

DOWNEY FINANCIAL CORP

Form 424B5

June 18, 2004

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As filed pursuant to
Rule 424(b)(5) SEC
File No. 333-50416

Prospectus Supplement
(To Prospectus dated December 1, 2000)

Downey Financial Corp.

\$200,000,000

6 1/2% Senior Notes due 2014

Interest on the notes is payable on January 1 and July 1 of each year, beginning on January 1, 2005. The notes will mature on July 1, 2014.

We may redeem the notes, in whole at any time or in part from time to time, at the redemption prices described in this prospectus supplement. The notes will not be subject to any sinking fund provision.

The notes are the unsecured and unsubordinated obligations of Downey Financial Corp. and are not deposits or savings accounts. The notes are not insured by the Federal Deposit Insurance Corporation or any other government agency or insurer.

The notes will be a new issue of securities and there is currently no trading market for the notes. We do not intend to apply for the notes to be listed on any securities exchange or to arrange for the notes to be quoted on any quotation system.

See Risk Factors beginning on page S-12 for a discussion of certain risks that you should consider in connection with an investment in the notes.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Price to Public	Underwriting Discounts	Proceeds to Us
Per Note	99.780%	.650%	99.130%
Total	\$199,560,000	\$1,300,000	\$198,260,000

The price to public set forth above does not include accrued interest, if any. Interest on the notes will accrue from June 23, 2004 and must be paid by the purchaser if the notes are delivered after June 23, 2004.

We expect to deliver the notes to investors through the book-entry delivery system of The Depository Trust Company and its participants on or about June 23, 2004.

Joint Book-Running Managers

Credit Suisse First Boston

JPMorgan

NBC Capital Markets Group

**Fox-Pitt, Kelton
Friedman Billings Ramsey**

June 16, 2004

You should rely only on the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not authorized anyone to provide you with any other information. You should not assume that the information contained in this prospectus supplement or the accompanying prospectus is accurate as of any date other than the date of this prospectus supplement or the accompanying prospectus, respectively, or that information contained in any document incorporated or deemed to be incorporated by reference is accurate as of any date other than the date of that document.

If the description of the notes varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement.

Unless otherwise indicated or unless the context requires otherwise, all reference in this prospectus supplement and the accompanying prospectus to Downey, we, us and our refer to Downey Financial Corp. and its consolidated subsidiaries.

The distribution of this prospectus supplement and the accompanying prospectus and the offering of the notes in some jurisdictions may be restricted by law. Persons who receive this prospectus supplement and the accompanying prospectus should inform themselves about and observe any such restrictions. This prospectus supplement and the accompanying prospectus do not constitute, and may not be used in connection with, an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary does not contain all of the information that may be important to you. For more complete information on Downey and a more complete understanding of the terms of the notes, before making your investment decision, you should carefully read:

this prospectus supplement;

the accompanying prospectus; and

the documents referred to in "Where You Can Find More Information" in this prospectus supplement.

DOWNEY FINANCIAL CORP.

Downey is a California-based savings and loan holding company. Our principal subsidiary is Downey Savings and Loan Association, F.A., which we refer to as the Bank. The Bank:

is one of the largest financial institutions headquartered in Southern California based on total assets;

was formed in 1957 as a California-licensed savings and loan and converted to a federal charter in 1995; and

at March 31, 2004, operated 171 retail branches, including 99 full-service branches located in supermarkets, which we refer to as in-store branches. Subsequent to March 31, 2004, we consolidated two traditional branches that were located near each other. We have five in-store branches with deposits totaling \$105 million at March 31, 2004 that are affected by Ralphs Grocery Company's decision to close supermarkets in Southern California. We are looking for replacement locations for these branches to maintain and increase customer relationships in those areas.

For the three months ended March 31, 2004, we had:

net income of \$8.9 million or \$0.32 per share on a diluted basis;

loan originations and purchases of \$3.0 billion;

total assets of \$13.5 billion;

total deposits of \$8.8 billion;

total stockholders' equity of \$925 million; and

non-performing assets of \$54 million or 0.40% of total assets.

For the year ended December 31, 2003, we had:

net income of \$101.7 million or \$3.64 per share on a diluted basis;

loan originations and purchases of \$11.3 billion;

total assets of \$11.6 billion;

total deposits of \$8.3 billion;

total stockholders' equity of \$917 million; and

non-performing assets of \$49 million or 0.42% of total assets.

Banking Activities

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Our primary business is banking. Our banking activities focus on:

the attraction of deposits from the general public through our retail branches;

the origination of loans, primarily loans secured by single family residential properties, which are either retained in our portfolio or sold in the secondary market;

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a strategy of providing exceptional customer service; and

continuing to offer products and services over the Internet and through our call center.

The types of loans we offer include:

adjustable rate residential mortgage loans, with rates tied primarily to the Eleventh District Cost of Funds Index (COFI) or the 12-month moving average of annual yields on actively traded U.S. Treasury securities to a constant maturity of one year (MTA), including subprime loans which carry higher interest rates;

fixed rate residential mortgage loans;

multi-family and commercial real estate loans, including loans secured by retail neighborhood shopping centers;

construction loans;

commercial loans; and

consumer loans.

We also invest in various securities to satisfy bank regulations regarding minimum levels of liquid assets and to provide a partial economic hedge against future value changes in our mortgage servicing rights.

Net income from our banking operations totaled \$8.4 million for the first three months of 2004 and \$95.5 million in 2003.

Real Estate Investment Activities

Downey is also involved in real estate investment, which is conducted primarily through the Bank's subsidiary, DSL Service Company. Activities include development, construction and property management relating to our portfolio of projects primarily within California but also in Arizona. Because of regulatory restrictions that have been placed on the Bank's real estate investment activities, we have reduced the amount of this business in recent years. Net income from our real estate investment and real estate joint venture activities was \$0.5 million for the first three months of 2004 and \$6.3 million in 2003.

Operating Strategy

Our operating strategy is to:

capitalize on our strong position in our core California market and expand customer usage of our Internet banking business;

focus on our residential lending expertise;

maintain our high lending standards and strong asset quality;

continue to strengthen our retail franchise;

continue to attract low-cost deposits from our retail customer base;

provide high-quality service to depositors and borrowers; and

improve our operating efficiency.

Our principal executive offices are located at 3501 Jamboree Road, Newport Beach, California, 92660, and our telephone number is (949) 854-0300.

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The information appearing above under the captions Banking Activities, Real Estate Investment Activities and Operating Strategy supersedes and replaces the information appearing under the same captions under Prospectus Summary in the accompanying prospectus.

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Anticipated Developments

We intend to use approximately \$123.7 million of the net proceeds from the sale of the notes to redeem all of our outstanding junior subordinated debentures, all of which are held by Downey Financial Capital Trust I, a special purpose entity (the Trust). Upon redemption of the junior subordinated debentures, the Trust will contemporaneously redeem all of its outstanding capital securities and common securities. In connection with our redemption of the junior subordinated debentures, we expect to incur an after-tax charge of approximately \$2.4 million. This charge represents the remaining unamortized issuance cost for the capital securities. See Use of Proceeds.

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The following table presents our summary consolidated financial data as follows:

the financial data as of and for the three months ended March 31, 2004 and 2003 has been derived from our unaudited consolidated quarterly financial statements which, in the opinion of management, include all adjustments, consisting of only normal, recurring adjustments, considered necessary for a fair presentation; and

the financial data as of, and for the years ended, December 31, 2003, 2002, 2001, 2000 and 1999 has been derived from our audited consolidated financial statements.

You should read the following financial information in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 that we have incorporated by reference into this prospectus supplement. See Where You Can Find More Information in this prospectus supplement. Our results of operations and financial condition as of and for the three months ended March 31, 2004 are not necessarily indicative of our results of operations or financial condition to be expected for any future period.

