

DOWNEY FINANCIAL CORP
Form DEF 14A
March 15, 2005

[Click here to quickly move through the Proxy filing.](#)

[Navigation Links](#)

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

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934
(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

DOWNEY FINANCIAL CORP.

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

DOWNEY FINANCIAL CORP.
3501 Jamboree Road
Newport Beach, CA 92660
(949) 854-0300

March 16, 2005

Notice of Annual Meeting of Shareholders
Wednesday, April 27, 2005
10:00 a.m.

Irvine Marriott Hotel
18000 Von Karman Avenue
Irvine, California

Dear Friends and Shareholders:

The Board of Directors and officers of Downey Financial Corp. (Downey) are pleased to extend to you a cordial invitation to attend Downey s Annual Meeting of Shareholders at the time and place shown above to:

1. Elect three Class 1 Directors for terms of three years each;
2. Ratify the appointment of KPMG LLP as auditors for the year 2005; and
3. Transact such other business as may properly come before the Annual Meeting and any adjournments thereof.

The Board of Directors has selected February 25, 2005 as the record date for the Annual Meeting. Only those shareholders of record at the close of business on that date will be entitled to notice of and to vote at the Annual Meeting or any adjournments thereof. Information about the matters on which shareholders will act is included in the attached Proxy Statement. Downey s directors and executive officers will be available at the meeting to meet with shareholders.

Your vote is important regardless of the number of shares you own. Whether or not you expect to attend the meeting, we ask that you **PLEASE SIGN AND RETURN THE ENCLOSED PROXY CARD IN THE POSTAGE-PAID ENVELOPE PROVIDED.** Thank you in advance for your cooperation.

We look forward to seeing you at the meeting.

Sincerely yours,

/s/ Maurice L. McAlister
MAURICE L. McALISTER
Chairman of the Board

/s/ Cheryl E. Olson
CHERYL E. OLSON
Vice Chairman of the Board

/s/ Daniel D. Rosenthal
 DANIEL D. ROSENTHAL
 President and Chief Executive Officer

Page

Navigation Links

Table of Contents

	<u>Page</u>
Proxy Statement	1
Record Date and Voting of Shares	1
Voting and Revocation of Proxies	1
Solicitation of Proxies	1
Proposal 1. Election of Directors	2
Information Concerning Nominees and Directors	2
Nominees for Election at this Meeting, as Class 1 Directors to Terms Expiring in 2008	3
Class 2 Directors Whose Present Terms Continue until 2006	3
Class 3 Directors Whose Present Terms Continue until 2007	3
Proposal 2. Ratify the Appointment of Auditors	4
Board Committees and Meeting Attendance	5-6
Director Independence	6
Security Ownership of Directors and Executive Officers	7
Executive Officers	8-10
Audit Committee Report	11
Audit Philosophy	11
Communications with Independent Auditors	11
Section 404 of the Sarbanes-Oxley Act of 2002	11
Fees	12
Compensation Committee Report on Executive Compensation	13
Executive Compensation Philosophy	13
2004 Components of Executive Compensation	13-15
Review of Non-Employee Director Compensation	16
Conclusion	16
Compensation	17
Executive Compensation	17-18
Option/SAR Grants in Last Fiscal Year	18
Option Exercises and Holdings	18
Director Compensation	18-20
Nominating and Corporate Governance Committee Report	21-22

Performance Graph	23
Certain Relationships and Related Transactions	24
Transactions with Management and Certain Business Relationships	24
Loans to Management and Directors	24
Security Ownership of Certain Beneficial Owners	25
Principal Shareholders	25
Equity Compensation Plan Information	26
Section 16(a) Beneficial Ownership Reporting Compliance	26
New York Stock Exchange CEO Certification	26
Proposals of Shareholders	26
Annual Report to Shareholders	26
Other Business	27
Additional Matters	27
Presented by Shareholders	27
APPENDIX A Downey Financial Corp. Charter for the Audit Committee of the Board of Directors	28-31

DOWNEY FINANCIAL CORP.
3501 Jamboree Road
Newport Beach, California 92660

PROXY STATEMENT

This Proxy Statement and the accompanying proxy card are furnished in connection with the solicitation of proxies by the Board of Directors (the "Board") for use at the Annual Meeting of Shareholders of Downey Financial Corp., a Delaware corporation ("Downey"), to be held at 10:00 a.m., local time, on Wednesday, April 27, 2005, at the Irvine Marriott Hotel, 18000 Von Karman Avenue, Irvine, California 92612, and any adjournments thereof (the "Annual Meeting"). Certain of the information provided in this Proxy Statement relates to Downey Savings and Loan Association, F.A. and any predecessor entity (the "Bank"), a wholly-owned subsidiary of Downey and to DSL Service Company ("DSL"), a wholly-owned subsidiary of the Bank. This Proxy Statement and the accompanying form of proxy are being mailed to shareholders on or about March 16, 2005. The mailing address of the principal office of Downey is 3501 Jamboree Road, Newport Beach, California 92660. Downey's telephone number is (949) 854-0300.

