

The Honorable Richard A. Jones

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

IN RE: WSB FINANCIAL GROUP  
SECURITIES LITIGATION

Master File No. C07-1747RAJ

COMPLAINT – CLASS ACTION

**CONSOLIDATED CLASS ACTION  
COMPLAINT FOR VIOLATIONS OF  
THE FEDERAL SECURITIES LAWS**

CONSOLIDATED CLASS ACTION  
COMPLAINT  
Master File No. C07-1747RAJ

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1     I.     NATURE OF THE ACTION

2           1.     Court-appointed Lead Plaintiff, the Police and Fire Retirement System for the  
3     City of Detroit (“Detroit P&F” or “Lead Plaintiff”), brings this federal securities law class action  
4     on behalf of itself and all other persons and entities who purchased or acquired the common  
5     stock of WSB Financial Group, Inc. (“WSB Financial” or the “Company”) pursuant to or  
6     traceable to the Company’s Registration Statement and Prospectus issued in connection with the  
7     initial public offering of WSB Financial common stock completed on December 21, 2006 (the  
8     “IPO”).

9           2.     WSB Financial is a bank holding company. The Company’s wholly-owned  
10    subsidiary is Westsound Bank, a Washington commercial bank. According to the Company’s  
11    Registration Statement, WSB Financial has a sales-based delivery model focused primarily on  
12    real estate lending products. The Company has seven full service branches and three loan  
13    production offices located primarily in the west Puget Sound area. As of September 30, 2006,  
14    approximately 93.6% of the Company’s loans related to the construction or development,  
15    purchase, improvement or refinancing of commercial and residential real estate.

16          3.     On or about August 31, 2006, WSB Financial took the first steps towards the  
17    Company’s initial public offering of its common stock, filing an S-1 Registration Statement with  
18    the Securities and Exchange Commission (“SEC”). On December 8, 2006, WSB Financial filed  
19    its final amendment to the Registration Statement, which became effective on December 12,  
20    2006. On December 15, 2006, WSB Financial filed with the SEC and released to the public a  
21    Prospectus covering the sale of 2.3 million shares of common stock by WSB Financial. On  
22    December 21, 2006, the Company announced the completion of its IPO of 2,645,000 shares of  
23    common stock at a price of \$16.50, including 345,000 shares pursuant to the exercise in full of  
24    the underwriter’s over-allotment option. WSB Financial received net proceeds of approximately  
25    \$40.5 million in the offering. WSB Financial’s initial public offering was registered with the  
26    SEC, and was made pursuant to a formal registration statement and prospectus.

1           4.     The Registration Statement and Prospectus issued by WSB Financial in  
2 connection with its initial public offering was materially false and misleading, and materially  
3 overstated the Company's financial results in violation of Generally Accepted Accounting  
4 Principles ("GAAP"). Specifically, as detailed herein, the Registration Statement and Prospectus  
5 falsely stated that WSB Financial was in compliance with all relevant laws and regulations when,  
6 in reality, the Company was operating in violation of banking laws and regulations in the  
7 origination, administration, and monitoring of construction and mortgage loans. The  
8 Registration Statement and Prospectus also falsely stated that the Company focused on  
9 originating and maintaining a high-quality loan portfolio and had rigid underwriting policies  
10 designed to ensure the credit quality of the Company's portfolio. In reality, however, WSB  
11 Financial originated hundreds of high-risk loans in violation of the Company's stated policies for  
12 a total amount of at least \$90 million.

13           5.     As a result of these violations of banking laws and regulations and the  
14 originations of high-risk construction loans to individuals with no stated documentation of their  
15 ability to repay the loans absent an exit strategy, the Company's financial statements (which  
16 were repeated in the Registration Statement and Prospectus) materially understated the  
17 Company's loan loss reserves in violation of Generally Accepted Accounting Principles  
18 ("GAAP").

19           6.     On October 23, 2007, after the markets closed, WSB Financial issued a press  
20 release informing investors that "certain deficiencies in our origination, administration and  
21 servicing of certain lending products were identified." The Company further revealed that  
22 regulators from the Federal Deposit Insurance Corporation ("FDIC") and Washington  
23 Department of Financial Institutions ("WDFI") had determined that WSB Financial "violated  
24 certain banking laws and regulations which or primarily related to the origination, administration  
25 and monitoring of construction and mortgage loans," and that "due to the recommendations of  
26 our bank regulators, it is likely that we will be adding to our reserves."  
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1           7. Defendants, as the officers and directors of WSB Financial, and various other  
2 parties who participated in the Company's IPO, are strictly liable for these misstatements under  
3 the Securities Act of 1933 ("Securities Act").

