk-based capital equals the sum of core capital plus supplementary capital. Risk-based capital must be at least 8% of risk-weighted assets.

Risk-weighted assets. Risk-weighted assets equal assets plus the credit risk equivalent of certain off-balance sheet items, multiplied by the appropriate risk weight.

Supplementary capital. Supplementary capital includes certain permanent capital instruments, such as qualifying cumulative perpetual preferred stock, as well as some forms of term capital instruments, such as qualifying subordinated debt. Supplementary capital may not exceed 100% of core capital for purposes of the risk-based requirement.

Minimum requirements. These capital requirements discussed above are viewed as minimum standards by the OTS, and most associations are expected to maintain capital levels well above the minimum. In addition, the OTS regulations provide that minimum capital levels higher than those provided in the regulations may be established by the OTS for individual savings associations, depending upon their circumstances. These capital requirements are currently applicable to the Bank but not to Golden State. The Bank is not subject to any such individual regulatory capital requirement that is higher than the minimum.

At September 30, 2000, the Bank's regulatory capital levels exceeded the minimum regulatory capital requirements, with tangible, core and risk-based capital ratios of 6.25%, 6.25% and 13.20%, respectively. The following is a reconciliation of the Bank's stockholder's equity to regulatory capital as of September 30, 2000:

	<u>Tangible Capital</u>	<u>Core Capital</u>	<u>Risk-based Capital</u>
	(dollars in millions)		
Stockholder's equity of the Bank	\$ 4,001	\$ 4,001	\$ 4,001
Minority interest – REIT Preferred Stock	500	500	500
Unrealized holding loss on securities, net	202	202	202
Non-allowable capital:			
Intangible assets	(727)	(727)	(727)
Goodwill Litigation Assets	(159)	(159)	(159)
Investment in non-includable subsidiaries	(63)	(63)	(63)
Excess deferred tax asset	(10)	(10)	(10)
Supplemental capital:			
Qualifying subordinated debentures	--	--	93
General loan loss allowance	--	--	401
Assets required to be deducted:			
Land loans with more than 80% LTV ratio	--	--	(5)
Equity in subsidiaries	--	--	(6)
Low-level recourse deduction	--	--	(10)
Regulatory capital of the Bank	3,744	3,744	4,217
Minimum regulatory capital requirement	<u>898</u>	<u>2,397</u>	<u>2,556</u>
Excess above minimum capital requirement	<u>\$ 2,846</u>	<u>\$ 1,347</u>	<u>\$ 1,661</u>
Regulatory capital of the Bank	6.25%	6.25%	13.20%
Minimum regulatory capital requirement	<u>1.50</u>	<u>4.00</u>	<u>8.00</u>
Excess above minimum capital requirement	<u>4.75%</u>	<u>2.25%</u>	<u>5.20%</u>

The amount of adjusted total assets used for the tangible and leverage capital ratios is \$59.9 billion. Risk-weighted assets used for the risk-based capital ratio amounted to \$31.9 billion.

The Bank is also subject to the “prompt corrective action” standards prescribed in FDICIA and related OTS regulations, which, among other things, define specific capital categories based on an association’s capital ratios. The capital categories, in declining order, are “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” Under the regulation, the ratio of total capital to risk-weighted assets, core capital to risk-weighted assets and the leverage capital ratio are used to determine an association’s capital classification. The Bank met the capital requirements of a “well capitalized” institution under the FDICIA prompt corrective action standards as of September 30, 2000. The Bank is not presently subject to any enforcement action or other regulatory proceeding with respect to the prompt corrective action regulation.

At September 30, 2000, the Bank’s capital levels were sufficient for it to be considered “well capitalized,” as presented below.

	Leverage	Risk-based	
	<u>Capital</u>	<u>Tier 1</u>	<u>Total Capital</u>
Regulatory capital of the Bank	6.25%	11.69%	13.20%
“Well capitalized” ratio	<u>5.00</u>	<u>6.00</u>	<u>10.00</u>
Excess above “well capitalized” ratio	<u>1.25%</u>	<u>5.69%</u>	<u>3.20%</u>

OTS capital regulations allow a savings association to include a net deferred tax asset in regulatory capital, subject to certain limitations. To the extent that the realization of a deferred tax asset depends on a savings association’s future taxable income, such deferred tax asset is limited for regulatory capital purposes to the lesser of the amount that can be realized within one year or 10 percent of core capital. At September 30, 2000, \$10 million of the net tax benefit was determined to be attributable to the amount of taxable income that may be realized in periods beyond one year. Accordingly, such amount has been excluded from the Bank’s regulatory capital at September 30, 2000.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in reported market risks faced by Golden State since the Company’s report in Item 7A of its Form 10-K for the year ended December 31, 1999.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings.

Goodwill Litigation Against the Government

On April 9, 1999, the Claims Court issued its decision on a claim by the Bank against the United States Government (the “Government”) in the lawsuit, *Glendale Federal Bank, Federal Savings Bank v. United States*, Civil Action No. 90-772-C (the “Glendale Goodwill Litigation”), ruling that the Government must compensate the Bank in the sum of \$908.9 million. This decision was appealed by the Government and the Bank. After all appellate briefs were filed by both the Government and the Bank, oral argument on the appeal took place in conjunction with the argument in the California Federal Goodwill Litigation (as defined herein) on July 7, 2000.

On April 16, 1999, the Claims Court issued its decision on a claim by the Bank against the Government in the lawsuit, *California Federal Bank v. United States*, Civil Action No. 92-138C (the “California Federal Goodwill Litigation”), ruling that the Government must compensate the Bank in the sum of \$23.0 million. The summary judgment liability decision by the first Claims Court Judge has been appealed by the Government and the damage award by the second Claims Court Judge has been appealed by the Bank. After all appellate briefs were filed, oral argument in the Federal Circuit Court of Appeals took place in conjunction with the appellate argument in the Glendale Goodwill Litigation on July 7, 2000.

In each of the Glendale Goodwill Litigation and the California Federal Goodwill Litigation, it is alleged, among other things, that the United States breached certain contractual commitments regarding the computation of its regulatory capital for which each of Glendale Federal and California Federal seek damages and restitution. The claims arose from changes made by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 and its implementing regulations (“FIRREA”) with respect to the rules for computing regulatory capital.

Other Litigation

In addition to the matters described above, Golden State and its subsidiaries are involved in other legal proceedings on claims incidental to the normal conduct of their business. Although it is impossible to predict the outcome of any outstanding legal proceedings, management believes that such legal proceedings and claims, individually or in the aggregate, will not have a material effect on Golden State, GS Holdings, or the Bank.

ITEM 2. Changes in Securities.

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.

ITEM 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

3.1 Certificate of Incorporation of the Registrant, as amended. (Incorporated by reference to Exhibits 3.1 and 3.2 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1998.)

3.2 By-laws of the Registrant, as amended. (Incorporated by reference to Exhibit 3.2 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.)

27.1 Financial Data Schedule.

(b) Reports on Form 8-K:

None.

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.

Golden State Bancorp Inc.

/s/ Richard H. Terzian

By: Richard H. Terzian
Executive Vice President
and Chief Financial Officer
(Principal Financial Officer)

/s/ Renee Nichols Tucei

By: Renee Nichols Tucei
Executive Vice President and Controller
(Principal Accounting Officer)

November 8, 2000