RECORD DATE AND VOTING OF SHARES

On February 25, 2005, the record date for determining the shareholders entitled to notice of and to vote at the Annual Meeting, 27,853,783 shares of Downey's common stock ("Common Stock") were outstanding. A majority of the shares entitled to vote will constitute a quorum at the Annual Meeting. The three director nominees receiving the highest number of affirmative votes at the Annual Meeting will be elected. All other proposals require the affirmative "**FOR**" vote of a majority of those shares present in person or represented by proxy and entitled to vote on those proposals at the Annual Meeting. Abstentions and broker non-votes are counted for purposes of determining a quorum, but are not considered as having voted for purposes of determining the outcome of a vote.

VOTING AND REVOCATION OF PROXIES

Proxies are being solicited on behalf of the Board of Directors of Downey. All shares represented by a properly executed proxy will be voted in accordance with the directions on such proxy. If no directions are specified, such shares will be voted **FOR** the election of the Board's nominees for directors presented under Proposal 1 and **FOR** the ratification of KPMG LLP as auditors for the year 2005 presented under Proposal 2. If for any reason one or more of the nominees should be unable or refuse to serve as a director (an event which the Board does not anticipate), the persons named in the enclosed proxy, in their discretion, will vote for substitute nominees of the Board unless otherwise instructed. If any other matters are properly presented to the Annual Meeting for action (including any proposal to adjourn the Annual Meeting), the persons named in such proxy and acting thereunder will vote in accordance with their best judgment on such matters.

Any shareholder may revoke his or her proxy at any time before it is voted by filing with the General Counsel/Corporate Secretary of Downey a written instrument revoking it or by filing a duly executed proxy bearing a later date. The execution of the enclosed proxy will not affect the right of a shareholder to vote in person if such shareholder should decide to attend the Annual Meeting and desires to vote in person.

SOLICITATION OF PROXIES

Proxies are being solicited on behalf of the Board of Directors of Downey. Downey will bear the cost of soliciting proxies. Directors and officers of Downey and directors, officers and employees of the Bank may solicit proxies personally, by mail, telephone, telecopier or other electronic transmission. Such directors, officers or employees will receive no compensation for their solicitation services other

Page 1

[Navigation Links](#)

than their regular salaries, but may be reimbursed for out-of-pocket expenses. Downey will request record holders of shares beneficially owned by others to forward this Proxy Statement and related materials to the beneficial owners of such shares and will reimburse such record holders for their reasonable expenses incurred in doing so.

PROPOSAL 1. ELECTION OF DIRECTORS

The directors of Downey are divided into three classes, as nearly equal in number as possible, with one class to be elected annually. The members of each class are elected for terms of three years and until their successors are elected and qualified, with one of the three classes of directors being elected each year. Article III, Section 3.2 of Downey's Bylaws provides that the Board shall be composed of not less than seven nor more than nine members, the exact number to be fixed by the Board.

Accordingly, at this Annual Meeting, three Class 1 Directors are to be elected to serve three-year terms and until their respective successors are elected and qualified. The following persons have been nominated by the Board to serve as directors:

For election as Class 1 Directors to hold office until the 2008 Annual Meeting of Shareholders, and until their successors are duly elected and qualified: Gerald E. Finnell, Maurice L. McAlister and Daniel D. Rosenthal.

The Board of Directors unanimously recommends a vote "FOR" the election of each of the nominees.

Information Concerning Nominees and Directors

Certain information concerning each nominee for director and each current director is set forth below. For information regarding ownership of Downey Common Stock by nominees and directors of Downey, see "Security Ownership of Directors and Executive Officers" below. There are no arrangements or understandings between any

director, or any nominee, or any other person pursuant to which such director or nominee is or was nominated to serve as director.

The following table sets forth certain information concerning (i) the three nominees standing for election to the Board at the Annual Meeting, and (ii) all other directors whose terms as directors will continue after the Annual Meeting.

Name	Age At February 25, 2005	Position(s) Currently Held	Director of Downey Since ⁽¹⁾	Year Term Expires
Nominees For Election				
<i>Class 1</i>				
Gerald E. Finnell	65	Director	2003	2005
Maurice L. McAlister	79	Director/Chairman	1994	2005
Daniel D. Rosenthal	52	Director, President and Chief Executive Officer	1998	2005
Continuing Directors				
<i>Class 2</i>				
Michael B. Abrahams	52	Director	1999	2006
Cheryl E. Olson	48	Director/Vice Chairman	1994	2006
Lester C. Smull	72	Director	1994	2006
<i>Class 3</i>				
James H. Hunter	46	Director	2002	2007
Brent McQuarrie	53	Director	1994	2007
Jane Wolfe	59	Director	2004	2007

⁽¹⁾ Downey was organized on October 21, 1994. Prior thereto, Brent McQuarrie, Maurice L. McAlister, Cheryl E. Olson and Lester C. Smull were directors of the Bank.

