

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 June 30, 2002

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: 000-24915

Golden State Holdings Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-4669792

(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 July 31, 2002: 1,000 shares.

Registrant meets the conditions set forth in General Instruction H (1) (a) and (b) of Form 10-Q and is therefore filing this Form with certain reduced disclosures, as permitted by General Instruction H (2).

**GOLDEN STATE HOLDINGS INC.  
SECOND QUARTER 2002 REPORT ON FORM 10-Q  
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\* Item 3 of Part I and Items 2, 3 and 4 of Part II are not included as per conditions met by Registrant set forth in General Instruction H (1) (a) and (b) of Form 10-Q.

Golden State Holdings Inc. is a wholly owned subsidiary of Golden State Bancorp Inc. For more information, refer to Golden State Bancorp Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2002.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**June 30, 2002 and December 31, 2001**  
(Unaudited)  
(dollars in thousands, except per share data)

<u>Assets</u>	<u>June 30, 2002</u>	<u>December 31, 2001</u>
Cash and due from banks	\$ 770,042	\$ 709,139
Interest-bearing deposits in other banks	98	103
Short-term investment securities	<u>82,792</u>	<u>95,929</u>
Cash and cash equivalents	852,932	805,171
Securities available for sale, at fair value	118,231	116,054
Securities held to maturity	29,260	30,602
Mortgage-backed securities available for sale, at fair value	4,887,838	7,057,903
Mortgage-backed securities held to maturity	1,170,973	1,385,113
Loans held for sale, net	1,324,335	2,608,365
Loans receivable, net	38,626,259	39,335,623
Investment in FHLB System	1,195,657	1,446,607
Premises and equipment, net	267,200	276,411
Foreclosed real estate, net	13,565	18,564
Accrued interest receivable	269,255	288,308
Goodwill (net of accumulated amortization of \$286,470 at both June 30, 2002 and December 31, 2001)	564,560	590,420
Other intangible assets (net of accumulated amortization of \$21,875 at June 30, 2002 and \$19,541 at December 31, 2001)	48,089	50,423
MSRs (net of valuation allowance of \$280,452 at June 30, 2002 and \$153,345 at December 31, 2001)	1,539,592	1,623,947
Derivative assets	224,000	349,026
Other assets	<u>766,602</u>	<u>536,281</u>
Total assets	<u>\$51,898,348</u>	<u>\$56,518,818</u>
 <u>Liabilities, Minority Interest and Stockholder's Equity</u>		
Deposits	\$24,381,991	\$25,146,827
Securities sold under agreements to repurchase	2,060,144	2,363,945
Borrowings	20,708,897	24,444,541
Derivative liabilities	262,162	250,711
Other liabilities	<u>1,213,111</u>	<u>1,188,005</u>
Total liabilities	<u>48,626,305</u>	<u>53,394,029</u>
Commitments and contingencies	--	--
Minority interest	500,000	500,000
Stockholder's equity		
Common stock, \$1.00 par value, 1,000 shares authorized, issued and outstanding	1	1
Additional paid-in capital	1,575,565	1,569,894
Accumulated other comprehensive loss, net	(83,572)	(63,327)
Retained earnings (substantially restricted)	<u>1,280,049</u>	<u>1,118,221</u>
Total stockholder's equity	<u>2,772,043</u>	<u>2,624,789</u>
Total liabilities, minority interest and stockholder's equity	<u>\$51,898,348</u>	<u>\$56,518,818</u>

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**  
**Six Months Ended June 30, 2002 and 2001**  
**(Unaudited)**  
(in thousands)

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Interest income:		
Loans receivable	\$1,291,002	\$1,541,014
Mortgage-backed securities available for sale	168,498	344,977
Mortgage-backed securities held to maturity	39,730	70,983
Loans held for sale	70,703	52,676
Securities available for sale	3,281	14,575
Securities held to maturity	276	16,452
Interest-bearing deposits in other banks	158	539
Dividends on FHLB stock	40,792	45,372
Other	<u>12,078</u>	<u>--</u>
Total interest income	<u>1,626,518</u>	<u>2,086,588</u>
Interest expense:		
Deposits	260,862	464,489
Securities sold under agreements to repurchase	42,354	121,392
Borrowings	583,848	853,847
Other	<u>1,455</u>	<u>--</u>
Total interest expense	<u>888,519</u>	<u>1,439,728</u>
Net interest income	737,999	646,860
Provision for loan losses	<u>--</u>	<u>--</u>
Net interest income after provision for loan losses	<u>737,999</u>	<u>646,860</u>
Noninterest income:		
Loan servicing fees, net	(106,586)	(6,906)
Customer banking fees and service charges	119,020	105,820
Gain on sale, settlement and transfer of loans, net	55,515	21,885
Gain on sale of assets, net	8,382	16,221
Other income	<u>11,637</u>	<u>36,440</u>
Total noninterest income	<u>87,968</u>	<u>173,460</u>
Noninterest expense:		
Compensation and employee benefits	242,595	231,197
Occupancy and equipment	81,012	77,801
Professional fees	16,069	14,650
Loan expense	7,531	8,569
Foreclosed real estate operations, net	(671)	(853)
Amortization of goodwill and other intangible assets	2,334	29,880
Other expense	<u>108,168</u>	<u>111,164</u>
Total noninterest expense	<u>457,038</u>	<u>472,408</u>
Income before income taxes, minority interest and cumulative effect of change in accounting principle	368,929	347,912
Income tax expense	113,607	123,709
Minority interest	<u>13,494</u>	<u>13,494</u>
Income before cumulative effect of change in accounting principle	241,828	210,709
Cumulative effect of change in accounting principle, net of applicable taxes of \$1,072 in 2001	<u>--</u>	<u>(1,552)</u>
Net income	<u>\$ 241,828</u>	<u>\$ 209,157</u>

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**  
**Three Months Ended June 30, 2002 and 2001**  
(Unaudited)  
(in thousands)

	<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Interest income:		
Loans receivable	\$641,843	\$ 763,224
Mortgage-backed securities available for sale	75,932	163,994
Mortgage-backed securities held to maturity	18,313	33,572
Loans held for sale	28,898	32,549
Securities available for sale	1,651	3,795
Securities held to maturity	129	7,951
Interest-bearing deposits in other banks	33	120
Dividends on FHLB stock	19,953	22,326
Other	<u>12,078</u>	<u>--</u>
Total interest income	<u>798,830</u>	<u>1,027,531</u>
Interest expense:		
Deposits	125,720	223,652
Securities sold under agreements to repurchase	21,004	53,447
Borrowings	281,038	414,044
Other	<u>750</u>	<u>--</u>
Total interest expense	<u>428,512</u>	<u>691,143</u>
Net interest income	370,318	336,388
Provision for loan losses	<u>--</u>	<u>--</u>
Net interest income after provision for loan losses	<u>370,318</u>	<u>336,388</u>
Noninterest income:		
Loan servicing fees, net	(97,771)	19,746
Customer banking fees and service charges	60,872	54,559
Gain on sale, settlement and transfer of loans, net	20,896	16,961
Gain on sale of assets, net	10,268	15,782
Other income	<u>5,409</u>	<u>7,181</u>
Total noninterest income	<u>(326)</u>	<u>114,229</u>
Noninterest expense:		
Compensation and employee benefits	117,811	113,462
Occupancy and equipment	40,777	39,951
Professional fees	8,743	9,802
Loan expense	3,375	4,367
Foreclosed real estate operations, net	161	(455)
Amortization of goodwill and other intangible assets	1,167	14,940
Other expense	<u>52,466</u>	<u>59,203</u>
Total noninterest expense	<u>224,500</u>	<u>241,270</u>
Income before income taxes, minority interest and cumulative effect of change in accounting principle	145,492	209,347
Income tax expense	22,320	87,526
Minority interest	<u>6,747</u>	<u>6,747</u>
Income before cumulative effect of change in accounting principle	116,425	115,074
Cumulative effect of change in accounting principle, net of applicable taxes of \$1,072 in 2001	<u>--</u>	<u>(1,552)</u>
Net income	<u>\$116,425</u>	<u>\$ 113,522</u>

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Statements of Comprehensive Income**  
**Six Months Ended June 30, 2002 and 2001**  
(Unaudited)  
(in thousands)

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Net income	\$241,828	\$209,157
Other comprehensive (loss) income, net of tax:		
Unrealized holding (loss) gain on securities available for sale:		
Unrealized holding (loss) gain arising during the period	(2,185)	98,165
Less: reclassification adjustment for gain included in net income	<u>(1,202)</u>	<u>(9,572)</u>
	(3,387)	88,593
Amortization of market adjustment for securities transferred from available-for-sale to held-to-maturity	--	3,466
Transition adjustment upon adoption of SFAS No. 133	--	(44,647)
Unrealized loss on derivatives used for cash flow hedges:		
Unrealized holding loss arising during the period	(68,286)	(28,677)
Less: reclassification adjustment for loss included in net income	<u>51,428</u>	<u>11,917</u>
Change in fair value of derivatives used for cash flow hedges, net of applicable taxes of \$11,642 in 2002 and \$11,574 in 2001	<u>(16,858)</u>	<u>(16,760)</u>
Other comprehensive (loss) income	<u>(20,245)</u>	<u>30,652</u>
Comprehensive income	<u>\$221,583</u>	<u>\$239,809</u>

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Statements of Comprehensive Income**  
**Three Months Ended June 30, 2002 and 2001**  
(Unaudited)  
(in thousands)

	<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Net income	\$116,425	\$113,522
Other comprehensive (loss) income, net of tax:		
Unrealized holding gain (loss) on securities available for sale:		
Unrealized holding gain (loss) arising during the period	21,537	(1,050)
Less: reclassification adjustment for gain included in net income	<u>(435)</u>	<u>(9,490)</u>
	21,102	(10,540)
Amortization of market adjustment for securities transferred from available-for-sale to held-to-maturity	--	1,989
Unrealized (loss) gain on derivatives used for cash flow hedges:		
Unrealized holding (loss) gain arising during the period	(79,519)	11,748
Less: reclassification adjustment for loss included in net income	<u>26,670</u>	<u>8,689</u>
Change in fair value of derivatives used for cash flow hedges, net of applicable taxes of \$36,500 in 2002 and \$14,114 in 2001	<u>(52,849)</u>	<u>20,437</u>
Other comprehensive (loss) income	<u>(31,747)</u>	<u>11,886</u>
Comprehensive income	<u>\$ 84,678</u>	<u>\$125,408</u>

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
**Consolidated Statement of Stockholder's Equity**  
**Six Months Ended June 30, 2002**  
(Unaudited)  
(in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Securities	Other Comprehensive (Loss) Derivatives	Income, Net Total	Retained Earnings (Substantially Restricted)	Total Stockholder's Equity
Balance at December 31, 2001	\$ 1	\$1,569,894	\$56,052	\$(119,379)	\$(63,327)	\$1,118,221	\$2,624,789
Net income	--	--	--	--	--	241,828	241,828
Change in net unrealized holding gain on securities available for sale	--	--	(3,387)	--	(3,387)	--	(3,387)
Change in net unrealized holding loss on derivatives	--	--	--	(16,858)	(16,858)	--	(16,858)
Dividends to parent	--	--	--	--	--	(80,000)	(80,000)
Impact of Golden State restricted common stock	--	2,600	--	--	--	--	2,600
Tax benefit on exercise of stock options	--	<u>3,071</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>3,071</u>
Balance at June 30, 2002	<u>\$ 1</u>	<u>\$1,575,565</u>	<u>\$52,665</u>	<u>\$(136,237)</u>	<u>\$(83,572)</u>	<u>\$1,280,049</u>	<u>\$2,772,043</u>

See accompanying notes to unaudited consolidated financial statements.



**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**  
**Six Months Ended June 30, 2002 and 2001**

(Unaudited)  
(in thousands)

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income	\$ 241,828	\$ 209,157
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of goodwill and other intangible assets	2,334	29,880
Amortization of purchase accounting premiums and discounts, net	6,033	4,308
Accretion of discount on borrowings	453	573
Amortization of MSRs	212,596	147,013
Gain on sale of assets, net	(8,382)	(16,221)
Gain on sale of foreclosed real estate, net	(1,179)	(1,717)
Loss on sale, settlement and transfer of loans, net	210,001	109,487
Capitalization of originated MSRs	(265,516)	(131,372)
Depreciation and amortization of premises and equipment	26,586	26,084
Amortization of deferred debt issuance costs	2,983	3,676
FHLB stock dividends	(40,792)	(45,372)
Purchases and originations of loans held for sale	(10,578,606)	(7,060,801)
Net proceeds from the sale of loans held for sale	11,657,621	5,478,985
Net gain on derivatives used to hedge MSRs	(3,939)	(8,957)
Provision for loss on MSRs	127,107	77,000
(Increase) decrease in other assets	(202,096)	370,794
Decrease in accrued interest receivable	19,053	22,601
Increase in other liabilities	118,761	332,142
Amortization of deferred compensation expense – Golden State restricted common stock	860	992
Gain on non-monetary exchange of Star Systems common stock	--	(20,671)
Reduction in net accrued tax liability	--	(25,805)
Income tax benefit	(37,129)	(3,247)
Minority interest: other	13,494	13,494
Dividends on restricted common stock	<u>11</u>	<u>35</u>
Net cash provided by (used in) operating activities	<u>1,502,082</u>	<u>(487,942)</u>

(Continued)

See accompanying notes to unaudited consolidated financial statements.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows (continued)**

**Six Months Ended June 30, 2002 and 2001**

(Unaudited)

(in thousands)

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Cash flows from investing activities:		
Purchases of securities available for sale	\$ (25,647)	\$ (21,479)
Proceeds from maturities of securities available for sale	25,269	586,733
Purchases of securities held to maturity	(1,927)	(4,992)
Principal payments and proceeds from maturities of securities held to maturity	3,269	68,363
Purchases of mortgage-backed securities available for sale	(43,644)	(120,810)
Principal payments on mortgage-backed securities available for sale	2,134,238	1,290,937
Principal payments on mortgage-backed securities held to maturity	214,160	229,638
Proceeds from sales of mortgage-backed securities available for sale	64,300	304,365
Proceeds from sales of loans	41,222	51,358
Loan originations and principal collections, net	3,496,685	557,082
Purchases of loans receivable	(2,815,296)	(2,349,144)
Purchases of FHLB stock	(41,136)	(23,193)
Redemption of FHLB stock	292,086	--
Purchases of premises and equipment	(20,223)	(20,485)
Proceeds from disposal of premises and equipment	14,757	6,639
Proceeds from sales of foreclosed real estate	14,802	17,131
Proceeds from sale of Concord EFS common stock	--	29,948
Purchases of MSRs	(177,458)	(128,206)
Hedge receipts (payments)	51,068	(14,412)
Purchases of derivatives	(833,385)	(272,589)
Proceeds from sales and settlements of derivatives	<u>1,045,738</u>	<u>215,420</u>
Net cash provided by investing activities	<u>3,438,878</u>	<u>402,304</u>
Cash flows from financing activities:		
Net (decrease) increase in deposits	(764,627)	903,555
Proceeds from additional borrowings	52,313,572	59,921,714
Principal payments on borrowings	(56,047,670)	(59,964,993)
Principal payment of FN Holdings Notes	(250)	--
Net decrease in securities sold under agreements to repurchase	(303,801)	(596,378)
Dividends on common stock	(80,000)	(60,000)
Dividends paid to minority stockholders of subsidiary, net of taxes	(13,494)	(13,494)
Tax benefit on exercise of stock options	<u>3,071</u>	<u>745</u>
Net cash (used in) provided by financing activities	<u>(4,893,199)</u>	<u>191,149</u>
Net change in cash and cash equivalents	47,761	105,511
Cash and cash equivalents at beginning of period	<u>805,171</u>	<u>783,074</u>
Cash and cash equivalents at end of period	<u>\$ 852,932</u>	<u>\$ 888,585</u>

See accompanying notes to unaudited consolidated financial statements.

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

(1) Basis of Presentation

These financial statements are in accordance with GAAP for interim financial information and Regulation S-X, Article 10. They are unaudited and exclude some of the disclosures for complete financial statements. Management believes it has made all adjustments necessary so that the financial statements are presented fairly. The results of operations for the three and six months ended June 30, 2002 may not indicate future results. Certain prior period amounts have been reclassified to conform to current presentation.

