

DOWNEY FINANCIAL CORP
Form DEF 14A
March 15, 2005

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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.
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(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

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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

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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;

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- 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.

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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

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 represents 144% of the targeted incentive amount.

Mr. Domingo: On February 2, 2004, Marangal I. Domingo became President and Chief Executive Officer of Downey and the Bank. Prior to that date, the Compensation Committee recommended and the Board approved an employment agreement for Mr. Domingo. The employment agreement provided for Mr. Domingo to receive a base salary of \$750,000 per year plus a bonus of up to \$1 million per year tied to Downey's annual return on equity performance. Mr. Domingo also received a signing bonus of \$250,000, a \$39,000 relocation package plus up to \$25,000 for moving expenses. The employment agreement also provided for severance to Mr. Domingo of \$750,000 if he was terminated without cause or demoted, his base salary or bonus was reduced or a change in control occurred. For 2004, the severance to Mr. Domingo would also include a pro-rated portion of his bonus.

On August 31, 2004, Downey announced that Mr. Domingo had resigned his position of President and Chief Executive officer and director of Downey, the Bank, and their affiliated companies. In connection therewith, and in accordance with the terms of the employment agreement, Downey and the Bank entered into a severance agreement and general release with Mr. Domingo pursuant to which he received a severance payment of \$750,000 in September

2004 and a pro-rated incentive compensation payment of \$583,333 in February 2005. Mr. Domingo also received a salary of \$435,095 for the portion of 2004 he was employed at Downey.

Retirement Package for Chief Administrative Officer

In January 2004, in recognition of Ms. Wolfe's valuable service to the Bank since 1974, the Compensation Committee recommended and the Board approved a retirement package.

Ms. Wolfe retired on May 28, 2004 and received (i) a lump-sum retirement payment equal to her annual base salary and pro-rated 2004 bonus of \$566,667; (ii) a retirement benefit of \$1,500 per month for 60 consecutive months (total \$90,000); (iii) accrued vacation of \$2,638; and (iv) the company match for the 401(k) Plan of \$6,150. Ms. Wolfe served as a consultant to the Bank for the balance of 2004 and received consulting fees totaling \$104,762.

Review of Non-Employee Director Compensation

During 2004 and early 2005, the Compensation Committee also reviewed director compensation at Downey and comparable financial institutions and trends in director compensation as a result of increased workload and risk under the Sarbanes-Oxley Act of 2002. Based upon its review and analysis, in January and February 2005, the Compensation Committee recommended and the Board approved changes in non-employee director compensation, as described in "Director Compensation" below.

Conclusion

The Compensation Committee believes that the management team is dedicated to achieving significant improvement in Downey's long-term financial performance. The Compensation Committee further believes that Downey's compensation policies are designed to align closely the financial interests of senior executive management with the interests of Downey's shareholders and, as administered by the Compensation Committee, will enhance management's efforts in these areas.

Respectfully submitted,

Michael B. Abrahams, Chairman

Cheryl E. Olson

James H. Hunter

COMPENSATION

Executive Compensation

The following Summary Compensation Table sets forth all compensation from Downey and its subsidiaries for services rendered during 2004, 2003, and 2002 which was earned, awarded or paid to Downey's Chief Executive Officer, Downey's four other most highly compensated executive officers as of the end of 2004, and two former executive officers (collectively, the "Named Executives"). Downey did not award any long term stock compensation during the periods presented.

Annual Compensation**All Other**

| Name and Principal Position | Year | Salary | Bonus | Compensation⁽¹⁾ |
|--|-------------|---------------|--------------|-----------------------------------|
| Daniel D. Rosenthal | 2004 | \$385,641 | \$691,200 | \$6,150 |
| President and Chief | 2003 | 350,000 | 403,200 | 6,000 |
| Executive Officer | 2002 | 350,000 | 126,000 | 6,000 |
| Thomas E. Prince | 2004 | \$343,173 | \$358,875 | \$6,150 |
| Chief Operating Officer and | 2003 | 250,000 | 60,000 | 6,000 |
| Chief Financial Officer | 2002 | 211,848 | 13,241 | 6,954 |
| John R. Gatzke | 2004 | \$321,586 | \$437,250 | \$6,150 |
| Executive Vice President | 2003 | 220,374 | 211,559 | 7,500 |
| and Chief Lending Officer | 2002 | 207,907 | 162,370 | 5,521 |
| Edward A. Luther | 2004 | \$202,476 | \$170,080 | \$4,007 |
| Senior Vice President | 2003 | 194,688 | 130,830 | 4,650 |
| Director, Major Loans | 2002 | 187,200 | 32,760 | 3,354 |
| Richard D. Grout | 2004 | \$200,000 | \$114,000 | \$6,150 |
| Executive Vice President | 2003 | 196,851 | 39,370 | 5,194 |
| Director, Retail Banking | 2002 | 189,287 | 11,830 | 5,454 |
| <i>Former Executives</i> | | | | |
| Marangal I. Domingo | 2004 | \$435,095 | \$ --- | \$1,643,981 ⁽²⁾ |
| Former President and Chief Executive Officer | | | | |
| Jane Wolfe | 2004 | \$165,739 | \$ --- | \$690,717 ⁽³⁾ |
| | 2003 | 320,650 | 307,824 | 6,822 |