Nominees for Election at this Meeting, as Class 1 Directors, to Terms Expiring in 2008

Gerald E. Finnell Mr. Finnell has served as a director of Downey and the Bank since 2003. Mr. Finnell was an audit partner with KPMG LLP from 1962 to 1995 and served as a director of KPMG LLP from 1987 to 1994.

Maurice L. McAlister Mr. McAlister is the Chairman of the Board of Directors of both Downey and the Bank and was a co-founder of the Bank together with the other co-founder, the late Gerald H. McQuarrie. Mr. McAlister

served as President of the Bank from 1957 until his retirement in September 1991. In addition, Mr. McAlister is a director and President of McAlister Investments, Inc., an affiliate of Downey.

Daniel D. Rosenthal Mr. Rosenthal has served as a director of Downey and the Bank since 1998 and has served as the President and Chief Executive Officer of Downey and the Bank since September 2004. Mr. Rosenthal also served as the President and Chief Executive Officer of Downey and the Bank from November 1998 until January 2004. Mr. Rosenthal joined the Bank in 1975, was appointed a director of DSL Service Company, and was appointed as DSL Service Company's Acting President in 1993. Mr. Rosenthal was named President of DSL Service Company in 1994 and continues in that capacity. During 1998, Mr. Rosenthal served as the Chief Operating Officer of the Bank.

Class 2 Directors Whose Present Terms Continue until 2006

Michael B. Abrahams Mr. Abrahams has served as a director of Downey and the Bank since 1999. Mr. Abrahams is a Managing Director at Hofer & Arnett, Inc., a San Francisco based investment banking firm specializing in financial institutions. Mr. Abrahams was a senior research analyst for Sutro & Co. from 1996 to 1999 and a Senior Vice President, Investment Banking with Oppenheimer & Co., Inc. from 1991 to 1996. In addition to serving as a research analyst at Bateman Eichler, Hill Richards from 1988 to 1991 and Johnston, Lemon & Co. in Washington, DC from 1986 to 1988, Mr. Abrahams was a policy analyst in the Executive Office of the President, Office of Management and Budget, Washington, DC from 1981 to 1986.

Cheryl E. Olson Mrs. Olson is the Vice Chairman of the Boards of Downey and the Bank. Mrs. Olson has served as a director of the Bank since 1987. Mrs. Olson is actively involved in a variety of real estate development, management and consultant activities. Mrs. Olson also serves on the Board of Directors of Arrow Records, Inc. Mrs. Olson is the daughter of Maurice L. McAlister, Chairman of the Board of both Downey and the Bank.

Lester C. Smull Mr. Smull is a director of Downey and the Bank and has served as a director since 1994. In 1970, Mr. Smull founded Business Properties Development Company ("Business Properties"), a real estate development company with offices in Irvine, California and Phoenix, Arizona. Business Properties' activities consist of the development, construction and management of commercial shopping centers, office and industrial buildings throughout California and Arizona, in addition to land acquisition, planning, design, property management, marketing and asset management services. Mr. Smull is also a licensed general contractor and operates Business Properties Construction Company.

Class 3 Directors Whose Present Terms Continue Until 2007

James H. Hunter Mr. Hunter has served as a director of Downey and the Bank since 2002. Mr. Hunter's principal occupation for the past several years has been Executive Vice President of Planning and Acquisition for The Corky McMillin Companies, a San Diego based residential real estate developer. Mr. Hunter has been with The Corky McMillin Companies since 1990, following nine years with Exxon Co., U.S.A. where he held various engineering, management and supervisory positions associated with oil and gas exploration and production, and was involved in several major acquisitions.

Brent McQuarrie Mr. McQuarrie is a director of Downey and the Bank. Mr. McQuarrie has served as a director of the Bank since 1987. Mr. McQuarrie's principal occupation for more than the past five years has been President and director of Legacy Realty and Investment Corp., a Utah real estate and development company, formerly known as Seven Peaks Development.

Jane Wolfe Ms. Wolfe became a director of Downey and the Bank on September 1, 2004. Ms. Wolfe served as

Executive Vice President and Chief Administrative Officer of the Bank from January 2001 until her retirement in May 2004. Prior to re-joining the Bank as Executive Vice President and Chief Lending Officer in April 1994, Ms. Wolfe served as Senior Vice President and Manager of Mortgage Lending for Liberty National Bank from September 1993 to April 1994. Ms. Wolfe acted as a mortgage lending consultant to several financial institutions from November 1992 to September 1993. From August 1978 to November 1992, Ms. Wolfe served as Executive Vice President and Chief Lending Officer of the Bank and Chief Underwriter and Underwriter from July 1974 to February 1977.

PROPOSAL 2. RATIFY THE APPOINTMENT OF AUDITORS

The Audit Committee of the Board has appointed KPMG LLP as Downey's auditors for 2005 and this appointment is being submitted to the shareholders for ratification. In the event the appointment is not ratified by a majority of votes cast, in person or by proxy, it is anticipated that no change in auditors would be made for the current year because of the difficulty and expense of making any change so long after the beginning of the current year. However, such vote would be considered in connection with the appointment of auditors for the next year.