These financial statements should be read with the consolidated financial statements of GS Holdings included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001. A glossary of defined terms begins on page 54 of this document. All terms used but not defined in the glossary are clarified in the Company's Annual Report on Form 10-K.

GS Holdings, a wholly owned subsidiary of Golden State, is a holding company whose only significant asset is all of the common and preferred stock of the Bank. Activities for the consolidated entity are primarily carried out by the Bank and its subsidiaries.

These unaudited consolidated financial statements include the accounts of GS Holdings, the Bank and the Bank's wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Minority interest: other represents amounts attributable to the REIT Preferred Stock of California Federal Preferred Capital Corporation, a wholly owned subsidiary of the Bank.

As GS Holdings' common stock is wholly owned by Golden State, EPS data is not presented.

(2) Pending Merger

On May 21, 2002, Citigroup and Mercury Merger Sub, a wholly owned subsidiary of Citigroup, entered into a merger agreement with Golden State whereby Golden State will be merged with and into Mercury Merger Sub, with Mercury Merger Sub as the surviving company. The Merger, which is expected to close in the third quarter of 2002, is subject to regulatory and Golden State stockholder approvals. The Special Meeting of Golden State's stockholders to vote on the Merger is scheduled on August 22, 2002.

The value of the merger consideration per share of the Golden State's common stock will be the sum of

(a) \$16.40 and

(b) 0.5234 fractional share of Citigroup common stock for each share of Golden State common stock delivered at closing.

Golden State's common stockholders will be entitled to elect to receive merger consideration in the form of cash or Citigroup common stock, subject to certain limitations.

(3) Reclassification of Securities

On January 1, 2001, the Company reclassified \$1.1 billion and \$85.0 million carrying value of mortgage-backed securities and U.S. government and agency securities, respectively, from securities held to maturity to their respective available-for-sale portfolios, as permitted upon the adoption of SFAS No. 133. The net unrealized loss related to these securities of \$30.4 million, which was recorded in OCI upon their initial transfer to the held-to-maturity portfolio in April 2000, was reclassified from accumulated other comprehensive loss, and the securities were subsequently marked to market, in accordance with SFAS No. 115.

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

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

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
	(in thousands)	
Cash paid for:	\$929,970	\$1,544,070
Interest	79,291	100,799
Income taxes, net		
Transfer of loans to foreclosed real estate	8,535	17,812
Loans made to facilitate the sale of real estate	--	168
Reclassification of loans from loans held for sale to loans receivable	--	5,245
Reclassification of loans receivable to loans held for sale	95,521	22,351
Goodwill adjustment related to tax adjustments	(25,860)	--
Impact of restricted common stock	2,600	2,531
Reclassification of mortgage-backed securities from the held-to-maturity portfolio to the available-for-sale portfolio upon the adoption of SFAS No. 133	--	1,067,933
Reclassification of securities from the held-to-maturity portfolio to the available-for-sale portfolio upon the adoption of SFAS No. 133	--	84,984
Reclassification of derivative assets (\$173.6 million) and derivative liabilities (\$8.8 million) related to MSRs at fair value upon the adoption of SFAS No. 133	--	164,767
Transfer of loans receivable to claims receivable	122,247	103,077

(5) Redemption of FN Holdings Notes

On January 2, 2002, GS Holdings redeemed the remaining \$250 thousand principal of the FN Holdings 10<sup>5</sup>/<sub>8</sub>% Senior Notes for a redemption price of \$263 thousand, including accrued interest. The premium paid in connection with the redemption was not material.

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

(6) Segment Reporting

The Company derives most of its revenues from interest income, and interest expense is the most significant expense. Therefore, net interest income after provision for loan losses is presented for each segment. 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.

	Six Months Ended June 30,			Three Months Ended June 30,		
	Community Banking	Mortgage Banking	Total	Community Banking	Mortgage Banking	Total
	(in thousands)					
Net interest income after provision for loan losses: (a)						
2002	\$ 707,665	\$ 77,894	\$ 785,559	\$ 359,743	\$ 32,507	\$ 392,250
2001	673,654	41,788	715,442	341,625	33,760	375,385
Noninterest income: (b)						
2002	\$ 166,169	\$ (58,958)	\$ 107,211	\$ 90,579	\$ (81,296)	\$ 9,283
2001	166,868	22,125	188,993	83,609	37,665	121,274
Noninterest expense: (c)						
2002	\$ 377,576	\$ 81,782	\$ 459,358	\$ 187,293	\$ 38,367	\$ 225,660
2001	397,711	77,017	474,728	203,317	39,113	242,430
Pre-tax contribution:						
2002	\$ 496,258	\$ (62,846)	\$ 433,412	\$ 263,029	\$ (87,156)	\$ 175,873
2001	442,811	(13,104)	429,707	221,917	32,312	254,229
Segment assets at period end: (d)						
2002	\$51,668,656	\$4,265,407 (e)	\$55,934,063	\$51,668,656	\$4,265,407 (e)	\$55,934,063
2001	60,911,345	7,346,871 (e)	68,258,216	60,911,345	7,346,871 (e)	68,258,216

(a) Includes \$47.6 million and \$68.6 million for the six months ended June 30, 2002 and 2001, respectively, in earnings credit provided to FNMC by the Bank, primarily for custodial bank account balances generated by FNMC. Also includes \$72.2 million and \$134.1 million for the six months ended June 30, 2002 and 2001, respectively, in interest income and expense on intercompany loans.

Includes \$21.9 million and \$39.0 million for the three months ended June 30, 2002 and 2001, respectively, in earnings credit provided to FNMC by the Bank, primarily for custodial bank account balances generated by FNMC. Also includes \$32.3 million and \$75.9 million for the three months ended June 30, 2002 and 2001, respectively, in interest income and expense on intercompany loans.

(b) Includes \$19.2 million and \$15.5 million for the six months ended June 30, 2002 and 2001, respectively, in intercompany servicing fees. Also includes \$9.6 million and \$7.0 million for the three months ended June 30, 2002 and 2001, respectively, in intercompany servicing fees.

(c) Includes \$2.3 million for each of the six months ended June 30, 2002 and 2001, in intercompany noninterest expense. Also includes \$1.2 million for each of the three months ended June 30, 2002 and 2001, in intercompany noninterest expense.

(d) Includes \$4.0 billion and \$6.9 billion for 2002 and 2001, respectively, in intercompany borrowings and \$48.4 million and \$47.8 million for 2002 and 2001, respectively, in intercompany deposits maintained with the Bank.

(e) Includes \$1.7 billion for both 2002 and 2001, in MSRs and the related hedge.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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The following reconciles the above table to the amounts shown on the consolidated financial statements (in thousands):

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Net interest income after provision for loan losses:				
Total net interest income for reportable segments	\$ 785,559	\$ 715,442	\$ 392,250	\$ 375,385
Elimination of intersegment net interest income	<u>(47,560)</u>	<u>(68,582)</u>	<u>(21,932)</u>	<u>(38,997)</u>
Total	<u>\$ 737,999</u>	<u>\$ 646,860</u>	<u>\$ 370,318</u>	<u>\$ 336,388</u>
Noninterest income:				
Total noninterest income for reportable segments	\$ 107,211	\$ 188,993	\$ 9,283	\$ 121,274
Elimination of intersegment servicing fees	<u>(19,243)</u>	<u>(15,533)</u>	<u>(9,609)</u>	<u>(7,045)</u>
Total	<u>\$ 87,968</u>	<u>\$ 173,460</u>	<u>\$ (326)</u>	<u>\$ 114,229</u>
Noninterest expense:				
Total noninterest expense for reportable segments	\$ 459,358	\$ 474,728	\$ 225,660	\$ 242,430
Elimination of intersegment expense	<u>(2,320)</u>	<u>(2,320)</u>	<u>(1,160)</u>	<u>(1,160)</u>
Total	<u>\$ 457,038</u>	<u>\$ 472,408</u>	<u>\$ 224,500</u>	<u>\$ 241,270</u>
Pre-tax contribution:				
Total contributions for reportable segments	\$ 433,412	\$ 429,707	\$ 175,873	\$ 254,229
Elimination of intersegment contributions	<u>(64,483)</u>	<u>(81,795)</u>	<u>(30,381)</u>	<u>(44,882)</u>
Total	<u>\$ 368,929</u>	<u>\$ 347,912</u>	<u>\$ 145,492</u>	<u>\$ 209,347</u>
Total assets at period end:				
Total assets for reportable segments	\$55,934,063	\$68,258,216	\$55,934,063	\$68,258,216
Elimination of intersegment borrowings	<u>(3,987,287)</u>	<u>(6,906,614)</u>	<u>(3,987,287)</u>	<u>(6,906,614)</u>
Elimination of intersegment deposits	<u>(48,428)</u>	<u>(47,812)</u>	<u>(48,428)</u>	<u>(47,812)</u>
Total	<u>\$51,898,348</u>	<u>\$61,303,790</u>	<u>\$51,898,348</u>	<u>\$61,303,790</u>

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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(7) Loans Receivable, Net

Loans receivable, net, included the following (in thousands):

	<u>June 30, 2002</u>	<u>December 31, 2001</u>
Real estate loans:		
1-4 unit residential	\$28,219,385	\$29,546,035
Multi-family residential	4,455,768	4,130,287
Commercial real estate	2,234,097	2,354,919
Land	10,651	14,055
Construction	870	2,495
Total real estate loans	<u>34,920,771</u>	<u>36,047,791</u>
Equity-line	802,916	639,297
Other consumer loans	237,569	283,434
Auto loans, net (a)	2,090,849	1,917,591
Commercial loans	800,038	693,114
Total consumer and other loans	<u>3,931,372</u>	<u>3,533,436</u>
Total loans receivable	<u>38,852,143</u>	<u>39,581,227</u>
Deferred loan fees, costs, discounts and premiums, net	236,657	243,120
Allowance for loan losses	(469,047)	(497,298)
Purchase accounting adjustments, net	6,506	8,574
Total loans receivable, net	<u>\$38,626,259</u>	<u>\$39,335,623</u>

(a) \$884 million, or 42% and \$766 million, or 40% of this portfolio, represents prime product as of June 30, 2002 and December 31, 2001, respectively.

(8) Intangible Assets

Upon adopting SFAS No. 142, management reviewed the records from the Company's various acquisitions. At June 30, 2002, the Company's goodwill and other intangible assets totalled \$612.6 million. Of this amount, \$564.6 million represents goodwill that is no longer being amortized as of January 1, 2002 pursuant to SFAS No. 142. The remaining \$48.1 million represents other intangible assets that continue to be amortized. In addition, the Company held MSR balances in the amount of \$1,539.6 million at June 30, 2002.

The following table provides details on intangible assets including MSRs:

	As of June 30, 2002			As of December 31, 2001		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value (dollars in thousands)	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Amortizable intangible assets:						
Unidentifiable intangibles	\$ 64,451	\$ (17,182)	\$ 47,269	\$ 64,451	\$ (15,030)	\$ 49,421
Core deposit intangibles	<u>5,513</u>	<u>(4,693)</u>	<u>820</u>	<u>5,513</u>	<u>(4,511)</u>	<u>1,002</u>
Other intangible assets	69,964	(21,875)	48,089	69,964	(19,541)	50,423
MSRs	2,856,885 (a)	(1,317,293)	1,539,592 (a)	2,728,643 (a)	(1,104,696)	1,623,947 (a)
Goodwill	--	--	--	876,890	(286,470)	590,420
Total amortizable intangible assets	<u>\$2,926,849</u>	<u>\$(1,339,168)</u>	<u>\$1,587,681</u>	<u>\$3,675,497</u>	<u>\$(1,410,707)</u>	<u>\$2,264,790</u>
Unamortizable goodwill	<u>\$ 851,030</u>	<u>\$ (286,470)</u>	<u>\$ 564,560</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ --</u>

(Continued)

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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- (a) After deducting \$280.5 million and \$153.3 million for the valuation allowance at June 30, 2002 and December 31, 2001, respectively.

As of June 30, 2002, all of the Company's goodwill, totalling \$564.6 million, is included in the community-banking reporting segment. During the second quarter of 2002, goodwill was reduced by the following:

- (a) \$12.7 million representing California state tax refunds and pre-merger interest related to Old Cal Fed
- (b) \$12.6 million related to a reversal of a portion of the deferred tax asset valuation allowance related to Old Cal Fed and adjustments for sales and use tax related to Old Glen Fed and
- (c) \$0.6 million related to the reversal of a portion of the tax reserve based upon the status of Glendale Federal tax audits for 1991 through 1997.

Intangible acquisitions during the period were as follows:

	Six Months Ended June 30,			
	2002		2001	
	Gross Carrying Value	Weighted Average Maturity (in years)	Gross Carrying Value	Weighted Average Maturity (in years)
	(dollars in thousands)			
MSRs originated and purchased during the period	\$442,974	5.4	\$259,578	6.6

  

	Three Months Ended June 30,			
	2002		2001	
	Gross Carrying Value	Weighted Average Maturity (in years)	Gross Carrying Value	Weighted Average Maturity (in years)
	(dollars in thousands)			
MSRs originated and purchased during the period	\$198,615	5.4	\$157,220	6.6



**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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In the first quarter of 2002, the Company reviewed the expected present value of future cash flows for all reporting units with recorded goodwill and determined that the carrying value of the goodwill was not impaired. Actual and estimated future amortization expense is as follows:

	<u>Unidentifiable Intangibles</u>	<u>Core Deposit Intangibles</u>	<u>MSRs</u>	<u>Goodwill</u>	<u>Total</u>
	(in thousands)				
Amortization expense:					
Three months ended June 30, 2002	\$1,076	\$ 91	\$ 98,271	\$ --	\$ 99,438
Six months ended June 30, 2002	2,152	182	212,596	--	214,930
Three months ended June 30, 2001	1,076	91	88,598	13,773	103,538
Six months ended June 30, 2001	2,152	182	147,013	27,546	176,893
Estimated amortization expense:					
Six months ending December 31, 2002	2,152	182	173,575	--	175,909
Year ending December 31,					
2003	4,304	364	263,019	--	267,687
2004	4,304	364	214,247	--	218,915
2005	4,304	364	173,447	--	178,115
2006	4,304	364	138,259	--	142,927
2007	4,304	364	109,249	--	113,917

The impact of the adoption of SFAS No. 142 on earnings was as follows:

	<u>Six Months Ended June 30,</u> <u>2002</u>	<u>2001</u>	<u>Three Months Ended June 30,</u> <u>2002</u>	<u>2001</u>
	(in thousands)			
Reported net income before cumulative effect of change in accounting principle	\$241,828	\$210,709	\$116,425	\$115,074
Add back goodwill amortization, net of tax	<u>--</u>	<u>27,425</u>	<u>--</u>	<u>13,713</u>
Adjusted net income before cumulative effect of change in accounting principle	<u>\$241,828</u>	<u>\$238,134</u>	<u>\$116,425</u>	<u>\$128,787</u>
	<u>Six Months Ended June 30,</u> <u>2002</u>	<u>2001</u>	<u>Three Months Ended June 30,</u> <u>2002</u>	<u>2001</u>
	(in thousands)			
Reported net income	\$241,828	\$209,157	\$116,425	\$113,522
Add back goodwill amortization, net of tax	<u>--</u>	<u>27,425</u>	<u>--</u>	<u>13,713</u>
Adjusted net income	<u>\$241,828</u>	<u>\$236,582</u>	<u>\$116,425</u>	<u>\$127,235</u>

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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(9) Deposits

A summary of the carrying value of deposits is as follows (dollars in thousands):

	<u>June 30, 2002</u>	<u>December 31, 2001</u>
Transaction Accounts:		
Non-interest checking	\$ 2,238,712	\$ 2,013,162
Interest-bearing checking	<u>2,252,180</u>	<u>2,139,674</u>
Subtotal checking	4,490,892	4,152,836
Money market	4,831,649	4,614,223
Passbook savings	<u>3,171,654</u>	<u>3,055,766</u>
Total transaction accounts	12,494,195	11,822,825
Certificates of deposit	<u>10,053,758</u>	<u>10,618,260</u>
Total customer deposits	22,547,953	22,441,085
Custodial accounts	1,705,080	2,512,684
Accrued interest payable	37,721	46,184
Purchase accounting	<u>150</u>	<u>329</u>
Total retail deposits	24,290,904	25,000,282
Brokered Deposits	<u>91,087</u>	<u>146,545</u>
Total deposits	<u><u>\$24,381,991</u></u>	<u><u>\$25,146,827</u></u>
Checking deposits (including custodials) as a % of retail deposits	25.5%	26.7%
Transaction accounts (including custodials) as a % of retail deposits	58.5%	57.3%
Checking deposits (excluding custodials) as a % of customer deposits	19.9%	18.5%
Transaction accounts (excluding custodials) as a % of customer deposits	55.4%	52.7%

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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(10) Accrued Termination and Facilities Costs

In connection with the Golden State Acquisition, the Company recorded liabilities resulting from:

- branch consolidations due to duplicate facilities and
- employee severance and termination benefits due to a planned reduction in force.