Former Executive
Vice President

and Chief
Administrative
Officer

| | | | |
|------|---------|--------|--------|
| 2002 | 291,500 | 87,450 | 14,240 |
|------|---------|--------|--------|

⁽¹⁾ Includes all other compensation in the chart on page 18, but excludes the value of other benefits which do not exceed \$50,000 or 10% of the total salary and bonus of the individual.

⁽²⁾ The amounts shown for Mr. Domingo include severance payments including a pro-rata bonus award (total \$1,333,333), accrued vacation (\$21,648), a signing bonus (\$250,000) and a relocation bonus (\$39,000).

⁽³⁾ The amounts shown for Ms. Wolfe include a retirement lump-sum payment including a pro-rata bonus award (\$566,667), accrued vacation (\$2,638), company match for 401(k) (\$6,150), monthly retirement payments (\$10,500) and consulting fees (\$104,762).

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| Name | Year | Company Matching 401(k) Contributions | Service Award | All Other Comp |
|---------------------|------|--|------------------|-------------------|
| Daniel D. Rosenthal | 2004 | \$6,150 | \$ --- | \$6,150 |
| | 2003 | 6,000 | --- | 6,000 |
| | 2002 | 6,000 | --- | 6,000 |
| Thomas E. Prince | 2004 | \$6,150 | \$ --- | \$6,150 |
| | 2003 | 6,000 | --- | 6,000 |
| | 2002 | 5,954 | 1,000 | 6,954 |
| John R. Gatzke | 2004 | \$6,150 | \$ --- | \$6,150 |
| | 2003 | 6,000 | 1,500 | 7,500 |
| | 2002 | 5,521 | --- | 5,521 |
| Edward A. Luther | 2004 | \$4,007 | \$ --- | \$4,007 |
| | 2003 | 3,650 | 1,000 | 4,650 |
| | 2002 | 3,354 | --- | 3,354 |
| Richard D. Grout | 2004 | \$6,150 | \$ --- | \$6,150 |
| | 2003 | 5,194 | --- | 5,194 |
| | 2002 | 5,454 | --- | 5,454 |

Option/SAR Grants in Last Fiscal Year

Downey did not grant any options or stock appreciation rights to the Named Executives during 2004.

Option Exercises and Holdings

The following table provides information with respect to the Named Executives concerning the exercise of options during 2004 and unexercised options held by the Named Executives as of December 31, 2004:

**Aggregated Option Exercises in 2004
and Year-End Option Values**

| Name | Number of Shares Acquired on Exercise | Value Realized | Number of Securities Underlying Options at 12/31/04 | Value of Unexercised In-the-Money Options at 12/31/04 ⁽¹⁾ |
|---------------------|--|-------------------|--|---|
| Daniel D. Rosenthal | 8,683 | \$337,370 | 29,484 | \$930,589 |
| Thomas E. Prince | 4,342 | 168,893 | 14,467 | 456,615 |
| Jane Wolfe | 26,536 | 648,808 | --- | --- |

⁽¹⁾ The value of unexercised "in-the-money" options is the difference between the market price of the Common Stock on December 31, 2004 (\$57.00 per share) and the exercise price of the options, multiplied by the number of shares subject to the option.

Director Compensation*Annual Compensation*

In January and February 2005, the Compensation Committee recommended and the Board approved certain increases in non-employee director compensation. The following information reflects the increases approved in January and February 2005.

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The following chart reflects director compensation for the years presented.

| | 2003 | 2004 | 2005 |
|--|----------|----------|----------|
| Annual retainer to each director ⁽¹⁾ | \$24,000 | \$24,000 | \$36,000 |
| Additional annual retainer to Chair of Downey Board ⁽²⁾ | 2,500 | 2,500 | 2,500 |
| | 2,500 | 2,500 | 2,500 |

Additional annual retainer to Chair of Bank Board ⁽²⁾

| | | | |
|---|-------|-----------------------|--------|
| Additional annual retainer to Chair of Audit Committee | 5,000 | 30,000 ⁽³⁾ | 30,000 |
| Additional annual retainer to Chair of Compensation Committee | 3,000 | 5,000 ⁽³⁾ | 5,000 |
| Additional annual retainer to Chair of Nominating and Corporate Governance Committee | --- | 5,000 ⁽³⁾ | 5,000 |
| Downey and/or Bank Board meeting fee (per day typically both Boards meet on the same day) | 1,000 | 1,000 | 3,000 |
| Committee meeting fee (per meeting) | N/A | N/A | 1,000 |
| Committee meeting fee (per day, other than on Board meeting day) | 1,000 | 1,000 | N/A |
| DSL Board meeting fee (per day) ⁽⁴⁾ | 1,000 | 1,000 | 1,000 |

⁽¹⁾ Each director of Downey is also a director of the Bank. The annual retainer listed is for services on both Boards.