<i>(Dollars in thousands)</i>	Three Months Ended March 31,		Year Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
Income statement data							
Total interest income	\$ 120,795	\$ 147,297	\$ 522,450	\$ 633,038	\$ 808,381	\$ 784,360	\$ 533,751
Total interest expense	51,439	66,401	233,837	318,012	503,183	522,257	326,428
Net interest income	69,356	80,896	288,613	315,026	305,198	262,103	207,323
Provision for (reduction of) loan losses	1,804	(1,709)	(3,718)	939	2,564	3,251	11,270
Net interest income after provision for (reduction of) loan losses	67,552	82,605	292,331	314,087	302,634	258,852	196,053
Other income, net:							
Loan and deposit related fees	12,456	11,978	53,076	47,220	50,486	30,089	20,097
Real estate and joint ventures held for investment, net	926	943	9,835	10,250	3,885	8,798	19,302
Secondary marketing activities:							
Loan servicing income (loss), net	(14,245)	(13,686)	(27,060)	(39,629)	(11,373)	(3,628)	1,672
Net gains on sales of loans and mortgage-backed securities	1,372	19,763	61,436	45,860	22,432	3,297	14,806
Net gains on sales of mortgage servicing rights		5	23	331	934		
Net losses on trading securities			(10,449)				
Net gains (losses) on sales of investment securities	2,112	8	8	219	329	(106)	288
Gain on sale of subsidiary(a)						9,762	
Litigation award		2,452	2,851				
Other	332	579	1,222	2,803	2,215	2,714	3,268
Total other income, net	2,953	22,042	90,942	67,054	68,908	50,926	59,433
Operating expense:							
Total general and administrative expense	55,092	51,984	207,999	186,644	162,496	136,189	144,382

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Net operation of real estate acquired in settlement of loans	(72)	297	(929)	11	239	818	19
Amortization of excess cost over fair value of branch acquisitions(b)					457	462	474
Total operating expense	55,020	52,281	207,070	186,655	163,192	137,469	144,875
Income before income taxes	15,485	52,366	176,203	194,486	208,350	172,309	110,611
Income tax expense	6,573	22,149	74,462	82,193	88,169	73,058	46,807
Net income(a)	\$ 8,912	\$ 30,217	\$ 101,741	\$ 112,293	\$ 120,181	\$ 99,251	\$ 63,804

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<i>(Dollars in thousands)</i>	Three Months Ended March 31,		Year Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
Selected period-end balances							
Total assets	\$ 13,525,129	\$ 11,441,650	\$ 11,645,980	\$ 11,981,878	\$ 11,108,757	\$ 10,897,590	\$ 9,411,267
Loans and							
mortgage-backed securities	11,594,098	10,675,557	10,396,510	10,976,942	10,132,413	10,084,353	8,746,063
Deposits	8,817,173	8,997,558	8,293,758	9,238,350	8,619,566	8,082,689	6,562,761
Borrowings	3,059,112	1,424,561	2,253,022	1,747,795	1,646,423	2,102,283	2,246,491
Stockholders' equity	924,557	851,650	917,018	823,104	733,896	624,636	532,418
Loans serviced for others	9,167,834	8,535,480	9,313,948	8,316,236	5,805,811	3,964,462	2,923,778
Loan activity							
Loans originated	\$ 2,890,646	\$ 2,348,312	\$ 10,548,675	\$ 10,445,978	\$ 8,128,285	\$ 5,217,421	\$ 7,132,486
Loans and							
mortgage-backed securities purchased	65,537	92,738	706,949	1,497,645	216,214	19,775	49,669
Loans and							
mortgage-backed securities sold	678,746	1,624,166	6,581,856	7,103,861	4,553,944	1,662,600	2,386,958
Asset quality data							
Net charge-offs as a percentage of average loans							
	%	0.01%	0.01%	0.02%	0.01%	0.01%	0.06%
End of period:							
Total non-performing assets	\$ 53,595	\$ 75,400	\$ 48,631	\$ 79,814	\$ 92,632	\$ 54,974	\$ 39,194
Non-performing assets as a percentage of total assets							
	0.40%	0.66%	0.42%	0.67%	0.83%	0.50%	0.42%
Allowance for loan losses as a percentage of total loans							
	0.29	0.33	0.30	0.34	0.38	0.35	0.44
Allowance for loan losses as a percentage of non-performing loans							
	66.27	50.78	70.82	51.89	46.76	76.63	116.25
Performance ratios							
Effective interest rate spread							
	2.42%	2.86%	2.61%	2.91%	2.91%	2.65%	2.88%
Return on average assets(a)							
	0.30	1.03	0.89	1.00	1.11	0.97	0.85
Return on average equity(a)							
	3.88	14.41	11.65	14.42	17.81	17.17	12.70
Efficiency ratio(c)							
	77.18	52.23	56.70	50.23	43.93	46.23	58.41
Capital ratios							
Average stockholders equity to average assets							
	7.73%	7.16%	7.62%	6.93%	6.22%	5.65%	6.70%
Bank only end of period (d)							
Core and tangible capital							
	6.90	7.26	7.96	6.92	7.10	6.42	6.27
Risk-based capital							
	13.36	13.87	15.55	14.08	14.53	12.94	12.14
Leverage ratio							
	12.92	13.34	15.06	13.52	13.90	12.34	11.41

(a) In 2000, a \$5.6 million after-tax gain was recognized from the sale of Downey Auto Finance Corp. Excluding the gain, 2000 net income would have been \$93.6 million, the return on average assets would have been 0.92% and the return on average equity would have been 16.20%.

(b) During the fourth quarter of 2002, we adopted SFAS 147, which required us to cease the amortization of goodwill as of January 1, 2002.

(c)

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We define the efficiency ratio as our general and administrative expense expressed as a percentage of net interest income plus other income, excluding income associated with real estate held for investment, a litigation award and gain on sale of subsidiary.

- (d) For more information regarding these ratios see Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Regulatory Capital Compliance in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 incorporated by reference in this prospectus supplement.

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THE OFFERING

The following summary contains basic information about the notes. It does not contain all the information that may be important to you. You should read this entire prospectus supplement and the accompanying prospectus and the documents incorporated and deemed to be incorporated by reference in this prospectus supplement carefully before making an investment decision.

Issuer	Downey Financial Corp., a Delaware corporation.
Securities Offered	\$200,000,000 principal amount of 6 1/2% Senior Notes due 2014.
Maturity Date	The notes will mature on July 1, 2014.
Interest Rate	6 1/2% per annum, accruing from June 23, 2004.
Interest Payment Dates	January 1 and July 1, beginning on January 1, 2005.
Optional Redemption	We may redeem the notes, in whole at any time or in part from time to time, at the redemption prices described under Description of the Notes Optional Redemption. The notes will not be subject to any sinking fund provisions and will not be subject to repayment, repurchase or redemption by us at the option of the holders.
Ranking	<p>The notes will be our unsecured and unsubordinated obligations and will rank equally in right of payment with all of our other unsecured and unsubordinated indebtedness. At March 31, 2004, Downey Financial Corp. had less than \$1.0 million aggregate principal amount of unsecured and unsubordinated indebtedness outstanding. The notes will rank senior in right of payment to our outstanding junior subordinated debentures. At March 31, 2004, Downey Financial Corp. had approximately \$123.7 million aggregate principal amount of outstanding junior subordinated debentures which it will redeem with a portion of the net proceeds from the offering of the notes. See Use of Proceeds. The notes will be effectively subordinated in right of payment to:</p> <p>all existing and future indebtedness, trade payables, lease obligations and other liabilities of our subsidiaries, including deposit liabilities of the Bank; at March 31, 2004, our subsidiaries had approximately \$12.5 billion of liabilities outstanding, including approximately \$8.8 billion of deposit liabilities of the Bank but excluding liabilities owed to us or other subsidiaries; and</p> <p>any secured indebtedness that we may incur in the future.</p> <p>The indenture that will govern the notes will not contain any limitation on the amount of indebtedness or other liabilities, including deposit liabilities, that we or our subsidiaries may incur in the future. See Risk Factors Risks Relating to the Notes We are a holding company and our ability to service our debt, including the notes, depends upon cash provided to us by our primary</p>