The merger and integration plan relating 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 summarizes the activity in the liability for the costs related to the plan (in thousands):

	<u>Branch Consolidations</u>	<u>Severance and Termination Benefits</u>	<u>Total</u>
Balance at December 31, 2001	\$14,208	\$12,500	\$26,708
Charges to liability account	<u>(2,492)</u>	<u>--</u>	<u>(2,492)</u>
Balance at June 30, 2002	<u>\$11,716</u>	<u>\$12,500</u>	<u>\$24,216</u>

(11) Income Taxes

During the six months ended June 30, 2002, GS Holdings recorded gross income tax expense of \$150.7 million, which was offset by a tax benefit of \$37.1 million, for net income tax expense of \$113.6 million. Based on the current status of Mafco Holdings' audits for the years 1991 through 1995 and anticipated reversal of deferred tax assets with established valuation allowance, management changed its judgment about the realizability of the Company's deferred tax assets and reduced its valuation allowance by \$44 million. As a result of reducing the valuation allowance, income tax expense was reduced by \$31.4 million and goodwill was reduced by \$12.6 million.

In addition, an accrued liability had been established in prior years for the purpose of satisfying assessments that may result from issues arising during audits with various state taxing authorities. As a result of recent documentation received pertaining to the California audit of Glendale Federal Bank for the years 1991 through 1997, management reduced its accrued state tax liability by \$8.7 million during the six months ended June 30, 2002. Goodwill was reduced by \$0.6 million in connection with this transaction. The Company also recorded additional Federal tax expense of \$3.1 million due to the reduction of the state tax expense.

During the six months ended June 30, 2001, GS Holdings recorded net income tax expense of \$123.7 million, which included net tax benefits of \$29.0 million. In prior years, an accrued liability was established for the purpose of satisfying assessments that may result from issues arising during audits with various state taxing authorities. As a result of the completion and settlement of audits in various state taxing jurisdictions, additional guidance on the deductibility of covered asset losses, and the current assessment of exposure for tax strategies employed for prior years, management reduced its accrued state tax liability by \$39.7 million. The Company also recorded additional Federal tax expense of \$13.9 million due to the reduction of the state tax expense.

In addition, during the six months ended June 30, 2001, an income tax benefit was recorded for \$3.2 million due to the utilization of net operating losses of a subsidiary made available as a result of the subsidiary's liquidation into California Federal Bank.

(12) Stockholder's Equity

At June 30, 2002, there were 1,000 shares of GS Holdings common stock issued and outstanding.

Dividends on common stock during the six months ended June 30, 2002 and 2001 totalled \$80.0 million and \$60.0 million, respectively.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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(13) Executive and Stock Compensation

In the six months ended June 30, 2002, Golden State granted to certain of the Company's employees non-qualified stock options equivalent to 884,000 shares of common stock at a weighted average price of \$27.69 per share under the Stock Plan, all within the first quarter. During the three and six months ended June 30, 2001, Golden State granted to certain of the Company's employees non-qualified stock options equivalent to 560,100 and 1,411,100 shares, respectively, of common stock at a weighted average price of \$30.75 and \$27.69, respectively. 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 six months ended June 30, 2002, in accordance with the intrinsic value accounting methodology prescribed in APB Opinion No. 25, 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 and six months ended June 30, 2002, 319,909 and 427,675 options were exercised, and 9,917 and 42,597 options were cancelled or expired, respectively, under all plans. During the three and six months ended June 30, 2001, 91,101 and 154,617 options were exercised and 4,432 and 21,677 options, respectively, were cancelled or expired under all plans.

At June 30, 2002 and 2001, options to acquire an equivalent of 5,129,449 and 4,906,205 shares and 675,583 and 966,166 LTW<sup>TM</sup>s, respectively, remained outstanding under all plans.

On January 22, 2002 and 2001, Golden State awarded to certain of the Company's employees 112,760 and 99,108 shares, respectively, of restricted stock under the Golden State Bancorp Inc. Omnibus Stock Plan. The market value on the date of the award was \$27.65 and \$26.38 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. During the three and six months ended June 30, 2002, 152,299 restricted shares were vested and 2,770 restricted shares were cancelled. During the three and six months ended June 30, 2001, 5,911 and 115,045 restricted shares were vested, respectively, and none was cancelled. At June 30, 2002, a total of 160,056 restricted shares was outstanding. The compensation expense based on the stock price on the date of these awards was recognized on a straight-line basis over the vesting period for each service period tranche of the award with a corresponding increase to additional paid-in capital. In addition, dividends on restricted stock are recorded as compensation expense with a corresponding increase to additional paid-in capital. During the three and six months ended June 30, 2002, \$0.5 million and \$0.9 million, respectively, in compensation expense was recognized related to such awards. During the three and six months ended June 30, 2001, \$0.5 million and \$1.0 million, respectively, in compensation expense was recognized related to such awards. These restricted shares have full voting and dividend rights.

(14) Cumulative Effect of Change in Accounting Principle

On September 21, 2000, the EITF issued EITF No. 99-20. This document, which was effective on April 1, 2001, establishes guidance for

- (a) recognizing interest income (including amortization of premiums or discounts) on
  - (i) all credit-sensitive mortgage and asset-backed securities and
  - (ii) certain prepayment-sensitive securities including agency interest-only strips and
- (b) determining when these securities must be written down to fair value because of impairment.

Existing GAAP did not provide interest recognition and impairment guidance for securities on which cash flows change as a result of both prepayments and credit losses and, in some cases, interest rate adjustments.

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On April 1, 2001, the Company identified a portfolio of securities with a total book value of \$80.7 million which are subject to the impairment provisions of EITF No. 99-20. All of these securities had previously been reported as available-for-sale securities, with changes in fair value reflected in OCI. As a result of its implementation of EITF No. 99-20, the Company recorded a loss of \$1.6 million, net of income tax credits of \$1.1 million, representing the cumulative effect of a change in accounting principle.

(15) Commitments, Contingencies and Other Off-balance Sheet Activities

*Credit Related Financial Instruments*

The Company is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

Listed below are unfunded financial instruments whose contract amounts represent credit risk (in thousands):

	Contract Amounts at	
	<u>June 30, 2002</u>	<u>December 31, 2001</u>
<u>Commitments to extend credit</u>		
Unutilized consumer lines	\$1,722,420	\$1,467,625
Unutilized commercial lines of credit	264,524	263,682
Commercial and standby letters of credit	32,042	24,953

The contracts for the Company's commitments to extend credit expire as follows (in thousands):

	June 30, 2002				
	Contract Amount Expiring in				
<u>Commitments to extend credit</u>	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1 – 3 Years</u>	<u>4 – 5 Years</u>	<u>More Than 5 Years</u>
Unutilized consumer lines	\$1,722,420	\$518,546	\$13,634	\$11,084	\$1,179,156
Unutilized commercial lines of credit	264,524	188,270	56,199	7,865	12,190
Commercial and standby letters of credit	32,042	31,876	166	--	--

The fair value of commitments to extend credit was not significant at either June 30, 2002 or December 31, 2001.

Unutilized consumer lines of credit are commitments to extend credit. These lines are either secured or nonsecured and may be cancelled by the Company if certain conditions of the contract are not met. Many consumer line of credit customers are not expected to fully draw down their total lines of credit and, therefore, the total contractual amount of these lines does not necessarily represent future cash requirements.

Unutilized commitments under commercial lines of credit are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

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Commercial and standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. All letters of credit issued have expiration dates within three years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments in an amount deemed to be necessary.

*Off-Balance Sheet Commitments to Originate, Purchase and Sell Loans*

The following is a summary of the Company's pipeline of loans in process and mandatory forward commitments to sell loans that have not been recorded in the Company's balance sheet as they do not meet the definition of a derivative financial instrument. These amounts exclude commitments to extend credit which are summarized above. For more information on derivative instruments, see note 16.

	Contract Amounts at	
	<u>June 30, 2002</u>	<u>December 31, 2001</u>
	(in thousands)	
Commitments to originate loans	\$2,770,634	\$3,937,422
Commitments to purchase loans	995,883	3,791,436
Mandatory commitments to sell loans	317,569	679,182

The Company's pipeline of loans in process includes loan applications for both portfolio and non-portfolio loans in various stages of processing that do not meet the definition of a derivative financial instrument. Until all required documentation is provided and underwritten, there is no credit risk to the Company. There is no interest rate risk until a rate commitment is extended by the Company to a borrower. Some of these commitments will ultimately be denied by the Company or declined by the borrower and therefore the commitment amounts do not necessarily represent future cash requirements.

Mandatory and optional delivery forward commitments to sell loans are used by the Company to hedge its interest rate exposure from the time a loan has a committed rate to the time the loan is sold. These instruments involve varying degrees of credit risk. Credit risk on these instruments is controlled through credit approvals, limits and monitoring procedures. To the extent that counterparties are not able to fulfill forward commitments, the Company is at risk for any fluctuations in the market value of the mortgage loans and locked pipeline.

*Off-Balance Sheet Embedded Derivative Options*

The Company also has off-balance sheet embedded options in borrowings as shown in the table below (in thousands):

<u>Instruments</u>	<u>June 30, 2002</u>		<u>December 31, 2001</u>	
	<u>Notional Amount</u>	<u>Estimated Fair Value</u>	<u>Notional Amount</u>	<u>Estimated Fair Value</u>
Interest rate caps	\$2,000,000	\$34,913	\$2,000,000	\$52,163
Interest rate swaptions	1,250,000	1,750	1,250,000	9,448

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The off-balance sheet embedded options in borrowings at June 30, 2002 are scheduled to expire as shown in the table below (in thousands):

<u>Instruments</u>	<u>Contract Amount Expiring in:</u>			
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>Total</u>
Interest rate caps	\$400,000	\$350,000	\$1,250,000	\$2,000,000
Interest rate swaptions	150,000	--	1,100,000	1,250,000

*Commitments and Contingencies*

At June 30, 2002, the Bank had pledged as collateral the securities as detailed below (in thousands):

	<u>Securities Available for Sale</u>	<u>Mortgage-backed Securities Available for Sale</u>	<u>Mortgage-backed Securities Held to Maturity</u>	<u>Commercial Paper Investments</u>
Provide credit enhancements for certain bond-financed real estate projects originated by Old FNB	\$25,582	\$ 10,516	\$ 6,961	\$ --
Pledged securities for principal and interest on Bank loan securitization	--	265,144	6,844	--
Guarantee credit enhancements on multi-family bond issues and loans securitized by FNMA and FHLMC	1,027	124,948	27,779	--
Guarantee credit enhancements on loans transferred as part of securitization transactions by the Bank	--	--	--	29,260
Guarantee state and local agency deposits, and certain deposits with the Federal Reserve Bank	2,678	311,569	50,220	--
Secure various other obligations	--	1,968,602	752,127	--

At June 30, 2002, \$25.2 billion in residential loans, \$3.8 billion in multifamily loans and \$1.6 billion in commercial real estate loans were pledged as collateral for FHLB advances.

At June 30, 2002, loans receivable included approximately \$4.6 billion of loans that had the potential to experience negative amortization.

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**Notes to Unaudited Consolidated Financial Statements**

(16) On-Balance Sheet Derivative Instruments and Hedging Activities

*Interest Rate Risk Management – Risk Management Policies – Cash Flow Hedging Instruments and Fair Value Hedging Instruments*

The Company monitors the sensitivity of its NPV and net income under various interest rate scenarios and manages this risk. Quarterly, the Company simulates the NPV and net income expected to be earned over the next twelve months. Market interest rates are projected at various levels to estimate the impact on interest-earning assets, interest-bearing liabilities and mortgage prepayment speeds (which affect the MSR asset). The Company may use derivatives to reduce the volatility of NPV and net income within certain ranges of projected changes in interest rates. The Company evaluates the effectiveness of a derivative by measuring the cost of such an agreement in relation to the reduction in NPV and net income volatility within an assumed range of interest rates.

*Interest Rate Risk Management – Cash Flow Hedging Instruments – Balance Sheet Hedges*

Objectives and Context

The Company uses variable-rate debt including FHLB advances and Repos as a source of funds for lending and investment activities and other general business purposes. Interest payments on this debt may change if interest rates change. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases.

Management hedges a significant portion of its variable-rate interest payments to limit the effect of changing interest rates.

Strategies

Management enters into derivative instruments agreements to manage fluctuations in cash flows resulting from interest rate risk. These instruments include interest rate swaps.

The interest rate swaps change the variable-rate cash flow exposure on the short-term FHLB advances and Repos to fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, the Company receives variable interest rate payments and makes fixed interest rate payments, thereby creating fixed-rate FHLB advances and Repos.

Results

Hedges of FHLB advances and Repos were 100% effective for the three and six months ended June 30, 2002. The Company hedges the entire amount of the change in fair value of the liabilities with the entire amount of the change in fair value of the derivative instruments.

Fair value changes in interest rate swap hedging instruments relating to cash flows associated with FHLB advances and Repos are reported in OCI. These amounts are then reclassified into interest expense as a yield adjustment in the same period in which the related interest on the FHLB advances and Repos affects earnings. The net amount of OCI reclassified into interest expense during the three and six months ended June 30, 2002 was \$45.1 million and \$86.9 million, respectively, while \$14.7 million and \$20.1 million was reclassified during the three and six months ended June 30, 2001, respectively.

As of June 30, 2002 and 2001, approximately \$96.6 million and \$30.4 million of losses reported in OCI related to the interest rate swaps were expected to be reclassified into interest expense as a yield adjustment of the hedged FHLB advances and Repos during the twelve month period ending June 30, 2003 and 2002, respectively.



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*Interest Rate Risk Management – Fair Value Hedging Instruments – Mortgage Servicing Rights Hedges*

Objectives and Context

The Company purchases and originates MSR as a source of fee income. MSR expose the Company to the variability of their fair value due to changes in the assumed level of prepayments and other variables. The carrying value of MSR are first adjusted by the calculated change in the fair value of the MSR being hedged and are then recorded at the lesser of their amortized cost or fair value.

Management limits the variability in the fair value of a portion of its MSR asset by hedging the change in fair value of the servicing rights asset associated with fixed-rate, non-prepayment penalty loans for which it has recorded MSR. The Company determines appropriate coverage levels, given anticipated or existing interest rate levels and other market considerations, as well as the relationship of change in this asset to other assets of the Company.

Strategies

The Company utilizes interest rate swaps, PO swaps, interest rate floors, and swaptions to hedge the change in value of the mortgage servicing portfolio due to expected prepayment risk assumption changes. Although the Company hedges the change in value of its MSR, its hedge coverage ratio does not equal 100%. The Company keeps hedge coverage ratios at acceptable risk levels, which may vary depending on current and expected interest rate movement.

Interest rate swap agreements are contracts to exchange quarterly or semi-annual floating rate payments for fixed-rate payments. The notional amount of the contracts, on which the payments are based, are not exchanged. The primary risks associated with interest rate swaps are the ability of the counterparties to meet the terms of the contract and the possibility that swap rates may not move in an inverse manner or in an amount equal to mortgage rate movements.

PO swap agreements simulate the ownership of a PO strip, the value of which is affected directly by prepayment rates themselves in an inverse manner to the servicing rights, which act in a manner similar to IO strips. Under a PO swap agreement, the counterparty to the transaction purchases a PO strip and places the PO strip in a trust. The contracts executed prior to December 31, 1998 call for the Company to pay floating interest to the counterparty based on:

- (a) an index tied to one month LIBOR and
- (b) the amortized notional balance of the swap.