⁽²⁾ Downey and the Bank's Chairman has declined to accept the \$2,500 per year additional annual retainer from Downey or the Bank.

⁽³⁾ Approved in 2005, made retroactive to January 1, 2004.

⁽⁴⁾ There is no annual retainer paid to DSL Board members and no DSL Board meeting fee is paid if the meeting is on the same day as a Downey or Bank Board meeting.

Non-employee directors who review the Thrift Financial Reports and Consolidated Maturity/Rate Schedules required to be filed quarterly with the Office of Thrift Supervision receive a fee of \$500 per quarter. Directors are reimbursed for reasonable out-of-pocket expenses and are entitled to receive the same medical coverage benefits provided to the Bank's employees.

Employee directors receive no compensation for Board service.

Director Retirement Benefits Plan

During 2004, the Board approved a revised Director Retirement Benefits Plan (the "DRB Plan"). To be eligible for the DRB Plan benefits, the director must have retired from the Board, not been an employee of Downey or the Bank while a director, and served as a director for a minimum of either three years (if he or she joined the Board before April 23, 2003) or five years (if he or she joined the Board on or after April 23, 2003). The total benefit an eligible director receives under the DRB Plan equals one-third of the months the director served (up to a maximum of 60 months) multiplied by the average monthly director compensation received during the 36 months preceding retirement. The total benefit will be paid to each eligible director or his or her designated beneficiary, in 60 equal monthly installments, without interest, beginning the month after retirement. If a majority interest of Downey's outstanding stock is transferred or acquired (other than by will or by the laws of descent and distribution), then the entire earned benefit becomes payable immediately, and the three-year (or five year) minimum service requirement

does not apply. If a retired director so requests, Downey, at its option, may make a single lump-sum payment of the total benefit. Any such accelerated payment would be discounted to the present value at the interest rate then in effect for the Bank's two-year certificates of deposit.

Founder Retirement Agreement

On December 21, 1989, the Bank entered into a retirement agreement (the "Founder Retirement Agreement") with Mr. McAlister, pursuant to which Mr. McAlister's compensation was \$32,167 per month, which payments commenced upon Mr. McAlister's retirement as President of DSL Service Company, a subsidiary of the Bank, in 1993. The Founder Retirement Agreement provides for adjustments to compensation payments every three years, based on the Consumer Price Index, as defined under the Founder Retirement Agreement. Pursuant to these adjustments, Mr. McAlister's compensation was adjusted to \$39,210 per month, effective as of July 1, 2003.

During 2000, in consideration and in recognition of Mr. McAlister having completed more than thirty years of service and his continuing involvement with the growth of Downey and the Bank, the Bank agreed to amend the Founder Retirement Agreement pursuant to which Mr. McAlister and the Bank agreed that Mr. McAlister would be entitled to receive monthly compensation for so long as Mr. McAlister lives but not less than 120 months from June 28, 2000. Thus, the payments will be made to Mr. McAlister's estate through June 2010 should he die prior to that date. During 2004, Mr. McAlister received \$470,518 under the Founder Retirement Agreement. If a majority interest of Downey's Common Stock is transferred or acquired, then such compensation shall continue as scheduled or, at Downey's option, a lump-sum payment equal to the then present value of any remaining compensation shall be paid.

NOMINATING AND CORPORATE GOVERNANCE COMMITTEE REPORT

The current members of the Nominating and Corporate Governance Committee ("NCGC") are Cheryl E. Olson, Chair, Maurice L. McAlister and Brent McQuarrie. The Board has determined that each member of the NCGC is independent under applicable listing standards. In accordance with SEC and NYSE requirements, the Board has approved (i) a written charter for the NCGC; (ii) corporate governance guidelines; (iii) a code of ethical conduct for directors and financial officers; and (iv) a code of ethical conduct for all employees. Items (i)-(iii) and a summary of item (iv) are available on Downey's website at www.downeysavings.com by clicking on "Investor Relations" and then "Corporate Governance."

Nomination of Director Candidates

The NCGC is primarily responsible for identifying qualified director candidates, including shareholder nominees, and the NCGC considers, among other things, a candidate's age, diversity, skills, background, experience and ability to represent the long-term interests of shareholders as a whole.