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	<p>subsidiary, the Bank and Risk Factors Risks Relating to the Notes The notes will be effectively subordinated to the liabilities of our subsidiaries and to our secured indebtedness.</p>
Ratings	<p>The notes are expected to be rated Ba1 by Moody's Investors Service and BBB- by Standard & Poor's Ratings Services. See Description of the Notes Ratings.</p>
Denominations and Form	<p>The notes will be issued in denominations of \$1,000 and integral multiples of \$1,000. The notes will be issued in book-entry form and will be evidenced by one or more global certificates in fully registered form without coupons.</p>
Trustee	<p>Wilmington Trust Company</p>
Covenants	<p>The Indenture pursuant to which the notes will be issued will contain covenants that will, in general:</p> <ul style="list-style-type: none"> limit our ability to sell or otherwise dispose of or issue Voting Stock of a Principal Subsidiary Bank if, after giving effect to that transaction, we would own less than 80% of the outstanding shares of Voting Stock of that Principal Bank Subsidiary on a fully diluted basis; or limit our ability to create Liens upon more than 20% of the outstanding shares of Voting Stock of any Principal Subsidiary Bank. <p>These covenants are subject to a number of significant exceptions and limitations and you should carefully review the information under Description of the Notes Certain Covenants and Description of the Notes Certain Definitions for further information about these covenants, including information about the exceptions and limitations to these covenants, and the definitions of the capitalized terms used above.</p>
Use of Proceeds	<p>We estimate that the net proceeds from the sale of the notes, after deducting underwriting discounts and our estimated offering expenses, will be approximately \$197.8 million. We intend to use approximately \$123.7 million of the net proceeds from the sale of the notes to redeem all of our outstanding junior subordinated debentures, all of which are held by the Trust. Upon redemption of the junior subordinated debentures, the Trust will contemporaneously redeem all of its outstanding capital securities and common securities. See Prospectus Supplement Summary Downey Financial Corp. Anticipated Developments. We intend to use the remaining net proceeds for general corporate purposes, which may include advances to or investments in our subsidiaries, working capital and capital expenditures.</p>

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Absence of a Public Market for the Notes	The notes will be a new issue of securities for which there is no established market. Accordingly, there can be no assurance that a market for the notes will develop or as to the liquidity of any market that may develop. The underwriters have advised us that they currently intend to make a market in the notes. However, they are not obligated to do so and any market making with respect to the notes may be discontinued without notice.
Issuance of Additional Notes	We may, without the consent of the holders of the notes, issue additional notes from time to time in the future. See Description of the Notes General.
Risk Factors	You should carefully review the information appearing in this prospectus supplement under the caption Risk Factors before making an investment decision.

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RISK FACTORS

Your investment in the notes will involve a number of risks. You should carefully consider the following discussion of risks, and the other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus, before buying the notes.

Risks Relating to Downey

Our California business focus and economic conditions in California could adversely affect our operations.

Downey is headquartered in and its operations are concentrated in California. At March 31, 2004, approximately 94% of our total loans were secured by real estate located in California. As a result of this geographic concentration, our results depend largely upon economic and business conditions in this state. Deterioration of economic conditions in California could have a material adverse impact on the quality of our loan and real estate portfolios, the demand for our products and services and our results of operations and financial condition.

Significant changes in interest rates could adversely affect our performance and results of operations.

If interest rates vary substantially from present levels, our results may differ materially from recent levels. Changes in interest rates will influence the growth of loans, investments, deposits and borrowings and affect the rates received on loans and investment securities and paid on deposits and borrowings. Changes in interest rates also affect the value of our recorded mortgage servicing rights on loans we service for others, generally increasing in value as interest rates rise and declining as interest rates fall. If interest rates were to increase significantly, the economic feasibility of real estate investment activities also could be adversely affected. Accordingly, changes in interest rates could have a material adverse effect on our results of operations and financial condition.

We are subject to government regulation and federal monetary policy that could limit or restrict our activities, which could adversely affect our operations.

The financial services industry is subject to extensive federal and state supervision and regulation. Significant new laws or changes in, or repeals of, existing laws may adversely affect our results of operations. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for Downey, primarily through open market operations in United States government securities, the discount rate for borrowings and reserve requirements. A material change in these conditions could have a material adverse impact on our results.

Competition may adversely affect our performance.

The banking and financial services business in our market areas is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and continued consolidation among financial services providers. Increasing levels of competition in the banking and financial services businesses may reduce our market share, cause the prices we charge for our products to decline or cause the interest rates we are required to pay to attract deposits to increase. Our results may be adversely affected in future periods depending on the nature or level of competition.

If a significant number of borrowers, guarantors and related parties fail to perform as required by the terms of their loans, we will sustain losses.

A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. While we have adopted underwriting and loan quality monitoring systems, procedures and credit policies, including the establishment and review of the allowance for loan losses, such policies and procedures may not prevent losses that could materially affect our results.

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Risks Relating to the Notes

We are a holding company and our ability to service our debt, including the notes, depends upon cash provided to us by our primary subsidiary, the Bank.

The notes will be our obligation exclusively and will not be the obligation of, or guaranteed by, the Bank or any of our other subsidiaries. In addition, the notes are not savings accounts or deposits and are not insured by the Federal Deposit Insurance Corporation (the "FDIC") or any other governmental agency or insurer. We are a holding company and we conduct substantially all of our operations through the Bank and its subsidiary, DSL Service Company. We derive substantially all of our revenues from, and substantially all of our operating assets are owned by, the Bank. As a result, our cash flow and our ability to service our debt, including the notes, depend primarily on the results of operations of the Bank and upon the ability of the Bank to provide us cash to pay amounts due on our obligations, including the notes. The Bank and our other subsidiaries are separate and distinct legal entities and have no obligation to make payments on the notes or to make any funds available to us for that purpose. In addition, dividends, loans or other distributions from our subsidiaries to us are or may be subject to legal, regulatory and contractual restrictions, are dependent upon results of operations of our subsidiaries, and are subject to other business considerations.

In that regard, various statutory and regulatory restrictions limit, directly or indirectly, the ability of the Bank to provide funds to us, whether as dividends, loans, investments in us or otherwise. For example, the Bank generally may not declare dividends or make any other capital distribution to us if, after the payment of such dividend or other distribution, it would fall within any of the three undercapitalized categories under the prompt corrective action standards established by the Office of Thrift Supervision (the "OTS") and the other federal banking agencies pursuant to Section 38 of the Federal Deposit Insurance Act. A regulation of the OTS also limits the Bank's ability to pay dividends and make other capital distributions in a manner that depends upon the extent to which the Bank meets its regulatory capital requirements and other factors. Among other things, the Bank is required to obtain the prior approval of the OTS to pay dividends and make other capital distributions if the annual amount of the dividends and capital distributions exceeds its net income for that year to date added to its retained net income for the two preceding years. At March 31, 2004, the Bank could have paid approximately \$140 million in dividends to us without needing prior approval of the OTS. Further, applicable federal regulations require the Bank to give the OTS at least 30 days' advance notice of any proposed dividends or other capital distributions. Furthermore, the OTS may prohibit any dividend or other capital distribution that it determines would constitute an unsafe or unsound practice. As a consequence, the Bank's regulators could deem the payment of dividends by the Bank to us to be an unsafe or unsound practice, depending on the Bank's financial condition or otherwise, and prohibit such payments. If the Bank were unable to pay dividends to us, whether because of action by regulators or as a result of restrictions under applicable law or regulations, we would likely be unable to make debt service payments on the notes until such time as the Bank could again pay us dividends.

In addition to the regulation of dividends and other capital distributions, there are various statutory and regulatory limitations on the extent to which the Bank can finance or otherwise transfer funds to us or our non-banking subsidiaries, whether in the form of loans, extensions of credit, investments or asset purchases. The Director of the OTS may further restrict these transactions in the interests of safety and soundness.

As of March 31, 2004, the Bank met the capital and other requirements of a "well capitalized" institution under the OTS' prompt corrective action standards. There can be no assurance that the Bank will remain "well capitalized" in the future or that the OTS will not require the Bank to maintain higher levels of capital in light of the risk profile of its lending activities. As a result, the ability of the Bank to pay dividends and otherwise provide funds to us may be reduced, perhaps substantially, in the future.