KPMG LLP was Downey's auditor for the year ended December 31, 2004, and their representative is expected to attend the Annual Meeting.

In 1989, the Board engaged KPMG LLP as Downey's independent auditor and the relationship which has existed has been the customary relationship between an independent accountant and client.

The Board recommends that shareholders vote "FOR" this proposal. Proxies, unless indicated to the contrary, will be voted "FOR" this proposal.

BOARD COMMITTEES AND MEETING ATTENDANCE

Downey has four Board Committees: Audit, Compensation, Executive and Nominating and Corporate Governance. Membership in the committees, as of the record date of February 25, 2005, is as follows:

Audit

Gerald E. Finnell, Chair
Michael B. Abrahams
Brent McQuarrie

Compensation

Michael B. Abrahams, Chair
Cheryl E. Olson
James H. Hunter

Nominating

and Corporate Governance

Cheryl E. Olson, Chair
Maurice L. McAlister
Brent McQuarrie

Executive

Maurice L. McAlister, Chair
Cheryl E. Olson
Brent McQuarrie
Daniel D. Rosenthal

- Selects and retains Downey's and the Bank's independent accountants and assures their independence and objectivity;
- Reviews the scope of the audit plans of the independent accountants and the internal auditors;
- Oversees Downey's and the Bank's policies pertaining to the effectiveness of internal controls, financial reporting, compliance and risk management;
- Reviews the objectivity, effectiveness and resources of the internal audit and internal asset review functions which report directly to the Audit Committee;
- Approves non-audit services to be performed by the independent accountants; and
- Approves the fees for audit and non-audit services performed by the independent accountants.

Compensation Committee

Four Meetings in 2004

- Establishes the overall compensation and benefits policies for Downey and the Bank;
- Reviews and recommends to the Board, the salary and incentive compensation for the President and Chief Executive Officer;
- Reviews and approves the salaries and incentive compensation for other executive officers of Downey and the Bank; and
- Reviews and approves the short-term and long-term incentive compensation programs, including individual performance goals.

Nominating and Corporate Governance Committee

Three Meetings in 2004

Reviews and makes recommendations to the Board regarding:

- Oversight of Board activities related to corporate governance and organization structure;
- Qualifications for director candidates;
- Candidates for election and re-election to the Board;

Page 5

Navigation Links

- Candidates for the position of Chairman of the Board, and President and Chief Executive Officer; and
- The performance of the President and Chief Executive Officer, in conjunction with the Compensation Committee.

Executive Committee

Three Meetings in 2004

- Exercises the powers of the Board when the Board is not in session, except for the authority to approve the declaration of dividends and except as may otherwise be limited or restricted under applicable Delaware law or under Downey's Certificate of Incorporation or Bylaws.

Actions taken by any of the foregoing committees are reported to the Board, usually at its next meeting.

Board Meetings

During 2004, the Board met 12 times for regular meetings. All directors attended at least 75% of the aggregate meetings held during 2004 by the Board and the committees of the Board on which they served. Directors meet their responsibilities by attending Board and committee meetings, attending director education courses and reviewing director education materials and communicating with the Chairman, Vice Chairman, President and Chief Executive

Officer and other members of management on matters affecting Downey and the Bank.

During 2004, the independent directors met (without management) four times. The independent director meetings were chaired by Downey's Chairman of the Board or, if he was not present, by the Vice-Chairman.

Director Attendance At Annual Meetings

Downey's corporate governance policies state that directors are expected to attend annual meetings of shareholders. All nine directors attended the 2004 Annual Meeting.

DIRECTOR INDEPENDENCE

On November 4, 2003, the Securities and Exchange Commission ("SEC") approved the final corporate governance rules of the New York Stock Exchange ("NYSE"), including final criteria for director independence and a requirement that listed companies have a majority of independent directors. Applying the NYSE's final independence criteria, the Board has determined that six directors (Abrahams, Finnell, Hunter, McAlister, McQuarrie and Olson) are independent, because each director has no material relationship with Downey or the Bank, either directly or as a partner, shareholder or officer of an organization that has a relationship with Downey or the Bank. The Board also determined that the remaining three directors (Rosenthal, Smull and Wolfe) are not independent.

Page 6

[Navigation Links](#)

SECURITY OWNERSHIP OF DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth certain information as of February 25, 2005, regarding the beneficial ownership of shares of Common Stock by each director, each of the executive officers named in the Summary Compensation Table on Page 17 and by all directors and executive officers as a group. Unless otherwise stated, the beneficial owner exercises sole voting and investment power over their shares.