The NCGC will consider shareholder nominations for director in accordance with Downey's Bylaws. The nominating shareholder must be eligible to vote for the election of directors at the annual meeting for which the shareholder's director candidate is nominated. To be timely, a shareholder's nomination must be delivered to or received at Downey's principal executive offices not less than 20 days prior to the annual meeting; provided, however, that if Downey gives shareholders less than 30 days' notice of the date of the annual meeting (which notice must be accompanied by a proxy or information statement which identifies the nominees of the Board), to be timely Downey must receive the shareholder nomination by the close of business on the 10th day following the day on which such notice of the date of the meeting was mailed. Such shareholder's nomination notice shall set forth as to each director

nominee (i) the name, age, business address and residence address of such nominee; (ii) the principal occupation or employment of such nominee; and (iii) such nominee's written consent to serve as a director, if elected; and as to the shareholder giving the notice (i) the name and address of such shareholder; and (ii) the class and number of shares of Downey which are owned of record by such shareholder.

At the request of the Board, any person nominated by the Board for election as a director shall furnish to the General Counsel/Corporate Secretary of Downey the information required to be set forth in a shareholder's notice of nomination which pertains to the nominee together with the required written consents. Ballots bearing the names of all persons nominated by the NCGC and by shareholders shall be provided for use at the annual meeting. If the NCGC fails or refuses to act at least 20 days prior to the annual meeting, nominations for directors may be made at the Annual Meeting by any shareholder entitled to vote and shall be voted upon. No person shall be elected as a director of Downey unless nominated in accordance with the procedures set forth in this section.

The NCGC nominated only one new director in 2004 - Jane Wolfe. In August 2004, after Mr. Domingo resigned from the Board, the NCGC met and discussed the nomination of Ms. Wolfe, based upon her extensive banking knowledge and years of services as a senior officer of Downey. The Board accepted the nomination and Ms. Wolfe became a director of Downey and the Bank on September 1, 2004.

Downey does not currently employ or pay a fee to any third party to assist in identifying or evaluating director candidates.

Shareholder-Director Communications

The Board welcomes communications from shareholders. You may send communications to the Board or any particular director(s) in care of Downey's General Counsel/Corporate Secretary, 3501 Jamboree Road, North Tower, Newport Beach, California 92660, who shall forward the communications to the director(s) and may review such communications and distribute a copy to Downey's senior management.

Respectfully submitted,

Cheryl E. Olson, Chairman

Maurice L. McAlister

Brent McQuarrie

PERFORMANCE GRAPH

The table below compares the performance of Downey with that of the S&P 500 composite index and the selected Peer Group. The selected Peer Group is SNL Securities' Western Thrift Index for 27 publicly traded savings institution holding companies. The following table assumes \$100 invested on December 31, 1998 in Downey, the S&P 500 and equally in the companies in the Peer Group, and assumes reinvestment of dividends on a daily basis.

**Comparison of 5-year Cumulative Total Return
Downey, S&P 500 Index and Peer Group**

| | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> |
|------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Downey | 100.00 | 275.85 | 208.59 | 198.83 | 253.46 | 295.31 |
| S&P 500 | 100.00 | 91.20 | 80.42 | 62.64 | 80.62 | 89.47 |
| Peer Group | 100.00 | 197.55 | 182.89 | 207.51 | 272.67 | 312.92 |

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Transactions with Management and Certain Business Relationships

During 2004, employees of Downey and the Bank provided accounting and related services to Maurice L. McAlister, Chairman of Downey's Board of Directors, certain members of Mr. McAlister's family and certain of his controlled affiliates. The aggregate value of these services was approximately \$70,724. Downey and the Bank have been fully reimbursed for the services provided.

From time to time, the Bank's Board has approved having the Bank enter into commercial leases with California partnerships in which Lester C. Smull, a director of Downey and the Bank, is the managing general partner. These commercial leases are for a total of five Bank branches, one each in Huntington Beach, Dana Point, Chino, Simi Valley and Mission Viejo, California, and a branch regional office in Chino, California. The Bank's aggregate rental obligations on the six leases as of February 2005 is approximately \$36,656 per month. Management believes that the terms of the leases, including the monthly rent, are at least as favorable to the Bank as prevailing terms that could be obtained from a non-affiliated person.

Loans to Management and Directors

The Bank offers loans to directors, officers and employees of Downey, the Bank and their respective subsidiaries. These loans are made in the ordinary course of business and, in the judgment of management, do not involve more than the normal risk of collectability or present other unfavorable features. The loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions involving non-affiliated persons.

Over a period of approximately 29 years, the Bank has made various loans to Director Smull, in his individual capacity, to the Smull Family Trust and to a number of California partnerships in which Director Smull is a managing general partner. As of December 31, 2004, the Bank had loans outstanding to Director Smull or his related partnerships in an aggregate amount of approximately \$21.3 million. Each of the loans to Director Smull or his related partnerships (i) was made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions involving non-affiliated persons; and (ii) did not involve more than the normal risk of collectability or present other unfavorable features.