For more information about these regulatory requirements, see "Business Regulation Regulation of Downey" and "Business Regulation Regulation of the Bank" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, which is incorporated by reference in this prospectus supplement.

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The notes will be effectively subordinated to the liabilities of our subsidiaries and to our secured indebtedness.

Because of our holding company structure, the notes will be effectively subordinated to all existing and future indebtedness, trade payables, lease obligations and other liabilities of our subsidiaries, including deposit liabilities of the Bank. Therefore, our rights and the rights of our creditors, including the holders of the notes, to participate in the assets of any subsidiary upon the subsidiary's liquidation, conservatorship, receivership or reorganization will be subject to the prior claims of that subsidiary's creditors including, in the case of the Bank, the prior claims of the holders of its deposit liabilities, except (subject to the following discussion) to the extent that we may ourselves be a creditor with recognized claims against that subsidiary. In that regard, in the event that a receiver or conservator is appointed for any of our subsidiaries whose deposits are insured by the FDIC (our only subsidiary whose deposits are at present insured by the FDIC is the Bank), federal law grants the claims of holders of that subsidiary's deposit liabilities (including the FDIC as subrogee or transferee), and the claims of the receiver or conservator of that subsidiary for administrative expenses, priority over the claims of the subsidiary's general unsecured creditors. Thus, in the event of a conservatorship or receivership of the Bank or any other insured subsidiary, claims for its deposit liabilities and for the administrative expenses of the receiver or conservator would have a priority over any claims that we ourselves may have as a creditor of that subsidiary. Moreover, if we are a creditor of one of our subsidiaries, our claims would still be effectively subordinated to any security interests in, or mortgages or other liens on, the assets of that subsidiary and would be subordinate to any indebtedness of that subsidiary senior to that held by us. As of March 31, 2004, our subsidiaries had approximately \$12.5 billion of liabilities outstanding, including approximately \$8.8 billion of deposit liabilities of the Bank but excluding liabilities owed to us or other subsidiaries, to which the notes would be structurally subordinated.

The notes will also be effectively subordinated to any secured indebtedness we may incur in the future to the extent of the collateral pledged to secure that indebtedness. Downey Financial Corp. does not currently have any secured indebtedness.

The indenture that will govern the notes will not contain any limitation on the amount of indebtedness or other liabilities, including deposit liabilities, indebtedness and guarantees, that our subsidiaries and we may incur in the future.

It may be difficult for investors to sell their notes.

Investors may find it difficult to sell their notes because an active trading market for the notes may not develop. The notes will be a new issue of securities and there is currently no trading market for the notes. We do not intend to apply for the notes to be listed on any securities exchange or to arrange for the notes to be quoted on any quotation system. The underwriters have advised us that they currently intend to make a market in the notes, but they are not obligated to do so and the underwriters may discontinue any market making in the notes at any time in their sole discretion and without notice. Accordingly, we cannot assure investors that a trading market will develop for the notes or as to the liquidity of any trading market that may develop, that investors will be able to sell their notes at a particular time or that the prices that investors receive if and when they sell will be favorable.

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A WARNING ABOUT FORWARD-LOOKING INFORMATION

Downey has made forward-looking statements in this prospectus supplement and accompanying prospectus and in documents that are incorporated by reference herein and therein that are subject to risks and uncertainties. These statements are based on the beliefs and assumptions of management and on information available to management at the time these forward-looking statements were made. Forward-looking statements include the information concerning possible or assumed future operating results and financial condition appearing under Prospectus Supplement Summary and Risk Factors and statements preceded by, followed by or that include the words believes, expects, anticipates, intends, plans, estimates or similar expressions. Although we believe that our expectations are based on reasonable assumptions, actual results may differ materially from our expectations. Factors that could cause actual results to differ from expectations include those described under Risk Factors and the following:

General economic or business conditions, either nationally or in California, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality or a reduced demand for credit;

Because our business is concentrated in California, changes in the economic conditions in the California market could adversely affect our operations;

Changes in the interest rate environment could adversely affect our banking and real estate investment activities;

Regulatory changes could have adverse effects on the financial services industry;

Significant increases in competitive pressures among depository and other financial institutions could adversely affect our operations;

Federal monetary policy changes could have adverse effects on the financial services industry; or

We could experience greater than anticipated losses on our loans because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Actual results may differ from expectations due to many factors beyond our ability to control or predict, including those described above and under Risk Factors. For these statements, Downey claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the notes, after deducting underwriting discounts and our estimated offering expenses, will be approximately \$197.8 million. We intend to use approximately \$123.7 million of the net proceeds to redeem all of our outstanding junior subordinated debentures, all of which are held by Downey Financial Capital Trust I, a special purpose entity (the Trust). We intend to use the remaining proceeds for general corporate purposes, which may include advances to or investments in our subsidiaries, working capital and capital expenditures.

On July 23, 1999, the Trust issued \$120.0 million aggregate liquidation amount of its 10% capital securities in an underwritten public offering and contemporaneously sold \$3.7 million aggregate liquidation value of its 10% common securities to us. Proceeds from the offering of the capital securities and the sale of the Trust's common securities to us were used by the Trust to purchase \$123.7 million aggregate principal amount of junior subordinated debentures issued by us. The sole asset of the Trust is the junior subordinated debentures. The debentures carry an interest rate of 10% per annum and are due September 15, 2029.

We intend to redeem, in whole, the junior subordinated debentures on or shortly after July 23, 2004 before their maturity at a redemption price of 100% of their principal amount plus accrued and unpaid interest. Upon redemption of the junior subordinated debentures, the Trust will contemporaneously redeem all of its outstanding capital securities and common securities for an aggregate redemption price of \$123.7 million, plus accrued and unpaid distributions.

The capital securities and common securities pay quarterly cumulative cash distributions at an annual rate of 10% of the liquidation value of \$25 per security. We own all of the issued and outstanding common securities of the Trust and report them separately on our balance sheet. As a result, we will receive approximately \$3.7 million, plus accrued distributions, if any, when the common securities are redeemed by the Trust.

In connection with our redemption of the junior subordinated debentures, we expect to incur an after-tax charge of approximately \$2.4 million. This charge represents the remaining unamortized issuance costs for the capital securities.

Pending application of the net proceeds for the purposes described above, we may temporarily loan the net proceeds to the Bank.

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The following table sets forth our consolidated total capitalization as of March 31, 2004 on an actual basis and as adjusted to give effect to the issuance and sale of the notes and the redemption of the junior subordinated debentures as described under Use of Proceeds.

This table should be read in conjunction with our consolidated financial statements and the related notes in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2004 that we have incorporated by reference into this prospectus supplement.

(Dollars in Thousands, Except Per Share Amounts)	At March 31, 2004	
	Actual	As Adjusted
Borrowings		
Securities sold under agreements to repurchase	\$ 507,027	\$ 507,027
Federal Home Loan Bank advances and real estate notes	2,428,374	2,428,374
Junior subordinated debentures	123,711	
Senior notes offered hereby, net of issuance costs		197,760
Total borrowings	3,059,112	3,133,161
Stockholders equity		
Preferred stock, par value \$0.01 per share; authorized 5,000,000 shares; outstanding none		
Common stock, par value \$0.01 per share; authorized 50,000,000 shares; issued 28,235,022 shares	282	282
Additional paid-in capital	93,792	93,792
Accumulated other comprehensive income	1,753	1,753
Retained earnings(a)	839,898	837,501
Treasury stock, at cost, 281,275 shares	(11,168)	(11,168)
Total stockholders equity	924,557	922,160
Total capitalization	\$3,983,669	\$4,055,321

- (a) The decline in the As Adjusted column reflects the after-tax charge associated with the remaining unamortized issuance costs for the capital securities issued by the Trust that will be recognized in our financial statements in connection with the redemption of the junior subordinated debentures as described under Use of Proceeds.

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The following table sets forth our ratio of earnings to fixed charges on a consolidated basis for the periods specified.