Name of Beneficial Owner	Aggregate Number of Shares Beneficially Owned	Percent of Outstanding Shares
Maurice L. McAlister	5,630,615 ⁽¹⁾	20.2
Cheryl E. Olson	692,072 ⁽²⁾	2.5
Brent McQuarrie	417,177 ⁽³⁾	1.5
Daniel D. Rosenthal	108,363 ⁽⁴⁾	*
James H. Hunter	72,748 ⁽⁵⁾	*
Michael B. Abrahams	4,000	*
Jane Wolfe	996	*
Lester C. Smull	598	*
Gerald E. Finnell	500	*
Thomas E. Prince	14,467 ⁽⁶⁾	*
John R. Gatzke	4,074	*
All Directors and Executive Officers	6,956,864 ⁽⁷⁾	25.0%

as a Group (17
persons)

- (1) Mr. McAlister with his spouse, Dianne S. McAlister, as Co-trustor and Co-trustee of the McAlister Family Trust, exercise shared voting and investment power over all shares.
- (2) Mrs. Olson holds sole voting and investment power over all shares.
- (3) Includes 174,100 shares held by Mr. McQuarrie as Trustee for Jared McQuarrie, Jennifer McQuarrie, Justin McQuarrie and Jamie McQuarrie (Four Jays, Ltd.). In addition, Mr. McQuarrie shares voting and investment power with his spouse, Kathryn McQuarrie, as Co-trustor and Co-trustee with respect to 36,420 shares, all of which are held in trust for the benefit of their children. Mr. McQuarrie holds 2,967 shares in an Individual Retirement Account and Mr. McQuarrie's spouse, Kathryn McQuarrie, holds 827 shares in an Individual Retirement Account. Mr. McQuarrie holds sole voting and investment power with respect to 1,050 shares and Mr. McQuarrie's spouse, Kathryn McQuarrie, holds sole voting and investment power with respect to 1,080 shares. Mr. McQuarrie's daughter, Jamie McQuarrie, holds sole voting and investment power with respect to 733 shares. Mr. McQuarrie holds 200,000 shares through Next Generation, Ltd., a Utah limited partnership, in which he serves as General Partner.
- (4) Includes options covering 29,484 shares that are exercisable within 60 days.
- (5) Mr. Hunter holds 72,252 shares through Llano Development, Inc. Profit Sharing Plan and Trust and holds 496 shares through the Downey Financial Corp. Stock Purchase Plan.
- (6) Includes options covering 14,467 shares that are exercisable within 60 days.
- (7) Includes shared voting and investment power over 5,954,411 shares, includes options covering 52,914 shares that are exercisable within 60 days.
- * Less than 1% of outstanding Common Stock at February 25, 2005.

EXECUTIVE OFFICERS

Executive officers are elected annually and serve at the pleasure of the Board.

The following table sets forth the names of the current executive officers of Downey and the Bank, along with certain other information relating to such persons:

Name	Age At February 25, 2005	Current Position
Daniel D. Rosenthal	52	President and Chief Executive Officer of Downey and the Bank
Thomas E. Prince	58	Chief Operating Officer and Chief Financial Officer of Downey and the Bank
Gary F. Torrell	49	Executive Vice President, General Counsel and Corporate Secretary of Downey and the Bank
Stanley M. Tarbell	44	Senior Vice President and Tax Director of Downey and the Bank

John R. Gatzke	44	Executive Vice President and Chief Lending Officer of the Bank
Lillian E. Gavin	42	Executive Vice President and Director of Compliance and Risk Management of the Bank
Richard D. Grout	49	Executive Vice President and Director of Retail Banking of the Bank
Lelah Jenkins	58	Executive Vice President and Chief Information Officer of the Bank
Kendice K. Briggs	37	Senior Vice President and Director of Human Resources of the Bank
Edward A. Luther	48	Senior Vice President and Director of Major Loans of the Bank
Cliff J. Piscitelli	55	Senior Vice President and Director of Secondary Marketing of the Bank
Kent J. Smith	43	Senior Vice President and Controller of the Bank
Richard B. Swinney	56	Senior Vice President and Director of Lending Operations of the Bank

Daniel D. Rosenthal See Page 3 for a description of Mr. Rosenthal's business background.

Thomas E. Prince Mr. Prince was appointed Chief Operating Officer of Downey and the Bank in September 2004 in addition to his role as Chief Financial Officer. Prior to joining the Bank as Executive Vice President and Chief Financial Officer in May 1992, Mr. Prince spent 24 years at Security Pacific Corporation and Security Pacific National Bank in various financial capacities, the last eight years of which as Senior Vice President and Controller.

Gary F. Torrell Prior to joining the Bank as Executive Vice President, General Counsel and Corporate Secretary in January 2002, Mr. Torrell was senior counsel at City National Bank. From 1983 through 1999, Mr. Torrell was in private practice, including six years as a partner at Paul, Hastings, Janofsky & Walker, LLP.

Stanley M. Tarbell Mr. Tarbell has been Tax Director of the Bank since 1989 and was appointed Senior Vice President in June 1998. Mr. Tarbell joined the Bank as Tax Manager in 1987, and prior

thereto, was a practicing Certified Public Accountant with the firm of Kenneth Leventhal and Company.