The contracts call for the Company to receive cash from the counterparty based on the cash flows received from the PO strip. For PO swap agreements executed after December 31, 1998, the agreement also requires the PO swap to be marked to market value. A decrease in the market value of the PO swap requires the Company to increase the amount paid to the counterparty and an increase in the market value requires the counterparty to increase its payment to the Company. The amounts to be paid and to be received are then netted together each month. The nature of this instrument results in increased cash flows and positive changes in the value of the PO swap during a declining interest rate environment. This positive change in the value of the PO swap is highly correlated to prepayment activity. PO swap agreements present yield curve risk to the extent that short term interest rates (which impact the cash amount that the Company pays on the PO swap to the counterparty) rise while long term rates (which drive prepayment rates) stay the same. A third type of risk associated with PO swaps is the ability of the counterparties to meet the terms of the contract.

Interest rate floors are interest rate protection instruments that involve payment from the seller to the buyer of an interest differential. This differential is the difference between a long-term rate (e.g., 10-year Constant Maturity Swaps in 2002 and 2001) and an agreed-upon rate, the strike rate, applied to a notional principal amount. By purchasing a floor, the Company will be paid the differential on a monthly basis by a counterparty, when the current long-term rate falls below the strike level of the agreement. The fair value of interest rate floor agreements is

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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included in derivative assets or liabilities. Interest rate floors are subject to basis risk because of differences in movements of mortgage and LIBOR rates, market volatility and the impact of changes in the yield curve. In addition, a credit risk associated with purchased interest rate floor agreements is the ability of the counterparties to meet the terms of the contract.

A swaption is an over-the-counter option that provides the right, but not the obligation, to enter into an interest rate swap agreement at predetermined terms at a specified time in the future. Swaptions are subject to basis risk because of differences in movements of mortgage and LIBOR rates, market volatility and the impact of changes in the yield curve. In addition, credit risk associated with swaptions is the ability of the counterparties to meet the terms of the contract.

**Results**

Risk management results related to the hedging of MSRs are summarized below and are included in the caption entitled "Loan servicing fees, net" in the accompanying consolidated statements of income (in thousands). The net gain or loss represents the ineffectiveness of the hedges.

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Gain (loss) on designated derivative contracts	\$ 191,565	\$(74,601)	\$ 224,062	\$(108,198)
(Decrease) increase in value of designated MSRs	<u>(187,626)</u>	<u>83,558</u>	<u>(239,403)</u>	<u>114,750</u>
Net gain (loss) on derivatives used to hedge MSRs	<u>\$ 3,939</u>	<u>\$ 8,957</u>	<u>\$ (15,341)</u>	<u>\$ 6,552</u>

*Interest Rate Risk Management – Fair Value Hedging Instruments – Warehouse Loans*

**Objectives and Context**

The Company, as part of its traditional real estate lending activities, originates fixed-rate 1-4 unit residential loans for sale in the secondary market. At the time of origination, management identifies loans it plans to sell. These warehoused loans have been classified as loans held for sale, net, in the consolidated balance sheet and are carried at fair market value, less the values associated with servicing (for those loans which are hedged) or at the lower of aggregate amortized cost or fair market value (for those loans which are not hedged). These loans expose the Company to the variability of their fair value due to changes in interest rates. If interest rates increase, the value of the loans decreases. Conversely, if interest rates decrease, the value of the loans increases.

Management limits the variability of a major portion of the change in fair value of its loans held for sale by hedging substantially all of its warehoused loans held for sale to third parties.

**Strategies**

Management employs forward loan sale hedging techniques to minimize the interest rate and pricing risks associated with the origination and sale of such warehoused loans.

The forward loan sales lock in the price for the sale of either specific loans held for sale or a generic group of loans held for sale.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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Results

Risk management results related to the hedging of warehouse loans are summarized below and are included in the caption entitled “Gain on sale, settlement and transfer of loans, net” in the accompanying consolidated statements of income (in thousands):

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Transition adjustment upon adoption of SFAS No. 133	\$ --	\$ 3,834	\$ --	\$ --
Unrealized (loss) gain on designated forward loan				
sale commitments recognized	(38,538)	10,400	(25,020)	12,080
Increase (decrease) in value of warehouse loans	<u>43,381</u>	<u>(9,038)</u>	<u>24,671</u>	<u>(10,443)</u>
Net gain (loss) on derivatives used to hedge				
warehouse loans	<u>\$ 4,843</u>	<u>\$ 5,196</u>	<u>\$ (349)</u>	<u>\$ 1,637</u>

*Derivative Instruments Not Designated as Hedging Instruments*

Purpose - Interest Rate Lock Commitments and Forward Loan Sale Commitments

The Company enters into rate lock commitments to extend credit to borrowers for generally a 30-day period for the origination and/or purchase of loans. Some of these rate lock commitments will ultimately expire without being completed. To the extent that a loan is ultimately granted and the borrower ultimately accepts the terms of the loan, these rate lock commitments expose the Company to variability in their fair value due to changes in interest rates. If interest rates increase, the value of these rate lock commitments decreases. Conversely, if interest rates decrease, the value of these rate lock commitments increases.

To mitigate the effect of this interest rate risk, the Company enters into offsetting derivative contracts, primarily forward loan sale commitments. The forward loan sale commitments lock in an interest rate and price for the sale of loans similar to the specific rate lock loan commitments classified as derivatives. Both the rate lock commitments and the forward loan sale commitments are undesignated derivatives, and accordingly are marked to market through earnings.

Risk management results related to the undesignated hedging of interest rate lock commitments with undesignated forward loan sale commitments are summarized below and are included in the caption entitled “Gain on sale, settlement and transfer of loans, net” in the consolidated statements of income (in thousands):

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Transition adjustment upon adoption of SFAS No. 133	\$ --	\$ (2,785)	\$ --	\$ --
Unrealized (loss) gain on undesignated forward loan				
sale commitments recognized to income	(19,048)	10,120	(17,288)	11,096
Gain (loss) on undesignated interest rate loan				
commitments recognized to income	<u>21,464</u>	<u>(8,980)</u>	<u>16,025</u>	<u>(9,093)</u>
Net gain (loss) on derivatives	<u>\$ 2,416</u>	<u>\$(1,645)</u>	<u>\$ (1,263)</u>	<u>\$ 2,003</u>

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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*Notional Amounts of Derivatives*

Information pertaining to the notional amounts of the Company's derivative financial instruments utilized in both MSR and balance sheet hedging is as follows (in thousands). The fair values of these derivative financial instruments were recorded in the Company's balance sheet in accordance with SFAS No. 133.

	June 30, 2002		December 31, 2001	
	Notional Amount	Credit Risk (1)	Notional Amount	Credit Risk (1)
Interest rate swaps - borrowings	\$ 4,509,670	\$ --	\$ 4,089,670	\$ --
Interest rate swaps hedging MSRs	2,840,000	43,080	2,462,000	7,561
PO swaps	391,800	--	378,928	6,411
Interest rate floors	1,021,000	26,286	3,054,000	78,917
Interest rate swaptions	4,621,000	137,058	4,111,000	183,641
Forward loan sale commitments	1,940,749	--	3,980,863	36,879
Interest rate lock commitments	1,038,866	--	1,870,852	--
Other	75,000	744	--	--
Total	<u>\$16,438,085</u>	<u>\$207,168</u>	<u>\$19,947,313</u>	<u>\$313,409</u>

- (1) Credit risk represents the amount of unrealized gain included in derivative assets which is subject to counterparty credit risk. It reflects the effect of master netting agreements and excludes \$187.2 million and \$95.2 million cash collateral held by the Bank at June 30, 2002 and December 31, 2001, respectively.

Derivative financial instruments used for other-than-trading purposes at June 30, 2002 are scheduled to mature as follows (in thousands):

	Notional Amounts						
	Six Months Ending December 31, 2002	2003	2004	2005	2006	Thereafter	Total
Interest rate swaps - borrowings	\$ 300,000	\$ 700,000	\$1,670,000	\$ 819,670	\$900,000	\$ 120,000	\$ 4,509,670
Interest rate swaps hedging MSRs	--	--	--	--	--	2,840,000	2,840,000
PO swaps	96,002	70,920	81,451	--	--	143,427	391,800
Interest rate floors	--	--	--	--	--	1,021,000	1,021,000
Interest rate swaptions	--	3,451,000	464,000	706,000	--	--	4,621,000
Forward loan sale commitments	1,940,749	--	--	--	--	--	1,940,749
Interest rate lock commitments	1,038,866	--	--	--	--	--	1,038,866
Other	75,000	--	--	--	--	--	75,000
Total	<u>\$3,450,617</u>	<u>\$4,221,920</u>	<u>\$2,215,451</u>	<u>\$1,525,670</u>	<u>\$900,000</u>	<u>\$4,124,427</u>	<u>\$16,438,085</u>

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

(17) Recent Accounting Pronouncements

*Goodwill and Other Intangible Assets*

On January 1, 2002, the Company adopted SFAS No. 142. SFAS No. 142 supersedes APB Opinion No. 17 and establishes new accounting standards for both identifiable and unidentifiable intangible assets acquired in a business combination, including goodwill, but does not address internally developed intangible assets. It requires recognition of goodwill as an asset but does not permit amortization of goodwill as previously required by APB Opinion No. 17. Instead, goodwill is tested for impairment at a level referred to as a reporting unit. A reporting unit is the same level as, or one level below, an operating segment (as that term is used in SFAS No. 131).

Goodwill is tested for impairment annually and on an interim basis if an event or circumstance occurs between annual tests that might reduce the fair value of a reporting unit below its carrying value. An example of such an event or circumstance may include an adverse change in the business climate or market, a legal factor, an action by regulators, an introduction of competition, or a loss of key personnel. Goodwill would also be tested for impairment on an interim basis when:

- (a) a more-likely-than-not expectation exists that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of,
- (b) a significant asset group within a reporting unit is tested for recoverability under SFAS No. 121, or
- (c) a subsidiary of that reporting unit has recognized a goodwill impairment loss.

The fair value of each reporting unit would not have to be recomputed every year if the components of the reporting unit had not changed since the previous fair value computation, the previous fair value amount exceeded the carrying amount of the reporting unit by a substantial margin, and no evidence exists indicating that the current fair value of the reporting unit may be less than its current carrying amount.

Goodwill is tested for impairment using a two-step approach. The first step is a comparison of the fair value of a reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired and no further work is required. If the fair value of the reporting unit is less than its carrying amount, the second step of the impairment test must be performed. The second step of the impairment test is a comparison of the implied fair value of goodwill to its carrying amount. If the implied fair value of goodwill is less than its carrying amount, goodwill is considered impaired and an impairment loss recognized. The impairment loss would be measured as the amount by which the carrying amount of goodwill exceeds its implied fair value.

Acquired intangible assets other than goodwill are amortized over their useful economic life and reviewed for impairment in accordance with SFAS No. 144.

The impact of the adoption of SFAS No. 142 increases GAAP earnings by \$13.7 million per quarter in 2002.

*Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*

In December 2001, the AICPA issued SOP 01-6. SOP 01-6 is effective for annual and interim financial statements issued for fiscal years beginning after December 15, 2001. SOP 01-6 reconciles the specialized accounting and financial reporting guidance established in the existing Banks and Savings Institutions Guide, Audits of Credit Unions Guide, and Audits of Finance Companies Guide. The SOP eliminates differences in accounting and disclosure established by the respective guides and carries forward accounting guidance for transactions determined to be unique to certain financial institutions. The adoption of this pronouncement has not had a material impact on the Company's results of operations or financial condition.

**GOLDEN STATE HOLDINGS INC. AND SUBSIDIARIES**  
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*Rescission of SFAS No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections*

SFAS No. 145 rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion No. 30 will now be used to classify those gains and losses. SFAS No. 64 amended SFAS No. 4, and is no longer necessary because SFAS No. 4 has been rescinded.

The accounting, disclosure and financial statement provisions of SFAS No. 145 are effective for financial statements in fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in Opinion No. 30 for classification as an extraordinary item shall be reclassified.

The implementation of SFAS No. 145 is not expected to impact the Company's financial condition or operating results.

## Item 2. Management's Narrative Analysis of Results of Operations

*Forward-Looking Statements.* This quarterly report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that pertain to our future operating results. Words such as "anticipate," "believe," "expect," "intend" and other similar expressions are intended to identify these statements. Forward-looking statements are not historical facts and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. Our actual results could differ materially from those in the forward-looking statements due to such factors as (i) portfolio concentrations; (ii) interest rate changes, including changes in short-term interest rates, the shape of the yield curve and the Treasury-Eurodollar spread; (iii) changes in asset prepayment speeds; (iv) changes in our competitive and regulatory environments; and (v) changes in the availability of net operating loss carryovers and deferred tax liabilities. See "Business--Factors That May Affect Future Results" in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 for a discussion of these factors in greater detail. We assume no obligation to update any of our forward-looking statements.

### Critical Accounting Policies

In preparing its consolidated financial statements, the Company is required to make judgments and estimates that may have a significant impact upon its financial results. The Company's valuation of its MSRs and its determination of the adequacy of its allowance for loan losses are particularly subject to management's judgment and estimates. The Company's accounting policies for these two areas are discussed at length in notes 2(m) and 2(e) of the Company's Notes to Consolidated Financial Statements included in the Company's 2001 Annual Report on Form 10-K.

### Overview

GS Holdings, formerly FN Holdings, a wholly owned subsidiary of Golden State, is a holding company whose only significant asset is all of the common and preferred stock of the Bank.

The Company, headquartered in San Francisco, California, provides diversified financial services to consumers and small businesses in California and Nevada, primarily:

- (a) retail branches that provide deposit products such as demand, transaction and savings accounts, and investment products such as mutual funds, annuities and insurance; and
- (b) mortgage banking activities, including originating and purchasing 1-4 unit residential loans for sale or retention, servicing loans for itself and others and, to a lesser extent, originating and/or purchasing commercial real estate, commercial and consumer loans for investment.

The Company's revenues are derived from:

- (a) interest earned on loans and securities;
- (b) gains on sales of loans and other investments, fees received in connection with loan servicing and securities brokerage; and
- (c) other customer service transactions.

Expenses primarily consist of interest on customer deposit accounts and borrowings, and general and administrative expenses including compensation and benefits, occupancy and equipment, professional fees and other general administrative expenses.

### *Pending Merger*

On May 21, 2002, Citigroup and Mercury Merger Sub, a wholly owned subsidiary of Citigroup, entered into a merger agreement with the Company whereby the Company will be merged with and into Mercury Merger Sub, with Mercury Merger Sub as the surviving company. The Merger, which is expected to close in the third quarter of 2002, is subject to regulatory and Golden State stockholder approvals. See note 2 of the Company's Notes to Unaudited Consolidated Financial Statements.

### *Net Income*

GS Holdings reported net income of \$241.8 million for the six months ended June 30, 2002, compared with net income of \$209.2 million for the corresponding period in 2001. Net income for the six months ended June 30, 2001 includes a loss of \$1.6 million, net of tax, from the cumulative effect of change in accounting principle. Net income before the cumulative effect of change in accounting principle for the six months ended June 30, 2001 was \$210.7 million. The Bank's efficiency ratio was 47.34% for the six months ended June 30, 2002, compared to 49.30% for the comparable period in 2001.

Net interest income increased \$91.1 million during the first six months of 2002 as compared to the year-ago period, primarily as a result of declining market interest rates reducing the costs of liabilities at a faster rate than the decline in the yield on assets. Lower-costing liabilities were the result of the replacement of higher-rate borrowings and deposits with lower-rate borrowings and deposits as these instruments came due or were repaid. In addition, during the six months ended June 30, 2002, \$11.2 million of interest income was received in connection with a California income tax refund. Total noninterest income declined by \$85.5 million, primarily in loan servicing fees, net due to higher MSR amortization and an increased MSR valuation provision. Total noninterest expense declined \$15.4 million and includes a \$27.5 million decrease due to the adoption of SFAS No. 142 on January 1, 2002.

GS Holdings reported net income of \$116.4 million for the three months ended June 30, 2002, compared with net income of \$113.5 million for the corresponding period in 2001. Net income for the three months ended June 30, 2001 includes a loss of \$1.6 million, net of tax, from the cumulative effect of change in accounting principle. Net income before the cumulative effect of change in accounting principle for the three months ended June 30, 2001 was \$115.1 million. The Bank's efficiency ratio was 47.06% for the three months ended June 30, 2002, compared to 46.27% for the comparable period in 2001.