	Three Months Ended March 31, 2004	Year Ended December 31,				
		2003	2002	2001	2000	1999
Ratio of earnings to fixed charges:						
Excluding interest on deposits	1.80x	3.34x	3.60x	3.63x	2.20x	2.54x
Including interest on deposits	1.30x	1.73x	1.61x	1.41x	1.33x	1.33x

The ratio of earnings to fixed charges is calculated as follows:

$$\frac{(\text{income before income taxes}) + (\text{fixed charges}) - (\text{capitalized interest})}{(\text{fixed charges})}$$

Fixed charges, excluding interest on deposits, consist of:

interest on short-term borrowings and long-term debt;

amortization of debt expense;

capitalized interest; and

one-third of net rental expense, which we believe is representative of the interest factor.

Fixed charges, including interest on deposits, consist of all of the items listed immediately above plus interest on deposits.

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DESCRIPTION OF THE NOTES

The notes will be issued under an indenture dated as of November 15, 2000 (which is the Senior Indenture referred to in the accompanying prospectus), as amended and supplemented by a first supplemental indenture to be dated as of the closing date of this offering, between us and Wilmington Trust Company, as trustee. We refer to the indenture, as so amended and supplemented, as the Indenture. The terms of the Indenture include those stated in the Indenture and those made part of the Indenture by the Trust Indenture Act of 1939. The following summary of selected provisions of the Indenture and the notes is not complete and is subject to, and is qualified in its entirety by reference to, all the provisions of the Indenture and the notes. Copies of the Indenture and the form of certificate evidencing the notes are available or may be obtained from us as described in this prospectus supplement under Documents Incorporated by Reference and Where You Can Find More Information.

In this section, and in the section of the accompanying prospectus captioned Description of the Senior and Subordinated Debt Securities, references to Downey, we, our and us and similar references mean Downey Financial Corp. excluding, unless the context otherwise requires or otherwise expressly stated, its subsidiaries. Capitalized terms that are used in the following summary but not defined have the meanings given to those terms in the Indenture.

The notes offered by this prospectus supplement are a series of senior notes as described in the accompanying prospectus. The following description of the particular terms of the notes and the Indenture supplements, and to the extent inconsistent replaces, the description of the general terms and provisions of the senior notes and the Indenture contained in the accompanying prospectus.

General

The Indenture provides that we may issue debt securities (debt securities) under the Indenture from time to time in one or more series and permits us to establish the terms of each series of debt securities at the time of issuance. The Indenture does not limit the amount of debt securities that we may issue under the Indenture.

The notes will constitute a separate series of debt securities under the Indenture, initially limited to \$200,000,000 in aggregate principal amount. Under the Indenture we may, without the consent of the holders of the notes, reopen this series and issue additional notes from time to time in the future, except that we may not issue any additional notes if an event of default under the Indenture has occurred and is continuing with respect to the notes or if we have effected satisfaction and discharge, defeasance or covenant defeasance of the notes as described below under Satisfaction and Discharge or Defeasance; Covenant Defeasance. The notes offered by this prospectus supplement and any additional notes we may issue in the future will constitute a single series of debt securities under the Indenture.

The notes will mature on July 1, 2014. Interest on the notes will accrue from June 23, 2004 at the rate of 6 1/2% per annum, payable semi-annually in arrears on January 1 and July 1 of each year, beginning on January 1, 2005, to the persons in whose names the notes are registered at the close of business on December 15 or June 15, as the case may be, next preceding those interest payment dates. As a result, the interest that is due and payable on any interest payment date, including any interest payment date that is also the maturity date or a redemption date, will be payable to the holders of the notes (or one or more predecessor notes) registered as such at the close of business on the relevant record date. Interest on the notes will be computed on the basis of a 360-day year consisting of twelve 30-day months. The information in this paragraph and the immediately following paragraph supercedes and replaces the information set forth under the caption Description of the Senior and Subordinated Debt Securities Payment of Principal and Interest , Description of the Senior and Subordinated Debt Securities Interest and Interest Rates and the first three paragraphs under the caption Description of the Senior and Subordinated Debt Securities Payment of Interest in the accompanying prospectus.

If an interest payment date, redemption date or maturity date of a note falls on a day that is not a business day, then the payment of principal, premium, if any, or interest, as the case may be, due in respect of that note

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on that date need not be made on that date, but may be made on the next succeeding business day with the same force and effect as if made on that interest payment date, redemption date or maturity date, as the case may be, and no interest will accrue for the period from that interest payment, redemption date or maturity date, as the case may be, to that next succeeding business day.

The notes will be denominated and payable in U.S. dollars. The notes will be issued in fully registered form without coupons in denominations of \$1,000 and integral multiples of \$1,000. The notes will be issued in book-entry form and will be evidenced by one or more global certificates, which we sometimes refer to as global notes, registered in the name of Cede & Co., as nominee of The Depository Trust Company (DTC). We sometimes refer to DTC or any successor depository for the notes as the depository. Purchasers of the notes will not be entitled to receive notes in definitive certificated form, which we sometimes refer to as certificated notes, registered in their names, except in the limited circumstances described below under Certificated Notes. See Book-Entry Issuance in the accompanying prospectus for additional information applicable to the depository arrangements.

In the event that certificated notes are issued in exchange for interests in global notes, the certificated notes may be presented for payment and surrendered for registration of transfer and exchange at our agency maintained for that purpose in the Borough of Manhattan, The City of New York, currently the office of the trustee's agent located at c/o Computershare Trust Company of New York, 88 Pine Street, New York, New York 10005, and in Wilmington, Delaware, currently the office of the trustee located at Rodney Square North, 1100 North Market Street, Wilmington, Delaware 19890. Under the Indenture, we will be required to maintain an office or agency in the Borough of Manhattan, The City of New York, where notes may be surrendered for registration of transfer, exchange and payment. Holders will not be required to pay any service charge for the registration of transfer or exchange of notes, other than any tax or other governmental charge payable in connection with the transfer or exchange.

Payment of interest on global notes will be made to DTC or its nominee. Payment of interest on notes in certificated form, if issued, will be made against presentation of those notes at the offices or agencies referred to in the preceding paragraph or, at our option, by mailing checks payable to the persons entitled to that interest to their addresses as they appear in the note register or by wire transfer.

The notes will not be entitled to the benefit of any sinking fund and will not be subject to repurchase, repayment or redemption by us at the option of the holders. Without limitation to the foregoing, the Survivor's Option described in the accompanying prospectus under Description of the Senior and Subordinated Debt Securities Survivor's Option will not be applicable with respect to the notes and, as a result, the estate or authorized representative of a deceased owner of a note or a beneficial interest in a global note will not have the right to seek repayment of that note as described under that caption. The notes are not convertible or exchangeable for other securities, property, cash or other obligations.

The Indenture does not limit the amount of indebtedness or other liabilities that we or our subsidiaries may incur and, except to the limited extent described below under Certain Covenants and Merger, Consolidation and Transfer of Assets, the Indenture does not contain any provisions that are intended to protect holders of notes in the event of a highly-leveraged or similar transaction affecting us.

The notes will be subject to satisfaction and discharge, defeasance and covenant defeasance as described below under Satisfaction and Discharge and Defeasance; Covenant Defeasance.

Ranking

The notes will be our unsecured and unsubordinated obligations and will rank equally in right of payment with all of our other unsecured and unsubordinated indebtedness. The notes will rank senior in right of payment to our outstanding 10% junior subordinated debentures due 2029. See Use of Proceeds.

The notes will be our obligation exclusively and will not be the obligation of, or guaranteed by, any of our subsidiaries. In addition, the notes are not savings accounts or deposits and are not insured by the FDIC or any other governmental agency or insurer. We are a holding company and we conduct substantially all of our operations through the Bank and its subsidiary, DSL Service Company. Because of our holding company

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structure, the notes will be effectively subordinated to all existing and future indebtedness, trade payables, lease obligations and other liabilities of our subsidiaries, including deposit liabilities of the Bank. The notes will also be effectively subordinated to any secured indebtedness we may incur in the future to the extent of the collateral pledged to secure that indebtedness. See Risk Factors Risks Relating to the Notes We are a holding company and our ability to service our debt, including the notes, depends upon cash provided to us by our primary subsidiary, the Bank and Risk Factors Risks Relating to the Notes The notes will be effectively subordinated to the liabilities of our subsidiaries and to our secured indebtedness.