John R. Gatzke Mr. Gatzke was appointed Executive Vice President and Chief Lending Officer of the Bank in January 2001. Prior thereto, Mr. Gatzke served as Senior Vice President and Assistant Chief Lending Officer of the Bank from June 1998 to January 2001. Prior thereto, Mr. Gatzke served as Regional Manager of Wholesale and Retail

Lending of the Bank, and in 1997 was appointed Senior Vice President and Director of Wholesale Lending of the Bank. Mr. Gatzke previously held positions with the Bank from 1986 to 1990 and served as a loan officer. Prior to re-joining the Bank in 1992, Mr. Gatzke was employed by Knight Ridder Newspapers from 1990 to 1991, responsible for marketing and sales of real estate advertising.

Lillian E. Gavin Ms. Gavin was appointed Executive Vice President, Director of Compliance and Risk Management of the Bank in December 1998. Prior to joining the Bank as Senior Vice President, Director of Compliance and Risk Management in 1997, Ms. Gavin was a senior examiner with the Office of Thrift Supervision and its predecessor, the Federal Home Loan Bank Board, since 1987, and was a bank liquidation specialist with the Federal Deposit Insurance Corporation from 1984 to 1987.

Richard D. Grout Mr. Grout was appointed Executive Vice President, Director of Retail Banking of the Bank in March 2000. Previously, Mr. Grout was with Union Bank of California and was responsible for the bank's mortgage origination for Los Angeles County. From 1995 to 1998, Mr. Grout was with Home Savings of America and American Savings Bank from 1984 to 1995, where he held various retail banking management positions.

Lelah Jenkins Ms. Jenkins was appointed Executive Vice President, Chief Information Officer of the Bank in November 2002. From 1998 to 2002, Ms. Jenkins served as Senior Vice President, Technology Strategy at California Federal. From 1995 to 1998, Ms. Jenkins served as Executive Vice President, Chief Information Officer at Glendale Federal. From 1991 to 1995, Ms. Jenkins served as Director, Company-Wide Financial Systems for The Walt Disney Company. From 1986 to 1991, Ms. Jenkins served as Vice President, Systems and Programming at Glendale Federal Bank.

Kendice K. Briggs Ms. Briggs was appointed Senior Vice President, Director of Human Resources of the Bank in November 2000. Ms. Briggs joined the Bank in 1995 as an employment supervisor and was appointed Vice President and Manager of Human Resources in July 1998. Prior thereto, Ms. Briggs managed the Human Resources Department for Imperial Thrift and Loan Association from 1991 to 1995 and, prior thereto, worked for the accounting firm of Coopers & Lybrand in their Professional Personnel Department.

Edward A. Luther Mr. Luther was appointed Senior Vice President, Director of Major Loans in February 1999. Mr. Luther joined the Bank in January 1993 as the Environmental Risk Analyst and became the Construction Disbursement Manager for the Major Loan Department. Mr. Luther became a Vice President, Senior Account Officer in August 1996 and became the Operations Manager of the Major Loan Department in June 1997. Prior to joining the Bank, Mr. Luther was a Vice President, Loan Officer with Great American Bank.

Cliff J. Piscitelli Mr. Piscitelli was appointed Senior Vice President, Director of Secondary Marketing of the Bank in November 2004. Mr. Piscitelli previously held the position of Executive Vice President, Director of Asset Management of the Bank from April 2001 to May 2003. Prior thereto, Mr. Piscitelli served as Director of Mortgage Banking of the Bank from October 2000 to April 2001, Chief Executive Officer of KATL Properties from April 1995 to April 2000, and Chief Executive Officer and principal of Frontline Mortgage Company from December 1989 to January 1995.

Kent J. Smith Mr. Smith was appointed Senior Vice President, Controller of the Bank in January 2001. Prior thereto, Mr. Smith served as Vice President, Acting Controller of the Bank from August 2000 and Vice President, Assistant Controller of the Bank from June 1998 to July 2000.

Mr. Smith joined the Bank in October 1992 as a Senior Internal Auditor and was appointed Financial Reporting Manager in February 1996.

Richard B. Swinney Mr. Swinney joined the Bank in May 2003 as Vice President and Senior Counsel, and was appointed Senior Vice President and Director of Lending Operations in June 2003. His legal career has spanned twenty-five years, eighteen of which have been with financial institutions, including Washington Mutual, Great Western and American Savings.

AUDIT COMMITTEE REPORT

The Audit Committee is responsible for monitoring the integrity of Downey's financial reporting process and systems of internal controls regarding financial reporting, accounting and legal compliance. In addition, the Audit Committee is responsible for the selection and hiring of the independent auditor and monitoring the independence and performance of Downey's independent auditors, the internal auditing department and the internal asset review function. The Audit Committee also facilitates communication among the independent auditors, management, the internal auditing department, the internal asset review department and the Board. The current members of the Audit Committee are Gerald E. Finnell, Chair, Michael B. Abrahams and Brent McQuarrie. The Board has determined that each member of the Audit Committee is independent under applicable listing standards and that Gerald E. Finnell qualifies as an "audit committee financial expert."