4       II. JURISDICTION AND VENUE

5           8. This Court has jurisdiction over the subject matter of this action pursuant to  
6 Section 22 of the Securities Act, 15 U.S.C. § 77v. The claims alleged herein arise under Sections  
7 11, 12(a)(2) and 15 of the Securities Act.

8           9. Venue is proper in this District pursuant to Section 22 of the Securities Act,  
9 15 U.S.C. § 77v, and 28 U.S.C. § 1331. At all relevant times, WSB Financial maintained its  
10 headquarters and principal place of business in this District at 607 Pacific Avenue, Bremerton,  
11 Washington. Many of the acts and transactions giving rise to the violations of law complained of  
12 herein, including the preparation and dissemination to the investing public of materially false and  
13 misleading statements, including the materially false and misleading Registration Statement and  
14 Prospectus, occurred in this District. In addition, WSB Financial is incorporated in the State of  
15 Washington.

16          10. In connection with the acts alleged in the Complaint, defendants, directly or  
17 indirectly, used the means and instrumentalities of interstate commerce, including, but not  
18 limited to, the United States mails, interstate telephone communications and the facilities of  
19 national securities exchanges.

20       III. THE PARTIES

21           A. Lead Plaintiff

22          11. Court-appointed Lead Plaintiff Detroit P&F is a public pension fund system  
23 located in Detroit, Michigan, which was formed for the benefit of the current and retired police  
24 and fire personnel of the City of Detroit. Detroit P&F purchased shares of WSB Financial  
25 common stock both pursuant to and traceable to the Registration Statement and Prospectus  
26 issued in connection with the IPO of WSB Financial common stock on December 14, 2006, as  
27 detailed in Detroit P&F's certification filed with the Court on January 2, 2008 in support of its  
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1 motion to be appointed Lead Plaintiff. As a result of the unlawful conduct alleged herein,  
2 Detroit P&F suffered damages in connection with its purchases of WSB Financial common  
3 stock.

4 B. Defendants

5 12. WSB Financial is a bank holding company formed in 2005. WSB Financial's  
6 wholly-owned subsidiary, Westsound Bank, is a Washington commercial bank that provides  
7 commercial banking services to real estate developers, contractors, and small to medium-sized  
8 businesses in Washington. Westsound Bank opened for business in March 1999 and was  
9 privately held until the Company's IPO completed on December 21, 2006. The Company's  
10 lending activities comprise commercial and residential real estate loans, construction and land  
11 development loans, commercial and industrial loans, and consumer loans. As of September 30,  
12 2006, WSB Financial operated seven full service branches and three loan production offices  
13 located primarily in the west Puget Sound area.

14 13. Defendant D.A. Davidson & Co. ("D.A. Davidson") was the sole underwriter for  
15 WSB Financial's IPO. D.A. Davidson is a broker-dealer registered with the SEC and is a  
16 member of various exchanges and the National Association of Securities Dealers, Inc. D.A.  
17 Davidson is a Montana corporation that is a wholly-owned subsidiary of Davidson Companies.  
18 D.A. Davidson acted as financial advisor to WSB Financial in connection with the IPO, assisting  
19 in the drafting and dissemination of the Registration Statement and Prospectus. D.A. Davidson,  
20 as the sole underwriter for the IPO, sold and distributed 2,300,000 shares of WSB Financial  
21 common stock to the investing public pursuant to the Registration Statement and Prospectus and  
22 had the option to purchase an additional 345,000 shares to cover over-allotments, which it  
23 exercised in full. D.A. Davidson, by virtue of its role in underwriting the IPO, was responsible  
24 for ensuring the truth and accuracy of the various statements contained in the Registration  
25 Statement and Prospectus filed in connection with WSB Financial's IPO.