Ratings

The notes are expected to be rated Bal by Moody's Investors Service and BBB- by Standard & Poor's Rating Services. The rating of the notes should be evaluated independently from similar ratings on other types of securities. In addition, the credit ratings on the notes are subject to ongoing evaluation by credit rating agencies, and we cannot assure you that any such rating will not be changed or withdrawn by a rating agency in the future if, in its judgment, circumstances warrant. Moreover, a rating is not a recommendation to buy, sell or hold the notes, inasmuch as such rating does not comment as to market price or suitability for a particular investor.

Optional Redemption

The notes will be redeemable, in whole or from time to time in part, at the option of Downey on any date (each, a redemption date) at a redemption price equal to the greater of:

(a) 100% of the principal amount of the notes to be redeemed; and

(b) the sum of the present values of the remaining scheduled payments of principal and interest on the notes to be redeemed (exclusive of interest accrued to the applicable redemption date) discounted to such redemption date on a semiannual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate plus 30 basis points, plus, in the case of both clause (a) and (b) above, accrued and unpaid interest on the principal amount of the notes being redeemed to such redemption date. Notwithstanding the foregoing, installments of interest on notes that are due and payable on an interest payment date falling on or prior to the relevant redemption date will be payable to the holders of such notes (or one or more predecessor notes) registered as such at the close of business on the relevant record date. Notwithstanding any statement in the accompanying prospectus to the contrary, a redemption date for the notes need not be an interest payment date.

Treasury Rate means, with respect to any redemption date for the notes:

(a) the yield, under the heading that represents the average for the immediately preceding week, appearing in the most recently published statistical release designated H.15(519) or any successor publication which is published weekly by the Board of Governors of the Federal Reserve System and which establishes yields on actively traded United States Treasury securities adjusted to constant maturity under the caption Treasury Constant Maturities, for the maturity corresponding to the Comparable Treasury Issue (if no maturity is within three months before or after the Final Maturity Date for the notes, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue shall be determined and the Treasury Rate shall be interpolated or extrapolated from such yields on a straight-line basis, rounding to the nearest month); or

(b) if such release (or any successor release) is not published during the week preceding the calculation date or does not contain such yields, the rate per annum equal to the semiannual equivalent yield to maturity of the Comparable Treasury Issue, calculated using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

The Treasury Rate shall be calculated on the third Business Day preceding the applicable redemption date. Notwithstanding any other provision in this prospectus supplement or the accompanying prospectus to the

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contrary, as used in the immediately preceding sentence and in the definition of Reference Treasury Dealer Quotations below, the term Business Day means each Monday, Tuesday, Wednesday, Thursday and Friday which is not a day on which banking institutions in The City of New York are authorized or obligated by law, regulation or executive order to close.

Comparable Treasury Issue means, with respect to any redemption date for the notes, the United States Treasury security selected by the Independent Investment Banker as having a maturity comparable to the remaining term of the notes to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the notes to be redeemed.

Independent Investment Banker means, with respect to any redemption date for the notes, Credit Suisse First Boston LLC and its successors or J.P. Morgan Securities Inc. and its successors, whichever shall be selected by the trustee after consultation with Downey, or, if both such firms or the respective successors, if any, to such firms, as the case may be, are unwilling or unable to select the Comparable Treasury Issue, an independent investment banking institution of national standing appointed by the trustee after consultation with Downey.

Comparable Treasury Price means, with respect to any redemption date for the notes:

(a) the average of four Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations, or

(b) if the trustee obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

Reference Treasury Dealer means each of Credit Suisse First Boston LLC and J.P. Morgan Securities Inc. and their respective successors (provided, however, that if any such firm or any such successor, as the case may be, shall cease to be a primary U.S. Government securities dealer in New York City (a Primary Treasury Dealer), the trustee, after consultation with Downey, shall substitute therefor another Primary Treasury Dealer), and two other Primary Treasury Dealers selected by the trustee after consultation with Downey.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any redemption date for the notes, the average, as determined by the trustee, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the trustee by such Reference Treasury Dealer at 5:00 p.m., New York City time, on the third Business Day preceding such redemption date.

Final Maturity Date means July 1, 2014.

Notice of any redemption will be mailed at least 30 days but not more than 60 days before any redemption date to each holder of notes to be redeemed. If less than all the notes are to be redeemed at the option of Downey, the trustee will select, pro rata, by lot or in such other manner as it deems appropriate and fair, the notes to be redeemed.

Unless Downey defaults in payment of the redemption price, on and after any redemption date interest will cease to accrue on the notes or portions thereof called for redemption on such redemption date.

The information under this caption Optional Redemption supersedes and replaces the information appearing in the sixth paragraph under the caption Description of the Senior and Subordinated Debt Securities Redemption and Repayment in the accompanying prospectus.

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Certain Covenants

The following covenants will apply to the notes.

Limitation on Sale or Issuance of Voting Stock of a Principal Subsidiary Bank. Subject to the provisions described below under Merger, Consolidation and Transfer of Assets, Downey:

(a) will not, and will not cause or permit any Subsidiary to, directly or indirectly, sell, assign, transfer or otherwise dispose of or issue any shares of Voting Stock of, or any securities convertible into or exchangeable for or any options, warrants or rights to subscribe for or purchase shares of Voting Stock of, any Principal Subsidiary Bank or any Subsidiary which owns, directly or through one or more other Subsidiaries, shares of Voting Stock of, or any securities convertible into or exchangeable for or options, warrants or rights to subscribe for or purchase shares of Voting Stock of, any Principal Subsidiary Bank, or

(b) cause or permit any Principal Subsidiary Bank, in any transaction or series of related transactions, to consolidate or merge with or into, or sell, lease, assign, transfer or otherwise convey all or substantially all of its properties and assets to, any other person (a Surviving Person),

unless the following conditions are satisfied:

(1) in the case of any transaction described in clause (a) above, such transaction is for not less than fair market value (as determined by the board of directors of Downey or of the Principal Subsidiary Bank or other Subsidiary, as the case may be, that is selling, assigning, transferring, disposing of or issuing the applicable shares, securities, options, warrants or rights, such determination to be evidenced by a resolution of such board of directors certified by the Secretary or an Assistant Secretary of Downey or of such Principal Subsidiary Bank or other Subsidiary, as the case may be, and delivered to the trustee, and which determination shall be conclusive) and, immediately after giving effect to such transaction and assuming the conversion or exchange, as the case may be, of all securities convertible into or exchangeable for and the exercise of any options, warrants or rights to subscribe for or purchase shares of Voting Stock of the applicable Principal Subsidiary Bank and all other Subsidiaries, Downey would own, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such Principal Subsidiary Bank, or

(2) in the case of any transaction described in clause (b) above, the Surviving Person is or will be (upon giving effect to such transaction) a Principal Subsidiary Bank and, immediately after giving effect to such transaction and assuming the conversion or exchange, as the case may be, of all securities convertible into or exchangeable for and the exercise of any options, warrants or rights to subscribe for or purchase shares of Voting Stock of such Surviving Person and all other Subsidiaries, Downey would own, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such Surviving Person and, immediately after giving effect to such transaction, no event of default under the Indenture and no event which, with notice or lapse of time or both, would become an event of default under the Indenture shall have occurred and be continuing;

provided, however, that the foregoing shall not prohibit any of the following:

(a) any sale, assignment, transfer or other disposition or issuance of such Voting Stock or other securities made, in the minimum amount required by law, to any person for the purpose of the qualification of such person to serve as a director of a Principal Subsidiary Bank; or

(b) any sale, assignment, transfer or other disposition or issuance of such Voting Stock or other securities made in compliance with an order of a court or regulatory authority of competent jurisdiction; or