Net interest income increased \$33.9 million during the three months ended June 30, 2002 as compared to the same period in 2001, primarily as a result of declining market interest rates reducing the costs of liabilities at a faster rate than the decline in the yield on assets. Lower-costing liabilities were the result of the replacement of higher-rate borrowings and deposits with lower-rate borrowings and deposits as these instruments came due or were repaid. In addition, during the three months ended June 30, 2002, \$11.2 million of interest income was received in connection with a California income tax refund. Total noninterest income declined by \$114.6 million, primarily in loan servicing fees, net due to higher MSR amortization and an increased MSR valuation provision. Total noninterest expense declined \$16.8 million and includes a \$13.8 million decrease due to the adoption of SFAS No. 142 on January 1, 2002.

As noted above, the Company adopted SFAS No. 142 effective January 1, 2002, which requires that goodwill no longer be amortized. The effect of the adoption was to reduce goodwill amortization by \$13.8 million and \$27.5 million for the three and six months ended June 30, 2002, respectively, compared to the same period a year ago. Excluding the effect of the adoption of SFAS No. 142, net income for the three and six months ended June 30, 2001 was \$127.2 million and \$236.6 million, respectively. Excluding the effect of the adoption of SFAS No. 142, income before the cumulative effect of change in accounting principle for the three and six months ended June 30, 2001 was \$128.8 million and \$238.1 million, respectively.



### *Financial Condition*

During the six months ended June 30, 2002, consolidated total assets decreased to \$51.9 billion from \$56.5 billion and total liabilities decreased to \$48.6 billion from \$53.4 billion at December 31, 2001. Mortgage-backed securities, loans held for sale and loans receivable declined \$2.4 billion, \$1.3 billion and \$0.7 billion, respectively, during the six month period. This shift in mortgage-backed securities and loans is primarily due to high repayment rates in light of the declining interest rate environment. Deposits decreased \$764.8 million during the six months ended June 30, 2002, including decreases of \$807.6 million in custodial accounts, \$564.5 million in CDs and \$55.5 million in Brokered Deposits, offset by a \$671.4 million increase in transaction accounts. Total borrowings, including securities sold under agreements to repurchase, FHLB advances and other borrowings, declined \$4.0 billion during the six months ended June 30, 2002.

During the six months ended June 30, 2002, stockholder's equity increased \$147.3 million to \$2.8 billion. The increase in stockholder's equity is principally the result of \$241.8 million in net income for the period, \$3.1 million from the exercise of stock options and \$2.6 million due to the impact of Golden State restricted common stock. These amounts are partially offset by \$80.0 million in dividends to parent, \$16.9 million in net unrealized losses, after tax, on derivatives and \$3.4 million in net unrealized losses, after tax, on securities available for sale.

GS Holdings' non-performing assets, consisting of non-performing loans, net of purchase accounting adjustments, foreclosed real estate, net, and repossessed assets, decreased to \$104.6 million at June 30, 2002 compared with \$124.1 million at December 31, 2001. Total non-performing assets as a percentage of the Bank's total assets was 0.20% at June 30, 2002 compared with 0.22% at December 31, 2001.

## Results of Operations

*Six months ended June 30, 2002 versus six months ended June 30, 2001*

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.

	Six Months Ended June 30, 2002		
	Average Balance	Interest	Average Rate
	(dollars in millions)		
ASSETS			
Interest-earning assets (1):			
Securities, interest-bearing deposits in banks and other (2)	\$ 351	\$ 16	8.99%
Mortgage-backed securities available for sale	5,598	168	6.02
Mortgage-backed securities held to maturity	1,266	40	6.28
Loans held for sale, net	2,226	71	6.35
Loans receivable, net:			
Residential	28,732	883	6.15
Commercial real estate	6,552	233	7.10
Consumer	978	30	6.18
Automobile	1,986	124	12.65
Commercial banking	733	21	5.74
Loans receivable, net	38,981	1,291	6.63
FHLB stock	1,318	41	6.24
Total interest-earning assets	49,740	1,627	6.55%
Noninterest-earning assets	4,149		
Total assets	\$53,889		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDER'S EQUITY			
Interest-bearing liabilities:			
Deposits	\$24,756	261	2.12%
Securities sold under agreements to repurchase (3)	2,189	42	3.85
Borrowings (3)	22,474	584	5.22
Other	165	2	1.76
Total interest-bearing liabilities	49,584	889	3.60%
Noninterest-bearing liabilities	1,151		
Minority interest	497		
Stockholder's equity	2,657		
Total liabilities, minority interest and stockholder's equity	\$53,889		
Net interest income		\$ 738	
Interest rate spread (4)			2.95%
Net interest margin			2.96
Return on average assets			0.90%
Return on average common equity			18.21%
Return on tangible common equity			24.14%
Average equity to average assets			4.93%

Six Months Ended June 30, 2001			
	Average Balance	Interest	Average Rate
(dollars in millions)			
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 1,051	\$ 32	6.01%
Mortgage-backed securities available for sale	10,385	345	6.64
Mortgage-backed securities held to maturity	1,685	71	8.43
Loans held for sale, net	1,523	53	6.92
Loans receivable, net:			
Residential	31,803	1,124	7.07
Commercial real estate	6,130	256	8.36
Consumer	875	40	9.31
Automobile	1,700	96	11.38
Commercial banking	<u>570</u>	<u>25</u>	8.69
Total loans receivable, net	41,078	1,541	7.51
FHLB stock	<u>1,391</u>	<u>45</u>	6.58
Total interest-earning assets	57,113	<u>2,087</u>	7.31%
Noninterest-earning assets	<u>3,593</u>		
Total assets	<u>\$60,706</u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDER'S EQUITY			
Interest-bearing liabilities:			
Deposits	\$23,997	465	3.90%
Securities sold under agreements to repurchase (3)	3,992	121	6.05
Borrowings (3)	28,784	854	5.96
Other	<u>1</u>	<u>--</u>	--
Total interest-bearing liabilities	56,774	<u>1,440</u>	5.09%
Noninterest-bearing liabilities	1,121		
Minority interest	497		
Stockholder's equity	<u>2,314</u>		
Total liabilities, minority interest and stockholder's equity	<u>\$60,706</u>		
Net interest income		<u>\$ 647</u>	
Interest rate spread (4)			<u>2.22%</u>
Net interest margin			<u>2.25%</u>
Return on average assets			<u>0.69%</u>
Return on average common equity			<u>18.08%</u>
Return on tangible common equity			<u>29.19%</u>
Average equity to average assets			<u>3.81%</u>

- (1) Non-performing assets are included in the average balances for the periods indicated.
- (2) Includes securities, interest-bearing deposits in other banks, securities purchased under agreements to resell, interest income on California income tax refund and other interest income.
- (3) Interest and average rate include the impact of interest rate swaps.
- (4) Interest rate spread represents the difference between the average rates of total interest-earning assets and total interest-bearing liabilities.

The following table shows the changes in interest income and expense 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.

	Six Months Ended June 30, 2002 vs. 2001		
	Increase (Decrease) Due to		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
	(in millions)		
INTEREST INCOME:			
Securities, interest-bearing deposits in banks and other	\$ (13)	\$ (3)	\$ (16)
Mortgage-backed securities available for sale	(147)	(30)	(177)
Mortgage-backed securities held to maturity	(15)	(16)	(31)
Loans held for sale, net	22	(4)	18
Loans receivable, net	(40)	(210)	(250)
FHLB stock	<u>(2)</u>	<u>(2)</u>	<u>(4)</u>
Total	<u>(195)</u>	<u>(265)</u>	<u>(460)</u>
INTEREST EXPENSE:			
Deposits	30	(234)	(204)
Securities sold under agreements to repurchase	(46)	(33)	(79)
Borrowings	(161)	(109)	(270)
Other	<u>1</u>	<u>1</u>	<u>2</u>
Total	<u>(176)</u>	<u>(375)</u>	<u>(551)</u>
Change in net interest income	<u>\$ (19)</u>	<u>\$ 110</u>	<u>\$ 91</u>

**Interest Income.** Total interest income was \$1.6 billion for the six months ended June 30, 2002, a decrease of \$460.1 million from the six months ended June 30, 2001. Total interest-earning assets for the six months ended June 30, 2002 averaged \$49.7 billion, compared to \$57.1 billion for the corresponding period in 2001. The decrease in interest-earning assets is primarily a result of a decline in mortgage-backed securities, principally due to management's decision to sharply reduce purchases, and net loan run off, as well as decreased securities volume. These decreases were partially offset by an increase in loans held for sale due to heightened borrower refinancing activity in the declining interest rate environment. The yield on total interest-earning assets during the six months ended June 30, 2002 decreased to 6.55% from 7.31% for the six months ended June 30, 2001, primarily due to the repricing of loans and mortgage-backed securities available for sale at lower rates. At June 30, 2002, 11% of the Company's portfolio loans were tied to COFI indices, 12% to Treasury-based indices and 49% were "hybrid" ARMs - fixed for three to ten years and then adjusting annually. Twenty-three percent of the portfolio was fixed. The remaining 5% of the portfolio was in other adjustable-rate products.

GS Holdings earned \$1.3 billion of interest income on loans receivable for the six months ended June 30, 2002, a decrease of \$250.0 million from the six months ended June 30, 2001. The average balance of loans receivable was \$39.0 billion for six months ended June 30, 2002, compared to \$41.1 billion for the same period in 2001. The weighted average yield on loans receivable decreased to 6.63% for the six months ended June 30, 2002 from 7.51% for the six months ended June 30, 2001. The decrease in the average balance reflects the sharp run off of residential loans during a period of high refinancing activity. The decrease in the weighted average yield reflects the repricing of variable-rate loans, a decrease in the prime rate on commercial banking loans and comparatively lower market interest rates during the six months ended June 30, 2002, partially offset by a higher yield on auto loans purchased after July 1, 2001, which are recorded on a gross-coupon basis, rather than a credit-adjusted yield basis. The impact of this change on net interest income during the six months ended June 30, 2002 was to increase interest income by \$20.7 million.

Loan production is detailed in the table below (in thousands):

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Loans funded:		
Residential real estate loans:		
Adjustable-rate	\$ 3,455,177	\$ 3,854,221
Fixed-rate	<u>10,369,569</u>	<u>7,459,609</u>
Total residential real estate loans	13,824,746	11,313,830
Commercial real estate loans	903,169	886,836
Commercial loans	648,287	523,254
Consumer nonmortgage loans	526,246	393,648
Auto loans (a)	<u>619,694</u>	<u>635,466</u>
Total loans funded	<u>\$16,522,142</u>	<u>\$13,753,034</u>
Residential real estate loans purchased	<u>\$ 2,207,946</u>	<u>\$ 1,723,576</u>

(a) Approximately 50% and 41% of this volume was in prime product; 50% and 59% in sub-prime product for the six months ended June 30, 2002 and 2001, respectively.

GS Holdings earned \$70.7 million of interest income on loans held for sale for the six months ended June 30, 2002, an increase of \$18.0 million from the six months ended June 30, 2001. The average balance of loans held for sale was \$2.2 billion for the six months ended June 30, 2002, an increase of \$0.7 billion from the comparable period in 2001, primarily attributed to increased originations of residential fixed-rate loans as a result of heightened borrower refinancing activity in the declining interest rate environment. Fixed-rate production for sale totalled \$10.2 billion during the six months ended June 30, 2002, an increase of 46.5% over the \$6.9 billion originated during the comparable period in 2001. The weighted average yield on loans held for sale decreased to 6.35% for the six months ended June 30, 2002 from 6.92% for the six months ended June 30, 2001, primarily due to declining market interest rates.

Interest income on mortgage-backed securities available for sale was \$168.5 million for the six months ended June 30, 2002, a decrease of \$176.5 million from the six months ended June 30, 2001. The average portfolio balance decreased \$4.8 billion, to \$5.6 billion for the six months ended June 30, 2002 compared to the same period in 2001. The weighted average yield on these assets decreased from 6.64% for the six months ended June 30, 2001 to 6.02% for the six months ended June 30, 2002. The decrease in the volume is primarily attributed to management's decision to sharply reduce purchases, coupled with high repayments and sales of mortgage-backed securities. The decrease in the weighted average yield primarily reflects the repricing of variable-rate securities at lower rates.

Interest income on mortgage-backed securities held to maturity was \$39.7 million for the six months ended June 30, 2002, a decrease of \$31.3 million from the six months ended June 30, 2001. The average portfolio balance decreased \$0.4 billion, to \$1.3 billion for the six months ended June 30, 2002 compared to the same period in 2001, primarily due to repayments. The weighted average yields for the six months ended June 30, 2002 and 2001 were 6.28% and 8.43%, respectively. The decrease in the weighted average yield is primarily the result of the repricing of variable-rate securities at lower rates.

Interest income on securities, interest-bearing deposits in banks and other was \$15.8 million for the six months ended June 30, 2002, a decrease of \$15.8 million from the six months ended June 30, 2001. The average portfolio balance was \$0.4 billion and \$1.1 billion for the six months ended June 30, 2002 and 2001, respectively. The weighted average yield was 8.99% for the six months ended June 30, 2002 compared to 6.01% for the six months ended June 30, 2001. The decrease in the volume is primarily attributed to payments and maturities of securities. The increase in the weighted average yield reflects \$11.2 million of interest income related to a California income tax refund for which there is no corresponding earning asset; if this amount is excluded, the weighted average yield for the six months ended June 30, 2002 would be 2.61%. The weighted average yield also

reflects a shift in the mix of securities, with lower average balances of higher rate securities held to maturity during the first six months of 2002.

Dividends on FHLB stock were \$40.8 million for the six months ended June 30, 2002, a decrease of \$4.6 million from the six months ended June 30, 2001. The average balance outstanding was \$1.3 billion and \$1.4 billion for the six months ended June 30, 2002 and 2001, respectively. The weighted average dividend on FHLB stock declined to 6.24% for the six months ended June 30, 2002 from 6.58% for the six months ended June 30, 2001.

**Interest Expense.** Total interest expense was \$888.5 million for the six months ended June 30, 2002, a decrease of \$551.2 million from the six months ended June 30, 2001. The decrease is primarily due to declining market interest rates and a reduction in borrowings under FHLB advances and securities sold under agreements to repurchase, partially offset by additional deposits.

Interest expense on deposits, including Brokered Deposits, was \$260.9 million for the six months ended June 30, 2002, a decrease of \$203.6 million from the six months ended June 30, 2001. The average balance of deposits outstanding increased from \$24.0 billion for the six months ended June 30, 2001 to \$24.8 billion for the six months ended June 30, 2002. The increase in the average balance is primarily attributed to increases in the average balances of money market accounts, retail customer checking accounts, custodial accounts and savings account balances, partially offset by a decline in CDs. The overall weighted average cost of deposits decreased to 2.12% for the six months ended June 30, 2002 from 3.90% for the six months ended June 30, 2001, primarily due to declining market interest rates and a shift in the mix of deposits, with higher average balances of lower rate money market, checking, custodial and savings accounts, and a lower average balance of higher rate CDs during the first half of 2002.

Interest expense on securities sold under agreements to repurchase totalled \$42.4 million for the six months ended June 30, 2002, a decrease of \$79.0 million from the six months ended June 30, 2001. The average balance of such borrowings for the six months ended June 30, 2002 and 2001 was \$2.2 billion and \$4.0 billion, respectively. The decrease in the average balance is primarily the result of maturities, which were not renewed in light of the decline in interest-earning assets. The weighted average interest rate on these instruments decreased to 3.85% for the six months ended June 30, 2002 from 6.05% for the six months ended June 30, 2001, primarily due to maturities of higher fixed-rate borrowings and the repricing of variable-rate borrowings at lower rates.

Interest expense on borrowings totalled \$583.8 million for the six months ended June 30, 2002, a decrease of \$270.0 million from the six months ended June 30, 2001. The average balance outstanding for the six months ended June 30, 2002 and 2001 was \$22.5 billion and \$28.8 billion, respectively. The weighted average interest rate on these instruments decreased to 5.22% for the six months ended June 30, 2002 from 5.96% for the six months ended June 30, 2001. The decrease in the average volume is primarily the result of maturities, which were not renewed in light of the decline in interest-earning assets, while the decrease in the weighted average rate is primarily due to declining market interest rates.

**Net Interest Income.** Net interest income was \$738.0 million for the six months ended June 30, 2002, an increase of \$91.1 million from the six months ended June 30, 2001. The interest rate spread increased to 2.95% for the six months ended June 30, 2002 from 2.22% for the six months ended June 30, 2001, primarily as a result of declining market interest rates reducing costs of liabilities at a faster rate than the decline in the yield on assets. Lower-costing liabilities were the result of the replacement of higher-rate borrowings and deposits with lower-rate borrowings and deposits as these instruments came due or were repaid. The net interest margin increased to 2.96% for the six months ended June 30, 2002, up 71 bps from the 2.25% reported during the first half of 2001. Excluding the \$11.2 million interest on the California income tax refund, the interest rate spread and net interest margin for the six months ended June 30, 2002 would be 2.90% and 2.91%, respectively.