26 14. Defendant David K. Johnson ("Johnson") was the President, Chief Executive  
27 Officer and a Director of WSB Financial and Westsound Bank. Johnson was President and CEO  
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1 of Westsound Bank from April 2001 until his resignation on March 7, 2008. Johnson signed the  
2 Registration Statement filed in connection with the December 21, 2006 IPO.

3 15. Defendant Mark Freeman (“Freeman”) is the Executive Vice President of Finance  
4 and Operations and Chief Financial Officer (“CFO”) of WSB Financial and Westsound Bank.  
5 On March 7, 2008, Freeman was named the Company’s interim President and Chief Executive  
6 Officer. Freeman signed the Registration Statement filed in connection with the December 21,  
7 2006 IPO.

8 16. Defendant Richard N. Christopherson (“Christopherson”) is a Director of WSB  
9 Financial and Westsound Bank. Christopherson signed the Registration Statement filed in  
10 connection with the December 21, 2006 IPO.

11 17. Defendant James H. Lamb (“Lamb”) is a Director of WSB Financial and  
12 Westsound Bank. Lamb signed the Registration Statement filed in connection with the  
13 December 21, 2006 IPO.

14 18. Defendant Brian B. McLellan (“McLellan”) is a Director of WSB Financial and  
15 Westsound Bank. McLellan signed the Registration Statement filed in connection with the  
16 December 21, 2006 IPO.

17 19. Defendant Dean Reynolds (“Reynolds”) is a Director of WSB Financial and  
18 Westsound Bank. Reynolds signed the Registration Statement filed in connection with the  
19 December 21, 2006 IPO.

20 20. Defendant Donald H. Tucker (“Tucker”) is a Director of WSB Financial and  
21 Westsound Bank. Tucker signed the Registration Statement filed in connection with the  
22 December 21, 2006 IPO.

23 21. Defendant Louis J. Weir (“Weir”) is a Director and Chairman of the Board of  
24 WSB Financial and Westsound Bank. Weir signed the Registration Statement filed in  
25 connection with the December 21, 2006 IPO.  
26  
27  
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22. Defendant Larry C. Westfall (“Westfall”) is a Director and Vice Chairman of the Board of WSB Financial and Westsound Bank. Westfall signed the Registration Statement filed in connection with the December 21, 2006 IPO.

23. Each of the defendants in ¶¶14-22 (collectively the “Individual Defendants”), by virtue of their position as an officer and/or director of WSB Financial and their signing of the Registration Statement filed in connection with the December 21, 2006 IPO, was responsible for ensuring the truth and accuracy of the various statements contained in the Company’s Registration Statement.

#### IV. CLASS ACTION ALLEGATIONS

24. Lead Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of all persons and entities who purchased the common stock of WSB Financial pursuant to or traceable to the Company’s Registration Statement issued in connection with WSB Financial’s initial public offering and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

25. The members of the Class are so numerous that joinder of all members is impracticable. WSB Financial was actively traded on the NASDAQ National Market under the ticker symbol WSFG. While the exact number of Class members is unknown to Lead Plaintiff at this time and can only be ascertained through appropriate discovery, Lead Plaintiff believes that there are hundreds or thousands of members in the proposed Class. WSB Financial registered and sold 2,645,000 shares of common stock in the IPO. Record owners and other members of the Class may be identified from records maintained by WSB Financial or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.



1           26.     Lead Plaintiff's claims are typical of the claims of the members of the Class as all  
2 members of the Class are similarly affected by defendants' conduct in violation of federal law  
3 that is complained of herein.

4           27.     Lead Plaintiff will fairly and adequately protect the interests of the members of  
5 the Class and have retained counsel competent and experienced in class and securities litigation.

6           28.     Common questions of law and fact exist as to all members of the Class and  
7 predominate over any questions solely affecting individual members of the Class. Among the  
8 questions of law and fact common to the Class are:

9                   (a)     whether the federal securities laws were violated by defendants' acts as  
10 alleged herein;

11                   (b)     whether statements made by defendants to the investing public in the  
12 Registration Statement and Prospectus misrepresented material facts about the business,  
13 operations, management and financial condition of WSB Financial; and

14                   (c)     to what extent the members of the Class have sustained damages and the  
15 proper measure of damages.

16           29.     A class action is superior to all other available methods for the fair and efficient  
17 adjudication of this controversy since joinder of all members is impracticable. Furthermore, as  
18 the damages suffered by individual Class members may be relatively small, the expense and  
19 burden of individual litigation make it impossible for members of the Class to individually  
20 redress the wrongs done to them. There will be no difficulty in the management of this action as  
21 a class action.