(c) any sale, assignment, transfer or other disposition or issuance of shares of Voting Stock of, or securities convertible into or exchangeable for or options, warrants or rights to subscribe for or purchase shares of Voting Stock of,

(1) a Principal Subsidiary Bank, or

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(2) any Subsidiary which owns, directly or through one or more other Subsidiaries, shares of Voting Stock of, or securities convertible into or exchangeable for or options, warrants or rights to subscribe for or purchase shares of Voting Stock of, any Principal Subsidiary Bank,

to Downey or a Subsidiary so long as, immediately after giving effect to such transaction and assuming the conversion or exchange, as the case may be, of all securities convertible into or exchangeable for and the exercise of any options, warrants or rights to subscribe for or purchase shares of Voting Stock of the applicable Principal Subsidiary Bank and all other Subsidiaries, Downey would own, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such Principal Subsidiary Bank; or

(d) the merger or consolidation of a Principal Subsidiary Bank with or into, or any sale, lease, assignment, transfer or other conveyance of all or substantially all of the properties and assets of any Principal Subsidiary Bank to, another Principal Subsidiary Bank or another Subsidiary (a Successor Subsidiary) which is or will be (upon giving effect to such transaction) a Principal Subsidiary Bank, so long as, immediately after giving effect to such transaction and assuming the conversion or exchange, as the case may be, of all securities convertible into or exchangeable for and the exercise of any options, warrants or rights to subscribe for or purchase shares of Voting Stock of such other Principal Subsidiary Bank or Successor Subsidiary, as the case may be, and all other Subsidiaries, Downey would own, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such other Principal Subsidiary Bank or Successor Subsidiary, as the case may be; or

(e) any sale, transfer or other disposition of all of the outstanding shares of Voting Stock of a Principal Subsidiary Bank owned, directly or indirectly, by Downey to, any merger of a Principal Subsidiary Bank into, any consolidation of a Principal Subsidiary Bank with, or any sale, lease, assignment, transfer or other conveyance of all or substantially all of the properties and assets of a Principal Subsidiary Bank to, any person that is not a Subsidiary, so long as all of the proceeds of such transaction are in cash and either

(x) within 180 days after such transaction, such proceeds are invested in one or more Principal Subsidiary Banks (including any existing Principal Subsidiary Bank or any other Subsidiary or person which in each case upon such investment becomes a Principal Subsidiary Bank) or

(y) within 180 days after such transaction, Downey has entered into a legally binding written agreement to invest such proceeds in one or more Principal Subsidiary Banks (including any existing Principal Subsidiary Bank or any other Subsidiary or person which in each case upon such investment will become a Principal Subsidiary Bank) but such investment has not been made because all regulatory or other similar approvals have not been obtained but are in the process of being obtained and such investment is made promptly after receipt of such approvals (provided that, if any such legally binding agreement is terminated or any such regulatory or other similar approvals are not obtained, Downey shall, within 90 days thereafter, invest such proceeds as described in clause (x) above),

and, in each case referred to in (x) and (y) above, the aggregate consolidated assets, determined in accordance with GAAP, of the Principal Subsidiary Bank or Banks, as the case may be, acquired or invested in or to be acquired or invested in (including any person which upon such investment becomes or would become, as the case may be, a Principal Subsidiary Bank) would be at least equal to 80% of the consolidated assets, determined in accordance with GAAP, of the Principal Subsidiary Bank being disposed of; provided, however, that if, within 180 days after the disposition of a Principal Subsidiary Bank, Downey acquires a person which upon such acquisition becomes a Principal Subsidiary Bank in accordance with the foregoing provisions of this paragraph (e) (including the consolidated asset requirement) in exchange for Downey's Common Stock or Preferred Stock with a fair market value at least equal to the proceeds of the transaction that resulted in the disposition of the applicable Principal Subsidiary Bank, Downey will not be required to invest the proceeds of such disposition as would otherwise be required by this paragraph (e) so long as Downey only issues Preferred Stock in such

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subsequent acquisition in an amount needed to replace any Preferred Stock of the acquired person outstanding at the time of, and not issued in contemplation of or in connection with, such acquisition; or

(f) any sale or issuance by any Principal Subsidiary Bank to its shareholders of additional shares of Voting Stock of, or any additional securities convertible into or exchangeable for or any additional options, warrants or rights to subscribe for or purchase shares of Voting Stock of, such Principal Subsidiary Bank at any price so long as (x) immediately prior to such sale or issuance, as the case may be, Downey owns, directly or indirectly, shares, securities, options, warrants and rights, as the case may be, of such Principal Subsidiary Bank of the same class or series, as the case may be, as are being sold or issued, as the case may be, and, immediately after such sale or issuance, as the case may be, Downey owns, directly or indirectly, at least as great a percentage of such class or series, as the case may be, of shares, securities, options, warrants or rights, as the case may be, of such Principal Subsidiary Bank as Downey owned immediately before such sale or issuance, as the case may be, and (y) immediately after such sale or issuance, as the case may be, and assuming the conversion or exchange, as the case may be, of all securities convertible into or exchangeable for and the exercise of any options, warrants or rights to subscribe for or purchase shares of Voting Stock of the applicable Principal Subsidiary Bank and all other Subsidiaries, Downey would own, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such Principal Subsidiary Bank; or

(g) any sale, assignment, transfer or other disposition of such Voting Stock or other securities made by Downey or any Subsidiary acting in a fiduciary capacity for any person other than Downey or any of its Subsidiaries.

The creation of a Lien shall not be deemed a sale, lease, assignment, transfer or other conveyance or disposition of Voting Stock, other securities or assets or property for purposes of any of the limitations described under Limitation on Sale or Issuance of Voting Stock of a Principal Subsidiary Bank above. The creation of any Liens on such Voting Stock or other securities is governed by the provisions described below under Limitations on Liens .

Limitation on Liens. Downey will not, and will not cause or permit any Subsidiary to, directly or indirectly, create, assume, incur or suffer to exist any Lien upon any shares of Voting Stock of any Principal Subsidiary Bank or any Subsidiary that owns, directly or through one or more other Subsidiaries, shares of Voting Stock of any Principal Subsidiary Bank.

The provisions set forth in the immediately preceding paragraph shall not prohibit the following:

(1) any Lien on any Voting Stock of any Principal Subsidiary Bank or any Subsidiary that owns, directly or through one or more Subsidiaries, shares of Voting Stock of any Principal Subsidiary Bank and which Lien secures loans, advances, lines of credit and other extensions of credit, provided that, so long as such Lien is in existence, Downey owns, directly or indirectly, not less than 80% of the outstanding shares of each class and series of Voting Stock of such Principal Subsidiary Bank or such other Subsidiary, as the case may be, free and clear of any Liens, other than any Liens permitted pursuant to clauses (2) through (7) below; or

(2) Liens on any shares of Voting Stock existing at the time of acquisition thereof (whether by merger, acquisition of stock or assets or otherwise) by Downey or any of its Subsidiaries, provided that such Liens were not created in contemplation of or in connection with such acquisition; or

(3) Liens securing any judgment if such judgment shall not have remained undischarged, or unstayed on appeal, for more than 60 days; or

(4) Liens for taxes, governmental assessments or similar governmental charges or levies not yet due or which are not overdue for a period of more than 30 days or which are being contested by Downey in good faith by appropriate proceedings; or

(5) Liens on Voting Stock that secure Debt owing by Downey or any Subsidiary to Downey or any Wholly-Owned Subsidiary; or