The Bank has made various loans to McMillin Companies, LLC, where Director Hunter is Executive Vice President of Planning and Acquisition. As of December 31, 2004, the Bank had loans outstanding to McMillin Companies, LLC and related entities in an aggregate amount of \$14.6 million. In addition, DSL has equity investments in real estate ventures associated with McMillin Companies, LLC, specifically (as of December 31, 2004) a \$4.5 million investment in Cristal @ Morgan Hill, LLC, a \$12.6 million investment in Montevina @ Morgan Hill, LLC, and a \$10.7 million investment in Ruffino @ Morgan Hill, LLC. Each of the loans to, and equity investments with, the McMillin-related entities (i) was made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions involving non-affiliated persons; and (ii) did not involve more than the normal risk of collectability or present other unfavorable features.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

At the close of business on February 25, 2005, the record date for the Annual Meeting, there were 27,853,783 shares of Downey's Common Stock outstanding and entitled to vote, all of one class, and each having one vote. The holders of a majority of the shares outstanding and entitled to vote, either present in person or represented by proxy, constitute a quorum for the Annual Meeting.

Principal Shareholders

Information concerning the owners of more than 5% of the outstanding Common Stock as of the record date for the Annual Meeting follows:

| Name/Address | Amount/Nature of Beneficial Ownership | Percent of Outstanding Stock |
|---|--|------------------------------------|
| McAlister Family Trust ⁽¹⁾ 3501 Jamboree Road Newport Beach, CA 92660 | 5,630,615 | 20.2% |

| | | |
|---|-----------|------|
| Delaware Management Holdings ⁽²⁾ | 1,569,031 | 5.6% |
|---|-----------|------|

One Commerce Square

2005 Market Street

Philadelphia, PA
19103

| | | |
|--|-----------|------|
| Gerald H. McQuarrie Family Trusts ⁽³⁾ | 1,559,891 | 5.6% |
|--|-----------|------|

Hawkins, Cloward & Simister

1095 South 800 East,
Suite #1

Orem, UT 84097

⁽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⁾ Information based upon Schedule 13G, filed on February 9, 2005 with the SEC by Delaware Management Holdings.

⁽³⁾ Oneida B. McQuarrie-Gibson serves as Trustee for the Gerald H. McQuarrie Family Trusts. This figure includes 1,138,086 shares held by the Gerald H. McQuarrie Non-Exempt Marital Trust; 98,379 shares held by OBM-Sandie, Ltd.; 92,743 shares held by OBM-Brent, Ltd.; 86,279 shares held by OBM-Scott, Ltd.; 76,150 shares held by the Gerald H. McQuarrie Exempt Marital Trust; 61,038 shares held by the Oneida B. McQuarrie-Gibson Survivors Trust; and 7,216 shares held by the Gerald H. McQuarrie By-Pass Trust.

Equity Compensation Plan Information

The following table summarizes information as of year-end 2004 and 2003 relating to equity compensation plans of Downey pursuant to which grants of options, restricted stock, or other rights to acquire shares have been or may be granted, all of which have been approved by security holders.

| Plan category | Number of securities | Weighted average | Number of securities |
|---------------|---|------------------|--|
| | to be issued upon exercise of outstanding options | | exercise price of outstanding options |

December 31, 2004:

Equity compensation plans

approved by security

| | | | |
|---------------------------|--------|---------|---------|
| holders | 52,914 | \$25.44 | 131,851 |
| December 31, 2003: | | | |
| Equity compensation plans | | | |
| approved by security | | | |
| holders | 92,475 | \$23.67 | 131,851 |

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires Downey's and, as may be determined, the Bank's and their respective subsidiaries' executive officers, directors and persons who own more than ten percent (10%) of Downey's Common Stock, to file with the SEC and the NYSE reports of ownership of Downey securities and changes in reported ownership. Officers, directors and greater than ten percent (10%) shareholders are required by SEC rules to furnish Downey with copies of all Section 16(a) reports they file.

Based solely on a review of the reports furnished to Downey, or written representations from reporting persons that all reportable transactions were reported, Downey believes that during the period January 1, 2004 to December 31, 2004, Downey's officers, directors and greater than ten percent (10%) owners timely filed all reports they were required to file under Section 16(a).

NEW YORK STOCK EXCHANGE CEO CERTIFICATION

The certification of Downey's Chief Executive Officer as required by the NYSE listing standards, Section 303A.12(a), was submitted to the NYSE on August 13, 2004.

PROPOSALS OF SHAREHOLDERS

It is presently anticipated that the 2006 annual meeting of shareholders will be held in April 2006. Shareholders desiring to exercise their rights under the proxy rules to submit shareholder proposals are advised that their proposals must be received by Downey no later than November 15, 2005, in order to be eligible for inclusion in Downey's proxy statement relating to that meeting. Shareholders desiring to submit proposals pursuant to the proxy rules should submit their proposals to the General Counsel/Corporate Secretary, Downey Financial Corp., 3501 Jamboree Road, Newport Beach, California 92660.

ANNUAL REPORT TO SHAREHOLDERS

Downey's Annual Report to Shareholders and Report on Form 10-K, which includes the consolidated financial statements and related notes thereto, accompanies this Proxy Statement.

Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge from our internet site, www.downeysavings.com, by clicking on "Investor Relations" located on our home page and proceeding to "Corporate Filings."

SINGLE COPIES OF DOWNEY'S ANNUAL REPORT TO SHAREHOLDERS, AND REPORT ON FORM 10-K (WITHOUT EXHIBITS) MAY BE OBTAINED, FREE OF CHARGE, UPON WRITTEN REQUEST TO: DOWNEY FINANCIAL CORP., 3501 JAMBOREE ROAD, NEWPORT BEACH,

CALIFORNIA 92660, ATTENTION: GENERAL COUNSEL/CORPORATE SECRETARY.

OTHER BUSINESS

Additional Matters

As of the date of this Proxy Statement, the management of Downey does not know of any other matters that are to be presented for action at the Annual Meeting. Should any other matters come before the Annual Meeting or any adjournment thereof, the persons named in the enclosed proxy will have discretionary authority to vote all proxies with respect to such matters in accordance with their judgment. Additional business may be properly brought before the Annual Meeting by or at the direction of a majority of Downey's Board.

Presented by Shareholders

Pursuant to Downey's Bylaws, only such business shall be conducted, and only such proposals shall be acted upon at the Annual Meeting as are properly brought before the Annual Meeting. For any new business proposed by management to be properly brought before the Annual Meeting such new business shall be approved by the Board, either directly or through its approval of proxy solicitation materials related thereto, and shall be stated in writing and filed with the General Counsel/Corporate Secretary of Downey at least 60 days before the date of the Annual Meeting, and all business so stated, proposed and filed shall be considered at the Annual Meeting. Any shareholder may make any other proposal at the Annual Meeting and the same may be discussed and considered, but unless properly brought before the Annual Meeting, such proposal shall not be acted upon at the Annual Meeting. For a proposal to be properly brought before an annual meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the General Counsel/Corporate Secretary of Downey. To be timely, a shareholder's notice must be delivered to or received at the principal executive offices of Downey not less than 120 calendar days before the date Downey's proxy statement is released to shareholders in connection with the previous year's annual meeting of shareholders, except that, if no annual meeting was held in the previous year or if the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, notice by the shareholder to be timely must be so received no later than the close of business on the 10th day following the day on which such notice of the date of the annual meeting was mailed. A shareholder's notice to the General Counsel/Corporate Secretary shall set forth as to each matter the shareholder proposes to bring before the annual meeting (i) a brief description of the proposal desired to be brought before the annual meeting, (ii) the name and address of the shareholder proposing such business, and (iii) the class and number of shares of Downey which are owned of record by the shareholder. Notwithstanding anything in the Bylaws to the contrary, no business shall be conducted at an annual meeting except in accordance with the procedures set forth in Downey's Bylaws.

/s/ Gary F. Torrell

Gary F. Torrell

General Counsel/Corporate Secretary

APPENDIX A

DOWNEY FINANCIAL CORP. CHARTER FOR THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

I. Audit Committee Purpose

The Audit Committee shall be appointed by the Board of Directors, to assist the Board in fulfilling its oversight responsibilities. The Audit Committee's primary duties and responsibilities are to:

- Assist Board oversight of the integrity of the financial statements of Downey Financial Corp. and its subsidiaries (individually "DFC" and with DFC's subsidiaries, collectively called "Downey");
- Assist Board oversight of the independence, qualifications and performance of Downey's independent auditors, the performance of the internal auditing department, and the internal asset review function;
- Assist Board oversight of Downey's compliance with legal and regulatory requirements; and
- Prepare any report required by the rules of the United States Securities and Exchange Commission ("SEC") to be included in DFC's annual proxy statement.

The Audit Committee shall have the sole authority to appoint or replace the independent auditors, subject to any required shareholder ratification. The Audit Committee may retain, at Downey's expense, independent legal, accounting, or other consultants or experts it deems necessary in the performance of its duties. Downey shall provide for appropriate funding, as determined by the Audit Committee, to compensate the independent auditors and any advisors the Audit Committee employs, and to cover ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.

II. Audit Committee Composition and Meetings

Audit Committee members shall satisfy the requirements for independence and expertise established by the New York Stock Exchange, Inc., in Rule 10A-3 of the Securities Exchange Act of 1934 ("Exchange Act") and other rules and regulations of the SEC. The Audit Committee shall be comprised of at least three directors, each of whom shall be independent non-executive directors, free from any relationship that would interfere with the exercise of his or her independent judgment. Each member of the Audit Committee shall be financially literate, as such qualification is interpreted by DFC's Board in its business judgment. At least one member of the Audit Committee shall have accounting or related financial management expertise.

The Audit Committee shall meet periodically (at least annually) in separate executive sessions with management, the Director of Internal Audit, the Director of Internal Asset Review, the independent auditors, and as a committee to discuss any matters that the Committee or each of those groups believe should be discussed.