**Noninterest Income.** Total noninterest income, consisting primarily of loan servicing fees, customer banking fees, gain on sale, settlement and transfer of loans, net, gain on sale of assets, net and other income, was \$88.0 million for the six months ended June 30, 2002, representing a decrease of \$85.5 million from the six months ended June 30, 2001.

Loan servicing fees for the Company, were \$(106.6) million for the six months ended June 30, 2002, compared to \$(6.9) million the six months ended June 30, 2001. The following table details the components of loan servicing fees, net (in thousands):

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Components of loan servicing fees, net:		
Loan servicing fees	\$ 249,676	\$ 224,292
Amortization of MSRs	(212,596)	(147,013)
Pass-through Interest Expense	(20,498)	(16,142)
Net gain on MSRs/MSR derivatives (SFAS No. 133)	3,939	8,957
MSR valuation provision	<u>(127,107)</u>	<u>(77,000)</u>
Total loan servicing fees, net	<u><u>\$(106,586)</u></u>	<u><u>\$ (6,906)</u></u>
Portfolio run off rate (residential portfolio only)	30.0%	25.6%
MSR value run off rate (residential portfolio only)	21.8	21.2
MSR amortization rate (residential portfolio only)	22.9	20.3

As the table reflects, gross loan servicing fees increased \$25.4 million from year-ago levels, which is primarily attributable to the growth of the Company's servicing portfolio and higher ancillary fees. The single-family residential loan servicing portfolio, excluding loans serviced for the Bank, increased from \$83.3 billion at June 30, 2001 to \$90.7 billion at June 30, 2002. The portfolio runoff rate, representing the percentage of the residential portfolio that has been paid off during the year, influences MSR amortization, which increased \$65.6 million in the six months ended June 30, 2002 over the same period in 2001. MSR amortization was also affected by a higher average MSR balance for the six months ended June 30, 2002 compared to the same period in 2001. Pass-through Interest Expense increased \$4.4 million or 27.0% year over year, also influenced by higher runoff rates. Total loan servicing fees, net for the six months ended June 30, 2002 and 2001 includes net pre-tax gains of \$3.9 million and \$9.0 million, respectively, from the impact of SFAS No. 133 pertaining to the MSR fair value hedges. After recording these gains in accordance with SFAS No. 133, the Company determined that the fair value of the MSR asset was less than its carrying value and recorded pre-tax valuation provisions on the MSRs of \$127.1 million and \$77.0 million during the six months ended June 30, 2002 and 2001, respectively.

Customer banking fees were \$119.0 million for the six months ended June 30, 2002 compared to \$105.8 million for the six months ended June 30, 2001. The following table details the components of customer banking fees and service charges (in thousands):

	<u>Six Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Components of customer banking fees and service charges:		
Customer and electronic banking fees	\$ 77,602	\$ 68,501
Other customer fees	1,517	1,298
Investment sales income	35,199	30,730
Insurance commissions	<u>4,702</u>	<u>5,291</u>
Total customer banking fees and service charges	<u><u>\$119,020</u></u>	<u><u>\$105,820</u></u>

The increase is primarily attributed to increased emphasis by management on transaction account growth and higher fee income on mutual fund, annuity and other investment and insurance product sales through CFI. 2002 also includes a \$1.6 million reclassification to reflect gross revenues from customer check printing fees rather than net revenues. The offset is included in the "other expense" line of the income statement. Transaction accounts (including custodial accounts) as a percentage of retail deposits increased to 58.5% at June 30, 2002, from 53.3% at June 30, 2001.

Gain on sale, settlement and transfer of loans, net totalled \$55.5 million for the six months ended June 30, 2002, an increase of \$33.6 million from the six months ended June 30, 2001. During the six months ended June 30, 2002, the Company sold \$11.9 billion in single-family mortgage loans with servicing rights retained as part of its ongoing mortgage banking operations at gains of \$43.7 million compared to \$5.6 billion of such sales for the corresponding period in 2001 at gains of \$14.1 million. The overall increase in the volume of loans sold and the related gain is a result of the significant increase in fixed-rate loan originations due to the overall decline in market interest rates and increased mortgage refinancing. The results in 2002 and 2001 include unrealized gains of \$7.3 million and \$3.6 million, respectively, on the derivative rate locks, forward loan sale commitments and closed loan inventory from the application of SFAS No. 133.

Gain on sale of assets, net totalled \$8.4 million for the six months ended June 30, 2002, compared to a net gain of \$16.2 million for the six months ended June 30, 2001. The gain during the first half of 2002 includes a \$14.2 million gain on the sale of a real estate partnership interest, a \$3.4 million gain on the sale of the Santa Barbara branch and a \$2.0 million gain on the sale of \$62.3 million in mortgage-backed securities, partially offset by an \$11.3 million loss on the mark-to-market of the Company's portfolio of IO strip and "B" tranche mortgage securities pursuant to EITF No. 99-20. The gain during 2001 is primarily attributed to a \$9.3 million gain on the sale of the Company's Concord EFS stock and a gain of \$6.6 million on the sale of \$298 million in mortgage-backed securities.

Other noninterest income for the six months ended June 30, 2001 included a gain of \$20.7 million on the non-monetary exchange of Star Systems common stock for 634,520 shares of Concord EFS common stock as a result of Concord's acquisition of Star Systems in February 2001.

**Noninterest Expense.** Total noninterest expense was \$457.0 million for the six months ended June 30, 2002, a decrease of \$15.4 million compared to the six months ended June 30, 2001. Excluding the amortization of goodwill and other intangible assets, noninterest expense for the six months ended June 30, 2002 was \$454.7 million, an increase of \$12.2 million over the same period in the prior year. Noninterest expense for the six months ended June 30, 2002 included decreases of \$27.5 million in amortization of intangible assets, \$3.0 million in other noninterest expense and \$1.0 million in loan expense. These decreases were partially offset by increases of \$11.4 million in compensation expense, \$3.2 million in occupancy and equipment expense and \$1.4 million in professional fees.

Compensation and employee benefits expense was \$242.6 million for the six months ended June 30, 2002, an increase of \$11.4 million from the six months ended June 30, 2001. The increase is primarily attributed to an increase in staff (from 8,015 FTE at June 30, 2001 to 8,185 at June 30, 2002) and temporary personnel, primarily in volume-related operating groups, as well as normal salary adjustments.

Professional fees were \$16.1 million for the six months ended June 30, 2002, an increase of \$1.4 million from the six months ended June 30, 2001, primarily due to an overall increase in legal fees related to various legal cases.

Amortization of intangible assets was \$2.3 million for the six months ended June 30, 2002, a decrease of \$27.5 million from the six months ended June 30, 2001, due to the adoption of SFAS No. 142 on January 1, 2002, which requires that goodwill no longer be amortized.

Other noninterest expense was \$108.2 million for the six months ended June 30, 2002 compared to \$111.2 million in the same period of 2001. The decrease in expenses relates to decreases in a number of operating expense categories, including retail back office operations, marketing, judgments and settlements, employee travel expense and telephone.

**Provision for Income Tax.** During the six months ended June 30, 2002, GS Holdings recorded gross income tax expense of \$150.7 million, which was offset by a tax benefit of \$37.1 million, for net income tax expense of \$113.6 million. Based on the current status of Mafco Holdings' audits for the years 1991 through 1995 and anticipated reversal of deferred tax assets with established valuation allowance, management changed its judgment about the realizability of the Company's deferred tax assets and reduced its valuation allowance by \$44 million. As a result of reducing the valuation allowance, income tax expense was reduced by \$31.4 million and goodwill was reduced by \$12.6 million.



In addition, an accrued liability had been established in prior years for the purpose of satisfying assessments that may result from issues arising during audits with various state taxing authorities. As a result of recent documentation received pertaining to the California audit of Glendale Federal Bank for the years 1991 through 1997, management reduced its accrued state tax liability by \$8.7 million during the six months ended June 30, 2002. Goodwill was reduced by \$0.6 million in connection with this transaction. The Company also recorded additional Federal tax expense of \$3.1 million due to the reduction of the state tax expense.

During the six months ended June 30, 2001, GS Holdings recorded net income tax expense of \$123.7 million, which included net tax benefits of \$29.0 million. In prior years, an accrued liability was established for the purpose of satisfying assessments that may result from issues arising during audits with various state taxing authorities. As a result of the completion and settlement of audits in various state taxing jurisdictions, additional guidance on the deductibility of covered asset losses, and the current assessment of exposure for tax strategies employed for prior years, management reduced its accrued state tax liability by \$39.7 million. The Company also recorded additional Federal tax expense of \$13.9 million due to the reduction of the state tax expense.

In addition, an income tax benefit was recorded for \$3.2 million due to the utilization of net operating losses of a subsidiary made available as a result of the subsidiary's liquidation into California Federal Bank.

GS Holdings' effective gross federal tax rate was 27% during the six months ended June 30, 2002 and 41% during the six months ended June 30, 2001, while its federal statutory tax rate was 35% during both periods. In 2002, the difference between the effective and statutory rates was primarily the result of a reduction of the valuation allowance, partially offset by an increase in federal tax recorded in conjunction with the reduction in the accrued state tax liability. In 2001, the difference between the effective and statutory rates was primarily the result of non-deductible goodwill amortization and additional federal tax liability recorded in conjunction with a reduction in the accrued state tax liability. GS Holdings' effective state tax rate was 3% and (5)% during the six months ended June 30, 2002 and 2001, respectively. The low effective state tax rate during 2002 and 2001 was the result of the previously discussed reduction in the accrued state tax liability.

**Minority Interest.** During each of the six months ended June 30, 2002 and 2001, dividends on the REIT Preferred Stock were recorded totalling \$13.5 million, net of income tax benefit, which will inure to the Company as a result of the deductibility of such dividends for income tax purposes.

**Cumulative Effect of Change in Accounting Principle.** Cumulative effect of change in accounting principle for the six months ended June 30, 2001 includes a write-down of \$1.6 million, net of income taxes of \$1.1 million, on certain securities as a result of the Company's implementation of EITF No. 99-20 on April 1, 2001. See note 14 of the Company's Notes to Unaudited Consolidated Financial Statements.

**Impact of SFAS No. 133.** On January 1, 2001, the Company adopted SFAS No. 133. The pronouncement impacted several other areas of the financial statements. The table summarizes the activity during the six months ended June 30, 2002 and 2001 below (debit/(credit); in thousands):

	Assets			Liabilities and Equity			Pre-tax Earnings	
	Loans Held for Sale	Residential MSRs	Derivative Assets	Derivative Liabilities	Taxes– Other Liabilities	OCI	Loan Servicing Fees, net	(Gain)/Loss on Sale of Loans
Fair value adjustments:								
MSRs and MSR hedges	\$ --	\$(187,626)	\$ 180,458	\$ 11,107	\$ --	\$ --	\$(3,939)	\$ --
Warehouse loans and Pipeline hedges	43,381	--	(28,685)	(7,437)	--	--	--	(7,259)
Cash flow (balance sheet) Hedges – swaps	--	--	--	(28,500)	11,642	16,858	--	--
Fair Value Adjustments – Six Months Ended June 30, 2002	43,381	(187,626)	151,773	(24,830)	11,642	16,858	(3,939)	(7,259)
Other Activity – Six Months Ended June 30, 2002:								
MSR hedge additions	--	--	833,385	--	--	--	--	--
MSR hedge sales and Maturities	--	--	(1,078,131)	32,393	--	--	--	--
MSR hedge receipts And payments	--	--	(32,053)	(19,014)	--	--	--	--
Total Other Activity – Six Months Ended June 30, 2002	--	--	(276,799)	13,379	--	--	--	--
Total Impact from SFAS No. 133 – Six Months Ended June 30, 2002	<u>\$43,381</u>	<u>\$(187,626)</u>	<u>\$ (125,026)</u>	<u>\$ (11,451)</u>	<u>\$11,642</u>	<u>\$16,858</u>	<u>\$(3,939)</u>	<u>\$(7,259)</u>
Total Impact from SFAS No. 133 – Six Months Ended June 30, 2001	<u>\$ (5,204)</u>	<u>\$ (81,330)</u>	<u>\$ 193,430</u>	<u>\$ (126,624)</u>	<u>\$42,409</u>	<u>\$61,407</u>	<u>\$(8,957)</u>	<u>\$(3,551)</u>

## Results of Operations

*Three months ended June 30, 2002 versus three months ended June 30, 2001*

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 June 30, 2002		
	Average Balance	Interest	Average Rate
	(dollars in millions)		
ASSETS			
Interest-earning assets (1):			
Securities, interest-bearing deposits in banks and other (2)	\$ 439	\$ 14	12.65%
Mortgage-backed securities available for-sale	5,093	76	5.96
Mortgage-backed securities held-to-maturity	1,204	18	6.08
Loans held for sale, net	1,758	29	6.57
Loans receivable, net:			
Residential	28,453	435	6.11
Commercial real estate	6,634	116	7.00
Consumer	1,011	15	6.06
Automobile	2,032	65	12.74
Commercial banking	<u>765</u>	<u>11</u>	5.75
Total loans receivable, net	38,895	642	6.60
FHLB stock	<u>1,247</u>	<u>20</u>	6.42
Total interest-earning assets	48,636	<u>799</u>	6.57%
Noninterest-earning assets	<u>4,040</u>		
Total assets	<u>\$52,676</u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDER'S EQUITY			
Interest-bearing liabilities:			
Deposits	\$24,702	126	2.04%
Securities sold under agreements to repurchase (3)	2,143	21	3.89
Borrowings (3)	21,341	281	5.27
Other	<u>168</u>	<u>1</u>	1.77
Total interest-bearing liabilities	48,354	<u>429</u>	3.55%
Noninterest-bearing liabilities	1,127		
Minority interest	499		
Stockholder's equity	<u>2,696</u>		
Total liabilities, minority interest and stockholder's equity	<u>\$52,676</u>		
Net interest income		<u>\$370</u>	
Interest rate spread (4)			<u>3.02%</u>
Net interest margin			<u>3.04%</u>
Return on average assets			<u>0.88%</u>
Return on average common equity			<u>17.27%</u>
Return on tangible common equity			<u>22.74%</u>
Average equity to average assets			<u>5.12%</u>

	Three Months Ended June 30, 2001		
	Average Balance	Interest (dollars in millions)	Average Rate
ASSETS			
Interest-earning assets (1):			
Securities and interest-bearing deposits in banks (2)	\$ 811	\$ 12	5.85%
Mortgage-backed securities available for sale	10,005	164	6.56
Mortgage-backed securities held to maturity	1,631	34	8.24
Loans held for sale, net	1,927	33	6.76
Loans receivable, net:			
Residential	31,939	554	6.94
Commercial real estate	6,225	128	8.22
Consumer	890	19	8.70
Automobile	1,762	50	11.36
Commercial banking	590	12	8.24
Total loans receivable, net	41,406	763	7.38
FHLB stock	1,402	22	6.39
Total interest-earning assets	57,182	1,028	7.19%
Noninterest-earning assets	3,722		
Total assets	<u>\$60,904</u>		
LIABILITIES, MINORITY INTEREST AND STOCKHOLDER'S EQUITY			
Interest-bearing liabilities:			
Deposits	\$24,334	224	3.69%
Securities sold under agreements to repurchase (3)	3,819	53	5.55
Borrowings (3)	28,755	415	5.75
Other	3	--	--
Total interest-bearing liabilities	56,911	692	4.86%
Noninterest-bearing liabilities	1,143		
Minority interest	499		
Stockholder's equity	2,351		
Total liabilities, minority interest and stockholder's equity	<u>\$60,904</u>		
Net interest income		<u>\$ 336</u>	
Interest rate spread (4)			<u>2.33%</u>
Net interest margin			<u>2.36%</u>
Return on average assets			<u>0.75%</u>
Return on average common equity			<u>19.31%</u>
Return on tangible common equity			<u>30.54%</u>
Average equity to average assets			<u>3.86%</u>

- (1) Non-performing assets are included in the average balances for the periods indicated.
- (2) Includes securities, interest-bearing deposits in other banks, securities purchased under agreements to resell, interest income on California income tax refund and other interest income.
- (3) Interest and average rate include the impact of interest rate swaps.
- (4) Interest rate spread represents the difference between the average rates of total interest-earning assets and total interest-bearing liabilities.