Audit Philosophy

During 2005, the Board approved a revised Audit Committee charter to comply with new rules relating to the functioning of corporate audit committees promulgated by the SEC and NYSE. The revised charter is attached to this Proxy Statement as Appendix A and is available on Downey's website at www.downeysavings.com by clicking on "Investor Relations" and then "Corporate Governance."

During 2004, the Audit Committee met 13 times. The Audit Committee reviewed and discussed with management Downey's quarterly earnings releases and financial statements as well as the annual audited financial statements. The Audit Committee discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61.

Communications with Independent Auditors

The Audit Committee discussed with the independent auditors changes in significant accounting policies, the process used by management in formulating material accounting estimates and the independent auditor's conclusions regarding the reasonableness of such policies, estimates and adjustments arising from the audit, if any, and any disagreements with management over the application of accounting principles.

The Audit Committee received, reviewed and discussed with the independent auditors, the auditor's written disclosures regarding independence and the letter from the auditor required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*. Based on the review of such disclosures and giving consideration to the non-audit services provided by KPMG LLP during 2004, the Audit Committee has concluded that KPMG's independence has not been impaired or compromised.

Section 404 of the Sarbanes-Oxley Act of 2002

The Audit Committee reviewed and discussed Downey's compliance with Section 404 of the Sarbanes-Oxley Act of 2002, including the Public Company Accounting Oversight Board's Auditing Standard No. 2 regarding the audit of internal control over financial reporting. The Audit Committee also reviewed and discussed Downey's guidelines for risk assessment and risk management and the major risk exposures of Downey and its business units, as

appropriate.

Fees

During 2004 and 2003, Downey paid KPMG LLP the following amounts for the services as described below:

Audit Fees

Downey paid KPMG LLP the following amounts as fees for audit and review of the annual financial statements, management's assessment of internal control and the review of the unaudited financial statements included in the Form 10-Qs:

2004: \$577,000.

2003: \$281,600.

Audit-Related Fees

Downey paid KPMG LLP the following amounts as fees for assurance and related services by the principal accountant reasonably related to the performance of the audit or review of the financial statements not reported above under Audit Fees:

2004: \$128,000.

2003: \$20,000.

Tax Fees

Downey paid KPMG LLP the following amounts as fees for professional services rendered by the principal accountant for tax compliance, tax advice and tax planning:

2004: \$45,000 for assistance on particular tax issues.

2003: \$8,950 for review of tax returns;

\$229,318 for assistance in obtaining sales tax refunds related to activities of a former subsidiary; and

\$7,270 for assistance on particular tax issues.

All Other Fees

2004: -0-.

2003: -0-.

The Audit Committee has approved all of the fees described above.

Based on the Audit Committee's review and discussions described above, the Audit Committee recommended to the Board that the audited financial statements be included in Downey's Form 10-K filed with the SEC.

Respectfully submitted,

Gerald E. Finnell, Chairman

Michael B. Abrahams

Brent McQuarrie

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The current members of the Compensation Committee are Michael B. Abrahams, Chair, Cheryl E. Olson and James H. Hunter. The Board has determined that each member of the Compensation Committee is independent under applicable listing standards. The Board has approved a written charter for the Compensation Committee to comply with SEC and NYSE requirements. The charter is available on Downey's website at www.downeysavings.com by clicking on "Investor Relations" and then "Corporate Governance."

Executive Compensation Philosophy

The Compensation Committee's goal is to align compensation programs with the strategic direction of Downey and the Bank and to attract, motivate and retain the best qualified employees. In carrying out its duties, the Compensation Committee evaluates compensation and benefits programs, including both qualified and nonqualified programs, and other benefits programs affecting all employees to ensure they are cost effective, competitive and fair.

The Compensation Committee periodically compares Downey's pay policies to peer group institutions. The Compensation Committee strives to implement benefits programs which, based upon competitive and cost considerations, deliver the highest level of value consistent with corporate and shareholder interests. Total compensation (including benefits) is established in the context of overall job responsibilities, achieving corporate and individual performance goals and objectives, as well as competitive compensation conditions.

2004 Components of Executive Compensation

During 2004, the components of the compensation programs included a base salary, a bonus program ("Annual Incentive Plan"), the 1994 Long-Term Incentive Plan, a Deferred Compensation Plan, a Section 125 Cafeteria Plan (i.e., medical, vision, dental and life coverages) and an Employees' Retirement and Savings Plan (401(k) Plan).

Base Salary

During 2004 and early 2005, the Compensation Committee recommended and the Board approved the base salaries of Daniel D. Rosenthal, the current President and Chief Executive Officer and Marangal I. Domingo, the former President and Chief Executive Officer. The Compensation Committee also approved the base salaries of other executive officers in accordance with the Compensation Committee charter. The Compensation Committee based its recommendations and approvals on assessment of market conditions and competitive factors, including salary surveys from nationally recognized third parties and salary surveys among the Bank's competitors.