22   V.     FACTUAL ALLEGATIONS

23       A.     General Background

24           30.     WSB Financial is a bank holding company headquartered in Bremerton,  
25 Washington. As of September 30, 2006, WSB Financial operated through seven full service  
26 branches and three loan production offices located primarily in the west Puget Sound area. As of  
27 September 30, 2006, WSB Financial had total assets of \$338.1 million, net loans of \$306.1

1 million, and total deposits of \$308.1 million. As of September 30, 2006, WSB Financial's  
2 provision for loan losses was \$1.3 million.

3 31. WSB Financial's wholly-owned subsidiary, Westsound Bank, is a Washington  
4 commercial bank that was opened for business in March 1999. WSB Financial was formed in  
5 2005.

6 B. WSB Financial's Loan Approval Process

7 32. According to the Registration Statement, WSB Financial's stated policy was that  
8 all loans over \$100,000 must be approved by the Company's Loan Committee, which includes  
9 the chief executive officer and four directors. The Registration Statement also states that WSB  
10 Financial's loan approval process was highly collaborative, with the Loan Committee taking an  
11 active role in the structuring and pricing of loans. The maturities for WSB Financial's  
12 construction loans generally ranged from 6 to 18 months for residential property.

13 33. Confidential Witness #1 ("CW#1"), a senior underwriter manager at WSB  
14 Financial from December 2003 to February 2006, confirmed that while she was with WSB  
15 Financial, the Board of Directors reviewed every construction loan. CW#1 stated that there was  
16 no underwriter assigned to the construction loans, which were underwritten and reviewed by the  
17 Board of Directors, who met weekly at WSB Financial's Silverdale branch location.

18 34. Confidential Witness #2 ("CW#2"), an underwriter at WSB Financial from  
19 February 2005 to October 2007, stated that while she was employed at the Company, she was the  
20 only underwriter and did not underwrite any loans for "spec homes" – homes in which the  
21 builder builds the home to sell the property. All "spec home" loans went straight to the Board of  
22 Directors for approval. CW#2 also confirmed that the majority of WSB Financial's construction  
23 loans matured after one year.

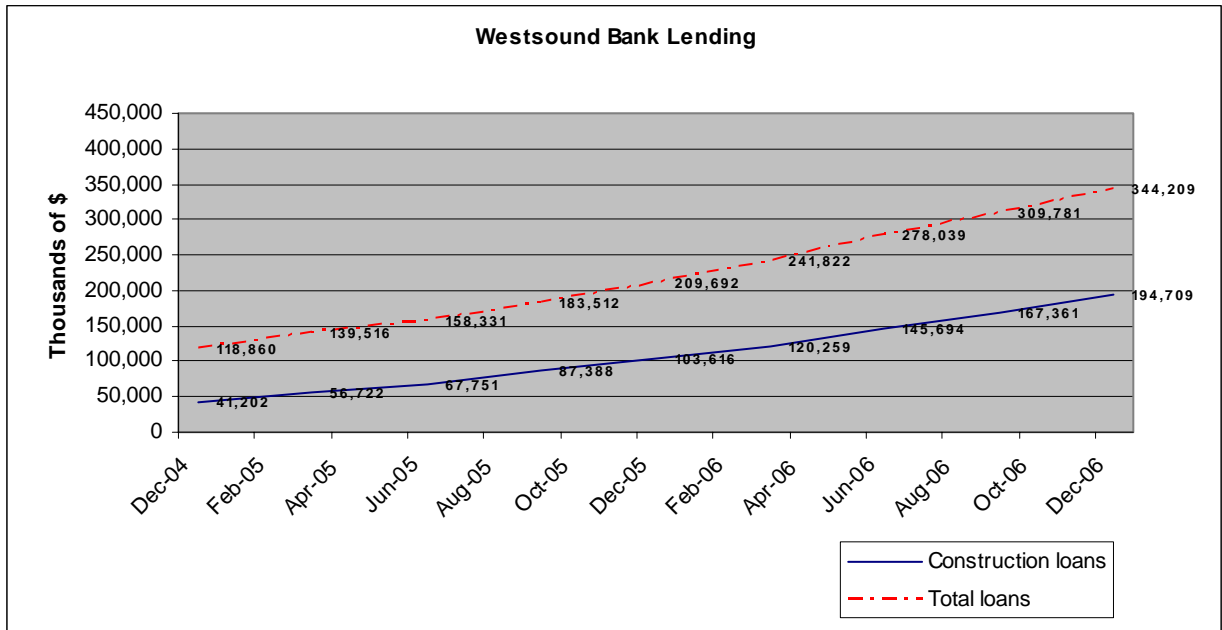
24 35. Confidential Witness #3 ("CW#3"), the branch manager at the Gig Harbor branch  
25 and Operations Officer from August 2005 through June 2007, also confirmed that these  
26 construction loans had to go through the Loan Committee for approval. The Loan Committee  
27