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 June 30, 2002 vs. 2001		
	Increase (Decrease) Due to		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
(in millions)			
<b>INTEREST INCOME:</b>			
Securities, interest-bearing deposits in banks and other	\$ (4)	\$ 6	\$ 2
Mortgage-backed securities available for sale	(74)	(14)	(88)
Mortgage-backed securities held to maturity	(8)	(7)	(15)
Loans held for sale, net	(3)	(1)	(4)
Loans receivable, net	24	(146)	(122)
FHLB stock	<u>(2)</u>	<u>--</u>	<u>(2)</u>
Total	<u>(67)</u>	<u>(162)</u>	<u>(229)</u>
<b>INTEREST EXPENSE:</b>			
Deposits	2	(100)	(98)
Securities sold under agreements to repurchase	(20)	(13)	(33)
Borrowings	(89)	(44)	(133)
Other	<u>--</u>	<u>1</u>	<u>1</u>
Total	<u>(107)</u>	<u>(156)</u>	<u>(263)</u>
Change in net interest income	<u>\$ 40</u>	<u>\$ (6)</u>	<u>\$ 34</u>

**Interest Income.** Total interest income was \$798.8 million for the three months ended June 30, 2002, a decrease of \$228.7 million from the three months ended June 30, 2001. Total interest-earning assets for the three months ended June 30, 2002 averaged \$48.6 billion, compared to \$57.2 billion for the corresponding period in 2001. The decrease in interest-earning assets is primarily a result of a decline in mortgage-backed securities, principally due to management's decision to sharply reduce purchases, and net loan run off, as well as decreased securities volume and loans held for sale. The yield on total interest-earning assets during the three months ended June 30, 2002 decreased to 6.57% from 7.19% for the three months ended June 30, 2001, primarily due to the repricing of loans and mortgage-backed securities available for sale at lower rates.

GS Holdings earned \$641.8 million of interest income on loans receivable for the three months ended June 30, 2002, a decrease of \$121.4 million from the three months ended June 30, 2001. The average balance of loans receivable was \$38.9 billion for three months ended June 30, 2002, compared to \$41.4 billion for the same period in 2001. The weighted average yield on loans receivable decreased to 6.60% for the three months ended June 30, 2002 from 7.38% for the three months ended June 30, 2001. The decrease in the average balance reflects the sharp run off of residential loans during a period of high refinancing activity resulting in a shift in the mix of loans, with a higher percentage of higher rate loans during the second quarter of 2002. The decrease in the weighted average yield reflects the repricing of variable-rate loans, a decrease in the prime rate on commercial banking loans and comparatively lower market interest rates during the three months ended June 30, 2002, partially offset by a higher yield on auto loans purchased after July 1, 2001, which are recorded on a gross-coupon basis, rather than a credit-adjusted yield basis. The impact of this change on net interest income during the three months ended June 30, 2002 was to increase interest income by \$11.9 million.

Loan production is detailed in the table below (in thousands):

	<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Loans funded:		
Residential real estate loans:		
Adjustable-rate	\$1,525,246	\$2,253,890
Fixed-rate	<u>4,073,907</u>	<u>4,968,232</u>
Total residential real estate loans	5,599,153	7,222,122
Commercial real estate loans	462,597	555,456
Commercial loans	352,402	297,011
Consumer nonmortgage loans	289,429	215,374
Auto loans (a)	<u>339,191</u>	<u>310,038</u>
Total loans funded	<u>\$7,042,772</u>	<u>\$8,600,001</u>
Residential real estate loans purchased	<u>\$1,080,339</u>	<u>\$ 558,081</u>

(a) Approximately 49% and 36% of this volume was in prime product; 51% and 64% in sub-prime product for the three months ended June 30, 2002 and 2001, respectively.

GS Holdings earned \$28.9 million of interest income on loans held for sale for the three months ended June 30, 2002, a decrease of \$3.7 million from the three months ended June 30, 2001. The average balance of loans held for sale was \$1.8 billion for the three months ended June 30, 2002, a decrease of \$0.2 billion from the comparable period in 2001, primarily attributed to increased originations of residential fixed-rate loans as a result of heightened borrower refinancing activity in the declining interest rate environment. Fixed-rate production for sale totalled \$4.0 billion during the three months ended June 30, 2002, a decline of 14.7% over the \$4.7 billion originated during the comparable period in 2001. The weighted average yield on loans held for sale decreased to 6.57% for the three months ended June 30, 2002 from 6.76% for the three months ended June 30, 2001, primarily due to declining market interest rates.

Interest income on mortgage-backed securities available for sale was \$75.9 million for the three months ended June 30, 2002, a decrease of \$88.1 million from the three months ended June 30, 2001. The average portfolio balance decreased \$4.9 billion, to \$5.1 billion for the three months ended June 30, 2002 compared to the same period in 2001. The weighted average yield on these assets decreased from 6.56% for the three months ended June 30, 2001 to 5.96% for the three months ended June 30, 2002. The decrease in the volume is primarily attributed to management's decision to sharply reduce purchases, coupled with high repayments and sales of mortgage-backed securities. The decrease in the weighted average yield primarily reflects the repricing of variable-rate securities at lower rates.

Interest income on mortgage-backed securities held to maturity was \$18.3 million for the three months ended June 30, 2002, a decrease of \$15.3 million from the three months ended June 30, 2001. The average portfolio balance decreased \$0.4 billion, to \$1.2 billion for the three months ended June 30, 2002 compared to the same period in 2001, primarily due to repayments. The weighted average yields for the three months ended June 30, 2002 and 2001 were 6.08% and 8.24%, respectively. The decrease in the weighted average yield is primarily the result of the repricing of variable-rate securities at lower rates.

Interest income on securities, interest-bearing deposits in banks and other was \$13.9 million for the three months ended June 30, 2002, an increase of \$2.0 million from the three months ended June 30, 2001. The average portfolio balance was \$0.4 billion and \$0.8 billion for the three months ended June 30, 2002 and 2001, respectively. The weighted average yield of 12.65% for the three months ended June 30, 2002 compared to 5.85% for the three months ended June 30, 2001. The decrease in the volume is primarily attributed to payments and maturities of securities. The increase in weighted average yield reflects \$11.2 million of interest income related to a California income tax refund for which there is no corresponding earning asset; if this amount is excluded, the weighted average yield for the three months ended June 30, 2002 would be 2.44%. The weighted average yield also reflects a

shift in the mix of securities, with lower average balances of higher rate securities held to maturity during the second quarter of 2002.

Dividends on FHLB stock were \$20.0 million for the three months ended June 30, 2002, a decrease of \$2.4 million from the three months ended June 30, 2001. The average balance outstanding was \$1.2 billion and \$1.4 billion for the three months ended June 30, 2002 and 2001, respectively. The weighted average dividend on FHLB stock increased to 6.42% for the three months ended June 30, 2002 from 6.39% for the three months ended June 30, 2001.

**Interest Expense.** Total interest expense was \$428.5 million for the three months ended June 30, 2002, a decrease of \$262.6 million from the three months ended June 30, 2001. The decrease is primarily due to declining market interest rates and a reduction in borrowings under FHLB advances and securities sold under agreements to repurchase, partially offset by a slight increase in average deposits.

Interest expense on deposits, including Brokered Deposits, was \$125.7 million for the three months ended June 30, 2002, a decrease of \$97.9 million from the three months ended June 30, 2001. The average balance of deposits outstanding increased from \$24.3 billion for the three months ended June 30, 2001 to \$24.7 billion for the three months ended June 30, 2002. The increase in the average balance is primarily attributed to increases in the average balances of money market accounts, retail customer checking and savings accounts, partially offset by a decline in CDs and custodial accounts. The overall weighted average cost of deposits decreased to 2.04% for the three months ended June 30, 2002 from 3.69% for the three months ended June 30, 2001, primarily due to declining market interest rates and a shift in the mix of deposits, with higher average balances of lower rate money market, checking and savings accounts, and a lower average balance of higher rate CDs during the second quarter of 2002.

Interest expense on securities sold under agreements to repurchase totalled \$21.0 million for the three months ended June 30, 2002, a decrease of \$32.4 million from the three months ended June 30, 2001. The average balance of such borrowings for the three months ended June 30, 2002 and 2001 was \$2.1 billion and \$3.8 billion, respectively. The decrease in the average balance is primarily the result of maturities, which were not renewed in light of the decline in interest-earning assets. The weighted average interest rate on these instruments decreased to 3.89% for the three months ended June 30, 2002 from 5.55% for the three months ended June 30, 2001, primarily due to maturities of higher fixed-rate borrowings and the repricing of variable-rate borrowings at lower rates.

Interest expense on borrowings totalled \$281.0 million for the three months ended June 30, 2002, a decrease of \$133.0 million from the three months ended June 30, 2001. The average balance outstanding for the three months ended June 30, 2002 and 2001 was \$21.3 billion and \$28.8 billion, respectively. The weighted average interest rate on these instruments decreased to 5.27% for the three months ended June 30, 2002 from 5.75% for the three months ended June 30, 2001. The decrease in the average volume is primarily the result of maturities, which were not renewed in light of the decline in interest-earning assets, while the decrease in the weighted average rate is primarily due to declining market interest rates.

**Net Interest Income.** Net interest income was \$370.3 million for the three months ended June 30, 2002, an increase of \$33.9 million from the three months ended June 30, 2001. The interest rate spread increased to 3.02% for the three months ended June 30, 2002 from 2.33% for the three months ended June 30, 2001, primarily as a result of declining market interest rates reducing costs of liabilities at a faster rate than the decline in the yield on assets. Lower-costing liabilities were the result of the replacement of higher-rate borrowings and deposits with lower-rate borrowings and deposits as these instruments came due or were repaid. The net interest margin increased to 3.04% for the three months ended June 30, 2002, up 68 bps from the 2.36% reported during the second quarter of 2001. Excluding the \$11.2 million interest on the California income tax refund, the interest rate spread and net interest margin for the three months ended June 30, 2002 would be 2.93% and 2.95%, respectively.

**Noninterest Income.** Total noninterest income, consisting primarily of loan servicing fees, customer banking fees, gain on sale, settlement and transfer of loans, net, gain on sale of assets, net and other income, was \$(0.3) million for the three months ended June 30, 2002, representing a decrease of \$114.6 million from the three months ended June 30, 2001.

Loan servicing fees for the Company, were \$(97.8) million for the three months ended June 30, 2002, compared to \$19.7 million the three months ended June 30, 2001. The following table details the components of loan servicing fees, net (in thousands):

	<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Components of loan servicing fees, net:		
Loan servicing fees	\$124,304	\$111,050
Amortization of MSRs	(98,271)	(88,598)
Pass-through Interest Expense	(8,463)	(9,258)
Net (loss) gain on MSRs/MSR derivatives (SFAS No. 133)	(15,341)	6,552
MSR valuation provision	<u>(100,000)</u>	<u>--</u>
Total loan servicing fees, net	<u>\$ (97,771)</u>	<u>\$ 19,746</u>
Portfolio run off rate (residential portfolio only)	26.4%	30.5%
MSR value run off rate (residential portfolio only)	19.8	25.5
MSR amortization rate (residential portfolio only)	20.7	23.5

As the table reflects, gross loan servicing fees increased \$13.3 million from year-ago levels, which is primarily attributable to the growth of the Company's servicing portfolio and higher ancillary fees. The single-family residential loan servicing portfolio, excluding loans serviced for the Bank, increased from \$88.5 billion at March 31, 2002 to \$90.7 billion at June 30, 2002. MSR amortization, which increased \$9.7 million in the second quarter of 2002 over the same period in 2001, is affected by a higher average MSR balance for the three months ended June 30, 2002 over the same period in 2001, partially offset by a lower portfolio runoff rate, representing the percentage of the residential portfolio that has been paid off during the year. Pass-through Interest Expense decreased \$0.8 million or 9% year over year, also influenced by lower runoff rates. Total loan servicing fees, net for the second quarter of 2002 and 2001 includes net pre-tax (loss) gain of \$(15.3) million and \$6.6 million, respectively, from the impact of SFAS No. 133 pertaining to the MSR fair value hedges. After recording these (losses) gains in accordance with SFAS No. 133, the Company determined that the fair value of the MSR asset was less than its carrying value and recorded a pre-tax valuation provision on the MSRs of \$100.0 million during the three months ended June 30, 2002.

Customer banking fees were \$60.9 million for the three months ended June 30, 2002 compared to \$54.6 million for the three months ended June 30, 2001. The following table details the components of customer banking fees and service charges (in thousands):

	<u>Three Months Ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
Components of customer banking fees and service charges:		
Customer and electronic banking fees	\$40,019	\$35,392
Other customer fees	805	678
Investment sales income	17,819	15,968
Insurance commissions	<u>2,229</u>	<u>2,521</u>
Total customer banking fees and service charges	<u>\$60,872</u>	<u>\$54,559</u>

The increase is primarily attributed to increased emphasis by management on transaction account growth and higher fee income on mutual fund, annuity and other investment and insurance product sales through CFI. Second quarter 2002 also includes a \$0.8 million reclassification to reflect gross revenues from customer check printing fees rather than net revenues. The offset is included in the "other expense" line of the income statement.



Gain on sale, settlement and transfer of loans, net totalled \$20.9 million for the three months ended June 30, 2002, an increase of \$3.9 million from the three months ended June 30, 2001. During the three months ended June 30, 2002, California Federal sold \$5.0 billion in single-family mortgage loans with servicing rights retained as part of its ongoing mortgage banking operations at gains of \$22.1 million compared to \$4.2 billion of such sales for the corresponding period in 2001 at gains of \$10.5 million. The overall increase in the volume of loans sold and the related gain is a result of the significant increase in fixed-rate loan originations due to the overall decline in market interest rates and increased mortgage refinancing. The results in 2002 and 2001 include a \$1.6 million unrealized loss and a \$3.6 million unrealized gain, respectively, on the derivative rate locks, forward loan sale commitments and closed loan inventory from the application of SFAS No. 133.

Gain on sale of assets, net totalled \$10.3 million for the three months ended June 30, 2002, compared to a net gain of \$15.8 million for the three months ended June 30, 2001. The gain during the second quarter of 2002 includes a \$14.2 million gain on the sale of a real estate partnership interest and a \$3.4 million gain on the sale of the Santa Barbara branch, partially offset by an \$8.1 million loss on the mark-to-market of the Company's portfolio of IO strip and "B" tranche mortgage securities pursuant to EITF No. 99-20. The gain during 2001 is primarily attributed to a \$9.3 million gain on the sale of the Company's Concord EFS stock and a gain of \$6.6 million on the sale of \$298 million in mortgage-backed securities.

**Noninterest Expense.** Total noninterest expense was \$224.5 million for the three months ended June 30, 2002, a decrease of \$16.8 million compared to the three months ended June 30, 2001. Excluding the amortization of goodwill and other intangible assets, noninterest expense for the three months ended June 30, 2002 was \$223.3 million, a decrease of \$3.0 million over the same period in the prior year. Noninterest expense for the three months ended June 30, 2002 included decreases of \$13.8 million in amortization of intangible assets, \$6.7 million in other expense, \$1.1 million in professional fees and \$1.0 million in loan expense. These decreases were partially offset by increases of \$4.3 million in compensation and employee benefits expense, \$0.8 million in occupancy and equipment expense and \$0.6 million in foreclosed real estate operations, net.

Compensation and employee benefits expense was \$117.8 million for the three months ended June 30, 2002, an increase of \$4.3 million from the three months ended June 30, 2001. The increase is primarily attributed to an increase in staff (from 8,015 FTE at June 30, 2001 to 8,185 at June 30, 2002) and temporary personnel, primarily in volume-related operating groups, and normal salary adjustments.

Professional fees were \$8.7 million for the three months ended June 30, 2002, a decrease of \$1.1 million from the three months ended June 30, 2001, primarily due to an overall decrease in legal fees related to various legal cases.

Amortization of intangible assets was \$1.2 million for the three months ended June 30, 2002, a decrease of \$13.8 million from the three months ended June 30, 2001, due to the adoption of SFAS No. 142 on January 1, 2002, which requires that goodwill no longer be amortized.