III. Audit Committee Responsibilities and Duties

The Audit Committee shall:

1. Meet to review and discuss with management and the independent auditors Downey's quarterly and annual audited financial statements, including disclosures made in "management's discussion and analysis of financial condition and results of operations" prior to filing or distribution and recommend to the Board whether the audited financial statements should be included in DFC's Form 10-K.
2. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures.

3. Review major issues regarding accounting principles and financial statement presentations, including any significant changes in Downey's selection or application of accounting principles, any major issues as to

the adequacy of Downey's internal controls and any special steps adopted in light of any material control deficiencies identified.

4. Discuss with management and the independent auditors the effect(s) of regulatory and accounting initiatives as well as off-balance sheet structures on Downey's financial statements.
5. Discuss DFC's earnings press releases including the type and presentation of information to be included therein (paying particular attention to any use of "pro forma" or "adjusted" non-GAAP information) as well as financial information and earnings guidance provided to analysts and rating agencies, if any.
6. Review and discuss quarterly reports from the independent auditors on: significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including all critical accounting policies and practices to be used; all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the independent auditors; and other material written communications between the independent auditors and management, such as any management letter or schedule of unadjusted differences.
7. Review the independence and performance of the independent auditors and annually select the independent auditors or approve any discharge of independent auditors when circumstances warrant.
8. Assume direct responsibility for the compensation and oversee the work of the independent auditors (including resolution of disagreements between management and the independent auditors regarding financial reporting) for purposes of preparing or issuing an audit report or related work. The independent auditors shall report directly to the Audit Committee. Preapprove all auditing services and permitted non-audit services (including the fees and terms thereof) to be performed for Downey by its independent auditors, subject to the de minimus exceptions for non-audit services described in Section 10A(I)(1)(B) of the Exchange Act which are approved by the Audit Committee prior to completion of the audit.
9. Set clear policies for the hiring of employees or former employees of the independent auditors who participated in any capacity in any audit of Downey.
10. Discuss certain matters required to be communicated to audit committees in accordance with AICPA SAS 61.⁽¹⁾
11. Evaluate the lead partner of the independent auditor team. Ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit

⁽¹⁾ *Statement of Auditing Standards (SAS) No. 61 requires auditors to discuss certain matters with audit committees. The communication may be in writing or oral and may take place before or after the financial statements are issued. Items to be communicated include:*

- The auditors' responsibility under Generally Accepted Auditing Standards (GAAS);
- Significant accounting policies;
- Management's judgments and accounting estimates;
- Significant audit adjustments;
- Other information in documents containing audited financial statements;
- Disagreements with management including accounting principles, scope of audit, disclosures;
- Consultation with other accountants by management;
- Major issues discussed with management prior to retention; and
- Difficulties encountered in performing the audit.

partner responsible for reviewing the audit as required by law. Consider whether there should be regular rotation of the audit firm itself in order to assure continuing auditor independence. Obtain and review a report from the independent auditors at least annually describing (a) the independent auditors' internal quality control procedures, (b) any material issues raised by the most recent internal quality control review or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five (5) years respecting one or more independent audits carried out by the firm, (c) any steps taken to deal with any such issues, and (d) all relationships between the independent auditors and Downey. Evaluate the qualifications, performance and independence of the independent auditors, taking into account the opinions of management and the internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditors to the Board.

12. Review and discuss with the independent auditors and management guidelines and policies with respect to risk assessment and risk management and financial strength.

13. Discuss with management and the independent auditors any correspondence with regulators or other governmental agencies and any published reports which raise material issues regarding Downey's financial statements or accounting policies.

14. Annually prepare a report to shareholders as required by the SEC to be included in DFC's annual proxy statement.

15. Establish procedures for the Audit Committee to receive, retain and address complaints Downey receives regarding accounting, internal accounting controls, or auditing matters, and any confidential, anonymous submissions by Downey employees regarding questionable accounting or auditing matters.

16. Maintain minutes of meetings and periodically report to the Board.

17. Evaluate the Audit Committee's performance annually.

18. Review with the independent auditors any audit problems or difficulties and management's response. This review should include any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. The committee may also review with the auditor: any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letter issued, or proposed to be issued, by the audit firm to Downey.

DOWNEY FINANCIAL CORP.

Audit Committee Meeting Agenda Guidelines

Scheduled Meetings
Apr. Jul. Oct. Jan.-Feb.