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(6) any agreement to sell, assign, transfer or otherwise dispose of or issue Voting Stock or any agreement to merge or consolidate a Principal Subsidiary Bank so long as (x) such agreement does not constitute or create a mortgage, pledge, charge, security interest or similar encumbrance on any shares of Voting Stock of a Principal Subsidiary Bank or any Subsidiary that owns, directly or through one or more Subsidiaries, shares of Voting Stock of any Principal Subsidiary Bank and no such Voting Stock shall, as a result of, pursuant to or in connection with such agreement or any transaction pursuant to such agreement, serve as collateral or security for any Debt or other obligation, (y) the only Lien on shares of Voting Stock of any Principal Subsidiary Bank or any Subsidiary that owns, directly or through one or more other Subsidiaries, shares of Voting Stock of any Principal Subsidiary Bank created pursuant to such agreement is the agreement to sell, assign, transfer or otherwise dispose of or issue such Voting Stock or the agreement to merge or consolidate such Principal Subsidiary Bank, as the case may be, and (z) such sale, assignment, transfer, disposition, issuance, merger or consolidation, as the case may be, and such agreement comply with the covenant set forth above under Limitation on Sale or Issuance of Voting Stock of a Principal Subsidiary Bank; or

(7) Liens for the sole purpose of extending, renewing or replacing in whole or in part the Debt or other obligation secured thereby referred to in the foregoing clause (2) or in this clause (7); provided, however, that the Lien excluded pursuant to this clause (7) shall be excluded only so long as the amount of the Debt or other obligation secured thereby does not exceed the amount of the Debt or other obligation so secured at the time of such extension, renewal or replacement (together with any premium, fees or expenses (other than interest) payable in connection with any such replacement, extension or renewal), and that such extension, renewal or replacement shall be limited to all or part of the shares of Voting Stock subject to the Lien so extended, renewed or replaced.

The information appearing above under Limitation on Sale or Issuance of Voting Stock of a Principal Subsidiary Bank, and the definition of Principal Subsidiary Bank appearing below under Certain Definitions supersede and replace the information appearing under the caption Description of Senior and Subordinated Debt Securities Sale or Issuance of Capital Stock of Principal Subsidiary Bank in the accompanying prospectus.

Merger, Consolidation and Transfer of Assets

The Indenture provides that Downey will not consolidate or merge with or into any other person or sell, lease, assign, transfer or otherwise convey all or substantially all of its properties and assets to any other person unless:

either (1) Downey shall be the continuing person (in the case of a merger) or (2) the successor person (if other than Downey) formed by or resulting from the consolidation or merger or to which such assets shall have been sold, leased, assigned, transferred or otherwise conveyed is a corporation organized and existing under the laws of the United States of America or any state thereof and shall expressly assume the due and punctual payment of the principal of, premium, if any, and interest on, all of the debt securities outstanding under the Indenture and the due and punctual performance of all of Downey's other obligations under the Indenture and the debt securities outstanding thereunder by means of a supplemental indenture, satisfactory to the trustee, executed and delivered by such successor corporation;

immediately after giving effect to such transaction, no event of default under the Indenture, and no event which, after notice or lapse of time or both would become an event of default under the Indenture, shall have occurred and be continuing; and

the trustee shall have received the officer's certificates and opinion of counsel called for by the Indenture.

Upon any consolidation by Downey with, or merger of Downey into, any other person or any sale, assignment, transfer, lease or conveyance of all or substantially all of Downey's properties and assets to any person in accordance with the provisions of the Indenture described above, the successor person formed by the

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consolidation or into which Downey is merged or to which the sale, assignment, transfer, lease or other conveyance is made shall succeed to, and be substituted for, Downey and may exercise every right and power of Downey under the Indenture with the same effect as if such successor person had been named as Downey therein; and thereafter, except in the case of a lease, the predecessor person shall be released from all obligations and covenants under the Indenture and the debt securities issued under the Indenture.

Events of Default

The Indenture defines an event of default with respect to the notes as any of the following events:

(1) default in the payment of any principal of or premium, if any, on any of the notes when due; or

(2) default in the payment of any interest on any of the notes when due and continuance of that default for 30 days; or

(3) default in the performance, or breach, of any other covenant of Downey in the Indenture or any note offered hereby (other than a covenant which has expressly been included in the Indenture, whether or not by means of a supplemental indenture, solely for the benefit of debt securities of a series other than the notes), and continuance of such default or breach (without such default or breach having been waived in accordance of the provisions of the Indenture) for a period of 60 days after written notice to Downey by the trustee or to Downey and the trustee by the holders of at least 25% in aggregate principal amount of the notes then outstanding; or

(4) default under any bond, note, debenture, mortgage, indenture or other instrument under which there may be issued or by which there may be secured or evidenced any Debt of Downey or any Principal Subsidiary Bank or Significant Subsidiary, which default shall result in such Debt in an aggregate principal amount exceeding \$20 million becoming or being declared due and payable prior to the date on which it would otherwise have become due and payable, without such Debt having been discharged, or such acceleration having been rescinded or annulled, within a period of 30 days after written notice to Downey by the trustee or to Downey and the trustee by the holders of at least 25% in aggregate principal amount of the notes then outstanding; or

(5) certain instances of bankruptcy, insolvency or reorganization with respect to Downey or any Principal Subsidiary Bank or Significant Subsidiary.

If an event of default occurs with respect to the notes and is continuing, either the trustee or the holders of at least 25% in principal amount of the notes then outstanding may declare the principal of, and accrued and unpaid interest on, the notes to be due and payable immediately. Upon satisfaction by Downey of certain conditions specified in the Indenture, the holders of a majority in principal amount of the notes then outstanding may rescind and annul such declaration of an event of default and its consequences. The information set forth in this paragraph and the immediately preceding paragraph supercedes and replaces the information set forth in the accompanying prospectus in the first and third paragraphs under the caption Description of Senior and Subordinated Debt Securities Defaults and Rights of Acceleration.

The Indenture provides that, within 90 days after the occurrence of any default with respect to the notes, the trustee will mail to all holders of the notes notice of the default if known to the trustee, unless that default has been cured or waived. However, the Indenture provides that, except in the case of a default in the payment of the principal of, premium, if any, or interest on any notes, the trustee may withhold notice of a default with respect to the notes if its board of directors or executive committee or a trust committee composed of directors and/or Responsible Officers of the trustee in good faith determines that the withholding of such notice is in the interests of the holders of notes. As used in this paragraph, the term default means any event which is, or after notice or lapse of time or both would become, an event of default with respect to the notes.

Subject to the provisions of the Trust Indenture Act of 1939 requiring the trustee, during the continuance of an event of default under the Indenture, to act with the requisite standard of care, the trustee is under no obligation to exercise any of its rights or powers under the Indenture at the request or direction of any of the holders of notes unless those holders have offered the trustee security or indemnity satisfactory to the trustee. Subject to the foregoing, the holders of a majority in principal amount of the outstanding notes have the right

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to direct the time, method and place of conducting any proceeding for any remedy available to the trustee under the Indenture with respect to the notes. The Indenture requires the annual filing by us with the trustee of a certificate which states whether or not we are in compliance with all conditions and covenants under the Indenture. The foregoing provisions of this paragraph supercede and replace the provisions set forth in the second and third paragraphs under the caption "Description of the Senior and Subordinated Debt Securities - Collection of Indebtedness" in the accompanying prospectus.

Notwithstanding any other provision of the Indenture, the holder of a note will have the right, which is absolute and unconditional, to receive payment of the principal of and premium, if any, and interest on that note on the respective due dates for those payments and to institute suit for the enforcement of those payments, and this right shall not be impaired without the consent of the holder.

Certain Definitions

As used in the Indenture, the following terms have the meaning specified below:

Bank means any person which is a savings association, savings bank, savings and loan association, bank, trust company or similar entity organized and doing business under the laws of the United States of America, any State thereof or the District of Columbia.

Business Day and **business day** mean any day other than a Saturday, Sunday or other day on which banking institutions in The City of New York are authorized or obligated by law, regulation or executive order to close; provided that such term shall mean, when used with respect to any payment of principal of, or premium or interest, if any, on, the debt securities of any series to be made in a Place of Payment (which Place of Payment shall be specified in the form of such debt security or pursuant to the Indenture) other than The City of New York, any day other than a Saturday, Sunday or other day on which banking institutions in such Place of Payment are authorized or obligated by law, regulation or executive order to close. The foregoing definition supersedes and replaces the definition of **Business Day** appearing under the caption "Description of the Senior and Subordinated Debt Securities - Payment of Interest" in the accompanying prospectus.

Capital Stock means, with respect to any person, any and all