Other noninterest expense was \$52.5 million for the three months ended June 30, 2002 compared to \$59.2 million for the same period in 2001. The decrease in expenses relates to decreases in a number of operating expense categories, including marketing, retail back office operations, judgments and settlements, employee travel expense and telephone.

**Provision for Income Tax.** During the three months ended June 30, 2002 and 2001, GS Holdings recorded net income tax expense of \$22.3 million and \$87.5 million, respectively. The expense recorded during the three months ended June 30, 2002 is net of income tax benefit of \$31.4 million from the reduction of the valuation allowance and \$5.7 million from the reduction of the accrued state tax liability. The expense recorded during the three months ended June 30, 2001 is net of income tax benefit of \$3.2 million recognized due to the utilization of net operating losses of a subsidiary made available as a result of the subsidiary's liquidation into California Federal Bank.

GS Holdings' effective gross federal tax rate was 15% and 36% during the three months ended June 30, 2002 and 2001, respectively, while its federal statutory tax rate was 35% during both periods. In 2002, the difference between the effective and statutory rates was primarily the result of a reduction of the valuation allowance, partially offset by an increase in federal tax recorded in conjunction with the reduction in the accrued state tax liability. In 2001, the difference between the effective and statutory rates was primarily the result of nondeductible goodwill amortization. GS Holdings' effective state tax rate was 0% and 6% during the three months ended June 30, 2002 and 2001, respectively. The effective state tax rate declined during 2002 as a result of a reduction of the accrued state tax liability.

**Minority Interest.** During each of the three months ended June 30, 2002 and 2001, dividends on the REIT Preferred Stock were recorded totalling \$6.7 million, net of income tax benefit, which will inure to the Company as a result of the deductibility of such dividends for income tax purposes.

**Cumulative Effect of Change in Accounting Principle.** Cumulative effect of change in accounting principle for the three months ended June 30, 2001 includes a write-down of \$1.6 million, net of income taxes of \$1.1 million, on certain securities as a result of the Company's implementation of EITF No. 99-20 on April 1, 2001. See note 12 of the Company's Notes to Unaudited Consolidated Financial Statements.

**Impact of SFAS No. 133.** On January 1, 2001, the Company adopted SFAS No. 133. The pronouncement impacted several other areas of the financial statements for the three months ended June 30, 2002 and 2001, as summarized below (debit/(credit); in thousands):

	Assets			Liabilities and Equity			Pre-tax Earnings	
	Loans Held for Sale	Residential MSRs	Derivative Assets	Derivative Liabilities	Taxes- Other Liabilities	OCI	Loan Servicing Fees, net	(Gain)/Loss on Sale of Loans
Fair value adjustments:								
MSRs and MSR hedges	\$ --	\$(239,403)	\$ 209,777	\$ 14,285	\$ --	\$ --	\$15,341	\$ --
Warehouse loans and pipeline hedges	24,671	--	(13,407)	(12,876)	--	--	--	1,612
Cash flow (balance sheet) hedges – swaps	--	--	--	(89,349)	36,500	52,849	--	--
Fair Value Adjustments – Three Months Ended June 30, 2002	24,671	(239,403)	196,370	(87,940)	36,500	52,849	15,341	1,612
Other Activity – Three Months Ended June 30, 2002:								
MSR hedge additions	--	--	416,498	--	--	--	--	--
MSR hedge sales and maturities	--	--	(569,501)	(1,229)	--	--	--	--
MSR hedge receipts and payments	--	--	(13,670)	(17,455)	--	--	--	--
Total Other Activity – Three Months Ended June 30, 2002	--	--	(166,673)	(18,684)	--	--	--	--
Total Impact from SFAS No. 133 – Three Months Ended June 30, 2002	<u>\$ 24,671</u>	<u>\$(239,403)</u>	<u>\$ 29,697</u>	<u>\$(106,624)</u>	<u>\$ 36,500</u>	<u>\$ 52,849</u>	<u>\$15,341</u>	<u>\$ 1,612</u>
Total Impact from SFAS No. 133 – Three Months Ended June 30, 2001	<u>\$(10,443)</u>	<u>\$ 114,750</u>	<u>\$(11,233)</u>	<u>\$ 25,109</u>	<u>\$(14,114)</u>	<u>\$(20,437)</u>	<u>\$(6,552)</u>	<u>\$(3,640)</u>

## **PART II - OTHER INFORMATION**

### **ITEM 1. Legal Proceedings.**

#### *California Federal Goodwill Litigation*

The Bank is the plaintiff in a lawsuit against the Government, the California Federal Goodwill Litigation. In the California Federal Goodwill Litigation, the Bank alleged, among other things, that the Government breached certain contractual commitments regarding the computation of its regulatory capital for which the Bank sought damages and restitution. The Bank's claims arose from changes, mandated by FIRREA, with respect to the rules for computing Old California Federal's regulatory capital.

In late 1997, a Claims Court Judge ruled in favor of the Bank's motion for partial summary judgment as to the Government's liability to the Bank for breach of contract, and a formal order in that regard was subsequently issued. In late 1998, a second Claims Court Judge ruled that California Federal could not meet its burden for proving lost profits damages and ordered that the case proceed to trial on the damage issue of restitution and reliance.

On April 16, 1999, the Claims Court issued its decision on the damages claim against the Government in the California Federal Goodwill Litigation, ruling that the Government must compensate the Bank in the sum of approximately \$23 million. The summary judgment liability decision by the first Claims Court Judge was appealed by the Government, and the damage award by the second Claims Court Judge was appealed by the Bank.

On April 3, 2001, the Court of Appeals for the Federal Circuit upheld the summary judgment liability decision and the approximately \$23 million damage award, but it also ruled that the Bank be allowed to present evidence regarding damages incurred under the lost profits theory. The case has been remanded back to the Claims Court for a damages trial under the lost profits theory, and trial is currently expected to begin in the first week of September 2002. In preparation for this trial, the Bank has had prepared a supplemental expert report, which contains alternate damage calculations based upon different assumptions, with the higher calculation being \$587 million in lost profits and the lower calculation being \$288 million in lost profits. The Government has had prepared reports from four different experts, all of which challenge, for a variety of reasons, the calculations in the Bank's expert report and which essentially contend that the Bank is not entitled to any damages other than the approximately \$23 million previously awarded by the Claims Court and affirmed by the Federal Circuit.

#### *Glendale Goodwill Litigation*

By virtue of the Glen Fed Merger, the Bank is also a plaintiff in a claim against the United States in a second lawsuit, the Glendale Goodwill Litigation. In the Glendale Goodwill Litigation, Glendale Federal sued the Government contending that FIRREA's treatment of supervisory goodwill constituted a breach by the Government of its 1981 contract with the Bank, under which the Bank had merged with a Florida thrift and was permitted to include the goodwill resulting from the merger in its regulatory capital. In 1992, the Claims Court found in favor of Glendale Federal's position, ruling that the Government breached its express contractual commitment to permit Glendale Federal to include supervisory goodwill in its regulatory capital and that Glendale Federal is entitled to seek financial compensation.

The trial began in February 1997 and concluded in September 1998. On April 9, 1999, the Claims Court issued its decision in 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.

On February 16, 2001, the Court of Appeals for the Federal Circuit vacated the trial court's award of damages and remanded the case back to the trial court for determination of total reliance damages to which the Bank might be entitled. Oral argument before the trial court took place on June 26, 2001, and on August 2, 2002, the Claims Court ruled that the Bank's total reliance damages were \$380.8 million.

*Bartold v. Glendale Federal Bank et al.*

On September 18, 1995, four plaintiffs commenced an action in Superior Court of California, County of Orange, alleging that the defendants Glendale Federal, to which the Bank is a successor by merger, and Verdugo, a wholly owned subsidiary of the Bank, failed timely to record their release of the mortgage interest following payoffs of residential mortgage loans and, in at least some instances, improperly required borrowers to pay fees for these releases. The plaintiffs' complaint seeks relief for the named plaintiffs, as well as purportedly for all others similarly situated in California and throughout the United States and the general public, on causes of action for violation of California Civil Code Section 2941 and California Business and Professions Code Section 17200, breach of contract, fraud and unjust enrichment. The plaintiffs seek statutory damages of \$300 for each supposed, separate violation of Section 2941 by Glendale Federal and Verdugo, restitution, punitive damages, injunctive relief and attorney's fees, among other things.

In October 1997, the trial court granted summary judgment for the defendants. In September 2000, the California Court of Appeals reversed this decision and remanded for further proceedings, including further development of class certification issues. On March 2, 2001, the trial court held that a California class had been certified. On June 7, 2001, the trial court dismissed two of the four causes of action against the Bank, holding that the OTS pre-empted the California courts from regulating the Bank's procedures for reconveying deeds. The California Court of Appeal denied plaintiff's petition for review of the trial court's decision.

In September 2001, the California state legislature amended California Civil Code Section 2941 (Assembly Bill 1090) clarifying the legislature's intent that loan servicers had 39 days from loan pay off to deliver reconveyance documents and that trustees had 21 days from the time of receiving the reconveyance documents to record or cause to be recorded the reconveyance. This amendment specifically abrogated the contrary September 2000 holding of the California Court of Appeal in this litigation.

The Bank believes that it has additional meritorious defenses to plaintiffs' claims and intends to continue to contest the remaining claims in the lawsuit vigorously.

*Other Litigation*

In addition to the matters described above, GS Holdings and its subsidiaries are involved in other legal proceedings and 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 GS Holdings or the Bank.

**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 Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 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, 1998.)

99.1 Certification of Periodic Report by Principal Executive Officer.

99.2 Certification of Periodic Report by Principal Financial Officer.

(b) Reports on Form 8-K:

None.

## GLOSSARY OF DEFINED TERMS

**AICPA** – American Institute of Certified Public Accountants  
**APB** – Accounting Principles Board  
**APB Opinion No. 17** – Intangible Assets  
**APB Opinion No. 25** – Accounting for Stock Issued to Employees  
**APB Opinion No. 30** – Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions  
**ARM** – Adjustable-rate mortgage  
**Bank** – California Federal Bank  
**bps** – basis points  
**Brokered Deposits** – Issued CDs through direct placement programs and national investment banking firms  
**Cal Fed Acquisition** – Agreement and Plan of Merger among FN Holdings, Cal Fed Bancorp Inc. and California Federal Bank, A Federal Savings Bank. FN Holdings acquired 100% of the outstanding stock of Cal Fed and Old California Federal, and First Nationwide merged with and into Old California Federal in January 1997.  
**California Federal** – California Federal Bank  
**California Federal Goodwill Litigation** – California Federal Bank v. United States, Civil Action 92-138  
**CD** – Certificate of deposit  
**Citigroup** – Citigroup Inc.  
**Claims Court** – United States Court of Federal Claims  
**COFI** – Cost of Funds Index (tied to the FHLB's 11<sup>th</sup> District cost of funds)  
**Company** – Golden State Holdings Inc.  
**EITF** – Emerging Issues Task Force  
**EITF No. 99-20** – Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets  
**EPS** – earnings per share  
**FASB** – Financial Accounting Standards Board  
**FDICIA** – Federal Deposit Insurance Corporation Improvement Act  
**Federal Circuit** – U.S. Court of Appeals for the Federal Circuit  
**FHLB** – Federal Home Loan Bank of San Francisco  
**FHLB System** – Federal Home Loan Bank System  
**FIRREA** – Financial Institutions Reform, Recovery and Enforcement Act of 1989 and its implementing regulations.  
**FN Holdings** – First Nationwide Holdings Inc.  
**FN Holdings Asset Transfer** – FN Holdings contributed all of its assets (including all of the common stock of the Bank) to GS Holdings in September 1998.  
**FN Holdings Notes** – FN Holdings 12<sup>1</sup>/<sub>4</sub>% Senior Notes, the FN Holdings 9<sup>1</sup>/<sub>8</sub>% Senior Sub Notes and the FN Holdings 10<sup>5</sup>/<sub>8</sub>% Notes, collectively  
**FNMC** – First Nationwide Mortgage Corporation  
**FTE** – Full-time equivalent staff  
**GAAP** – accounting principles generally accepted in the United States of America  
**Glen Fed Merger** – Glendale Federal Bank merged with and into the Bank  
**Glendale Federal** – Glendale Federal Bank, Federal Savings Bank  
**Glendale Goodwill Litigation** – Glendale Federal Bank v. United States, No. 90-772C  
**GNMA** – Government National Mortgage Association  
**Golden State** – Golden State Bancorp Inc.  
**Golden State Acquisition** – FN Holdings Asset Transfer, Holding Company Mergers and Glen Fed Merger, collectively  
**Government** – United States Government  
**GS Holdings** – Golden State Holdings Inc.  
**Holding Company Mergers** – FN Holdings merged with and into Golden State Financial Corporation, which owned all of the common stock of Glendale Federal.  
**Hunter's Glen** – Hunter's Glen/Ford, Ltd.  
**IO** – Interest only  
**IRS** – Internal Revenue Service

## GLOSSARY OF DEFINED TERMS (continued)

**LIBOR** – London Interbank Offered Rate

**LTW<sup>TM</sup>** – Litigation Tracking Warrants<sup>TM</sup>

**Mercury Merger Sub** – Mercury Merger Sub, Inc., a subsidiary of Citigroup

**Merger** – The merger of Golden State with and into Mercury Merger Sub, with Mercury Merger Sub as the surviving entity

**Merger Agreement** – the Agreement and Plan of Merger that provides for, among other things, the Merger

**MSR** – Mortgage servicing rights

**notional amount** – the amount on which calculations, payments, and the value of a derivative is based. Notional amounts do not represent direct credit exposures.

**NPV** – Net portfolio value

**OCI** – Other comprehensive income

**Old California Federal** – California Federal Bank, A Federal Savings Bank prior to the Cal Fed Acquisition.

**OTS** – Office of Thrift Supervision

**Pass-through Interest Expense** – represents interest that FNMC pays to the investor(s) for loans serviced by FNMC, which are paid off by the borrower(s) before the end of the month. FNMC pays the shortfall of interest on the respective loans as a result of the contractual agreement between the servicer (FNMC) and the investor(s) (*i. e.*, GNMA)

**PO** – Principal only

**Preferred Capital Corporation** – California Federal Preferred Capital Corporation

**REIT** – Real Estate Investment Trust

**REIT Preferred Stock** – 9<sup>1</sup>/<sub>8</sub>% Noncumulative Exchangeable Preferred Stock, Series A, issued by California Federal Preferred Capital Corporation in January 1996.

**Repos** – short-term securities sold under agreements to repurchase

**SEC** – United States Securities and Exchange Commission

**Securityholders** – consists of Mafco Holdings Inc., GSB Investments Corp., MacAndrews & Forbes Holdings Inc., Hunter's Glen/Ford, Ltd. and Gerald Ford

**Securityholders Agreement** – dated as of May 21, 2002, by and among Citigroup Inc., Golden State Bancorp Inc., Mafco Holdings Inc., GSB Investments Corp., MacAndrews & Forbes Holdings Inc., Hunter's Glen/Ford, Ltd. and Gerald Ford, pursuant to which the Securityholders, among other things, have agreed to vote certain shares of Company Common Stock beneficially owned by them, constituting approximately 31.5% of the outstanding shares of Golden State Common Stock, in favor of the Merger and against competing business combination proposals.

**SFAS** – Statement of Financial Accounting Standards

**SFAS No. 4** – Reporting Gains and Losses from Extinguishment of Debt

**SFAS No. 13** – Accounting for Leases

**SFAS No. 44** – Accounting for Intangible Assets of Motor Carriers

**SFAS No. 64** – Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements

**SFAS No. 115** – Accounting for Certain Investments in Debt and Equity Securities

**SFAS No. 121** – Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of

**SFAS No. 131** – Disclosures about Segments of an Enterprise and Related Information

**SFAS No. 133** – Accounting for Derivative Instruments and Hedging Activities

**SFAS No. 142** – Accounting for Goodwill and Intangible Assets

**SFAS No. 144** – Accounting for the Impairment or Disposal of Long-Lived Assets

**SFAS No. 145** – Rescission of SFAS No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections

**SOP** – Statement of Position

**SOP 01-6** – Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others

**Stock Plan** – Golden State Bancorp Inc. Omnibus Stock Plan

**The Merger** – Mercury Merger Sub merges with and into Golden State, with Mercury Merger Sub as the surviving entity

**Verdugo** – Verdugo Trustee Service Corporation

## 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 Holdings 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)

August 9, 2002