I. Audit Committee Purpose

| | | | | |
|--------------------------------|---|---|---|---|
| Conduct special investigations | * | * | * | * |
|--------------------------------|---|---|---|---|

II. Audit Committee Composition and Meetings

| | | | | |
|--|--|--|--|---|
| 1. Assess independence and financial literacy of audit committee | | | | X |
|--|--|--|--|---|

| | | | | |
|--|---|---|---|---|
| 2. Establish number of meetings | | | | X |
| 3. Audit Committee Chair to establish meeting agenda | X | X | X | X |
| 4. Enhance financial literacy update on current financial events | X | X | X | X |
| 5. Executive session with auditors, internal audit, mgmt., committee | * | * | * | * |

III. Audit Committee Responsibilities and Duties

| | | | | |
|--|---|---|---|---|
| 1. Review Charter, publish in proxy if necessary or appropriate | | | | X |
| 2. Meet to review annual financial statements-discuss with mgmt., auditors | | | | X |
| 3. Consider internal controls and financial risks | X | X | X | X |
| 4. Meet to review quarterly results and findings | X | X | X | X |
| 5. Recommend appointment of auditors | | | | X |
| 6. Approve audit fees | | | | X |
| 7. Discuss auditor independence | | | | X |
| 8. Review auditor plan | | | | X |
| 9. Discuss year-end results, SAS 61 report | | | | X |
| 10. Discuss quality of accounting principles | * | * | * | X |
| 11. Review internal audit plan | | | | X |
| 12. Review appointment, performance of Director of Internal Audit | | | | X |
| 13. Review significant internal audit reports | X | X | X | X |
| 14. Review legal matters with counsel | * | * | * | X |
| 15. Prepare report to shareholders | | | | X |
| 16. Perform other activities as appropriate | * | * | * | * |
| 17. Maintain minutes and report to Board | X | X | X | X |

X= Recommended timing

*= As needed

DOWNEY FINANCIAL CORP.
ANNUAL MEETING OF SHAREHOLDERS - APRIL 27, 2005
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned shareholder of Downey Financial Corp. ("Downey") hereby nominates, constitutes and appoints Brent McQuarrie and Cheryl E. Olson, and each of them, the attorney, agent and proxy of the shareholder, with full power of substitution, to vote all stock of the Downey which the shareholder is entitled to vote at the Annual Meeting of Shareholders of Downey (the "Annual Meeting") to be held at the Irvine Marriott, 18000 Von Karman Avenue, Irvine, California, on April 27, 2005 at 10:00 a.m., local time, and any adjournments thereof, as fully and with the same force and effect as the shareholder might or could do if personally thereat, as follows:

This proxy will be voted "FOR" the election of all three director nominees and "FOR" the ratification of the appointment of KPMG LLP as auditor for the year 2005 unless authority to do so is withheld.

(Continued and to be signed on the reverse side)

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ANNUAL MEETING OF SHAREHOLDERS OF
DOWNEY FINANCIAL CORP.

April 27, 2005

Please date, sign and mail
your proxy card in the
envelope provided as soon
as possible.

Please detach along perforated line and mail in the envelope provided.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE OF "FOR" THE ELECTION OF DIRECTORS AND "FOR" PROPOSAL 2.

PLEASE SIGN, DATE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE. PLEASE MARK YOUR

VOTE IN BLUE OR BLACK INK AS SHOWN HERE x

FOR AGAINST ABSTAIN

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

..

NOMINEES:

.. FOR ALL NOMINEES ;Gerald E. Finnell
 ;Maurice L. McAlister
.. WITHHOLD AUTHORITY ;Daniel D. Rosenthal
FOR ALL NOMINEES

3. **OTHER BUSINESS.** In their discretion, the proxyholders are authorized to transact such other business as may properly come before the Annual Meeting and any adjournment or adjournments thereof.

.. FOR ALL
EXCEPT
(See
instructions
below)

THE BOARD OF DIRECTORS RECOMMENDS A VOTE OF "FOR" THE ELECTION OF EACH OF THE NOMINEES LISTED AT LEFT AND "FOR" PROPOSAL 2. ALL PROPOSALS TO BE ACTED UPON ARE PROPOSALS OF DOWNEY. IF ANY OTHER BUSINESS IS PRESENTED AT THE MEETING, THIS PROXY SHALL BE VOTED BY THE PROXYHOLDERS IN ACCORDANCE WITH THE RECOMMENDATIONS OF A MAJORITY OF THE BOARD OF DIRECTORS.

The undersigned shareholder hereby ratifies and confirms that Brent McQuarrie, Cheryl E. Olson and/or their substitutes, shall lawfully act in accordance with this proxy by virtue hereof, and hereby revokes all proxies heretofore given by the shareholder to vote at the Annual Meeting. The shareholder hereby acknowledges receipt of the Notice of Annual Meeting and the Proxy Statement accompanying such notice.

INSTRUCTION:

To withhold authority to vote for any individual nominee(s), mark "**FOR ALL EXCEPT**" and fill in the circle next to each nominee you wish to withhold, as shown here: •

Please check here if you plan to attend the meeting. ..

To change the address on your account, please check the box at right and indicate your new address in the address space above. Please note that changes to the registered name(s) on the account may not be submitted via this method.

Signature of shareholder

Date:

Signature of

Shareholder

Date:

NOTE: Please sign exactly as your name or names appear on this Proxy. When shares are held jointly, each holder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If the signer is a partnership, please sign in partnership name by authorized person.

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