Annual Incentive Plan

During 2004, the Compensation Committee reviewed and the Board approved an Annual Incentive Plan for Downey. Individual performance objectives were established for all eligible participants in the Annual Incentive Plan based upon their individual responsibilities and Downey's 2004 approved corporate performance target for net income and net expense (general and administrative expense less non-interest income), which aligned each participant's compensation with Downey's approved business plan. During 2004, bonus incentives targeted under the Annual Incentive Plan for the current President (who is also the Chief Executive Officer) were targeted at 120% of the base salary. Other executive officers and eligible participants of Downey and the Bank were targeted at between 10% and 100% of their base salary. Pursuant to the Annual Incentive Plan, those targeted amounts may be adjusted based upon individual and corporate performance goals which provide for a potential bonus payment of

Page 13

[Navigation Links](#)

up to 144% of an individual's targeted bonus amount. However, to the extent that actual corporate performance was below 80% of the approved corporate performance goal, no bonus amounts were to be paid to participants pursuant to the Annual Incentive Plan.

During 2004, Downey achieved 120% of its corporate performance target. Based upon 2004 corporate and individual participant performance, bonuses paid, relative to the targeted amounts for all such participants, represented, on average, 133% of the bonus target.

1994 Long-Term Incentive Plan

In 1994, the Bank's Board approved a Long-Term Incentive Plan (the "LTIP"). The LTIP was submitted to the Bank's shareholders for approval at a special meeting of shareholders held on December 21, 1994. Thereafter, the LTIP was adopted and ratified by Downey and, pursuant thereto, shares of Downey are to be issued upon the exercise of options or payments of other awards for which payment is to be made in stock.

The LTIP was adopted to promote and advance the interests of Downey and its shareholders by providing a means by which selected officers and employees would be given an opportunity to acquire stock in Downey and other incentive-based awards, to assist in attracting and retaining the services of employees holding key positions and to provide incentives for such key employees to exert maximum efforts toward results that are in the best interests of all shareholders. Incentive stock options may be granted under the LTIP only to officers and key employees, including directors if they are employees. Currently, approximately 33 officers and key employees are eligible to receive awards under the LTIP. The LTIP is administered by the Compensation Committee and, during 2004, no stock option grants or other awards were made under the LTIP. There are 131,851 shares of common stock available for issuance under the LTIP.

Deferred Compensation Program

During 1995, the Compensation Committee reviewed and the Board approved implementation of a Deferred Compensation Plan for key management employees and directors. The Deferred Compensation Plan is considered to be an essential element in a comprehensive competitive benefits package designed to attract and retain individuals who contribute to the success of Downey. Participants are eligible to defer compensation on a pre-tax basis, including director fees, and earn a competitive interest rate on the amounts deferred. During 1999, the Board terminated the 1995 Deferred Compensation Plan and a 1999 Deferred Compensation Program was approved for key management employees and directors. Salary deferred pursuant to the 1999 Deferred Compensation Program earns interest at the current rate paid on one year certificates of deposit. The rate of interest paid in 2004 was 1.70%. Currently, 99 management employees and the directors are eligible to participate in the program. During 2004, 21 management

employees elected to defer compensation pursuant to the 1999 Deferred Compensation Program.

Employees Retirement and Savings Plan

The Bank offers to its employees a 401(k) plan. It is called the Downey Savings and Loan Association, F.A. Employees Retirement and Savings Plan. Participants are permitted to make contributions on a pre-tax basis, a portion of which is matched by the Bank. For 2004, the Bank contributed \$1.8 million as the employer match to the Downey Savings and Loan Association, F.A. Employees Retirement and Savings Plan.

Employee Stock Purchase Plan

Downey offers its employees participation in Downey's Employee Stock Purchase Plan. Downey believes that ownership of Downey's stock by employees will foster greater employee interest in

Downey's success, growth and development and will be to the mutual benefit of the employee and Downey. The Employee Stock Purchase Plan is designed to provide employees a continued opportunity to purchase Downey stock through systematic payroll deductions. Downey bears all costs of administering the Employee Stock Purchase Plan, including broker's fees, commissions, postage and other costs incurred with stock purchases. If an employee elects to terminate participation in the Employee Stock Purchase Plan, or sells stock acquired through the Employee Stock Purchase Plan, the employee is responsible for the associated costs.

President and Chief Executive Officer Compensation

Daniel D. Rosenthal served as President and Chief Executive Officer of Downey and the Bank from January 1 to February 1, 2004 and from September 1 through December 31, 2004. Marangal I. Domingo served in that capacity from February 2 through August 31, 2004. Accordingly, information regarding compensation provided to each of Mr. Rosenthal and Mr. Domingo is set forth below.

Mr. Rosenthal: After Mr. Rosenthal was reappointed President and Chief Executive Officer, the Compensation Committee recommended and the Board approved an increase in Mr. Rosenthal's base salary to \$550,000 per year, effective October 27, 2004. In accordance with the Annual Incentive Plan and achievement of Downey's 2004 corporate performance target, the Compensation Committee recommended and Downey's Board also approved an incentive compensation payment to Mr. Rosenthal of \$691,200, which amount represe