1 consisted of Defendant David Johnson, Brett Green, Executive Vice President of Sales and  
2 Lending, and certain Directors.

3 C. WSB Financial's Drastic Increase In Construction Loans

4 36. According to financial data published by the FDIC, from December 31, 2001 to  
5 June 30, 2006, WSB Financial was the fastest growing bank in the Pacific Northwest, based on  
6 percentage annual growth rates of assets for banks formed in 1999 or earlier. Between  
7 December 31, 2001 and June 30, 2006, WSB Financial increased assets by \$269 million. In  
8 particular, from December 31, 2001 to September 30, 2006, WSB Financial increased total assets  
9 from \$32.5 million to \$338.1 million, increased total net loans from \$25.3 million to \$306.1  
10 million, and increased total deposits from \$28.1 million to \$308.1 million.

11 37. Beginning in 2004, WSB Financial dramatically increased its loan portfolio.  
12 WSB Financial's drastic increase was a result of the Company's increase in construction loans.  
13 FDIC call reports for WSB Financial show explosive growth in construction lending between  
14 June 2005 and the Company's IPO in December 2006. As of June 2005, WSB had \$67.75  
15 million of construction loans. By December 2005, the total was \$103.6 million. By June 2006,  
16 construction lending was \$145.7 million. Finally, in December 2006, the month of the  
17 Company's IPO, WSB's construction loans reached \$194.7 million – an almost 200% increase in  
18 only 18 months. The following chart demonstrates the increased loan portfolio and WSB  
19 Financial's construction loans in relation to the Company's total loans in the periods leading up  
20 to the Company's IPO:



38. During this period of explosive growth leading up to the Company's IPO, defendants originated loans to borrowers based on stated income and did not obtain or require the necessary supporting documentation from the borrowers. Maturities for WSB Financial's construction loans generally ranged from 6 to 18 months for residential property and from 12 to 24 months for non-residential and multifamily properties. These loans were intended to be owner occupied – *i.e.*, for persons who wanted to build their own house and then live in it, and were intended to be replaced by longer-term financing once construction had been completed.

39. Prior to April 2007, the Company did not verify the incomes of many of the people who obtained construction loans. Rather, WSB Financial approved these construction loans on "stated income," without independent verification of the borrower's ability to repay the loan.

40. Stated-income loans are higher risk loans, do not require the borrower to prove his or her income, and anticipate an exit strategy for the loan – either selling the loan on the secondary market or the borrower obtaining a stated income loan once construction is complete that pays off the construction loan. In the Spring of 2007, however, most nationwide banks, including Countrywide, stopped buying or originating stated-income loans. Thus, WSB

1 Financial's stated income construction borrowers had no exit strategy. Even if they managed to  
2 finish construction on their homes, they had no way of getting a regular mortgage to "take out"  
3 the construction loan.

4 41. To make matters even worse for purchasers of WSB Financial stock in the IPO,  
5 most of the borrowers lied about their intent to live in the home after it was constructed. In  
6 reality, these homes were being built by tradesmen who intended to sell the properties as soon as  
7 they completed construction. As the FDIC call reports confirm, the majority of these borrowers  
8 were electricians, plumbers and carpenters who had no ability to make regular mortgage  
9 payments on the properties once construction was completed. The FDIC call reports also  
10 confirm that it was common for WSB Financial to originate construction loans to these  
11 borrowers on two properties on the same day. In other cases, WSB Financial approved and  
12 underwrote new owner occupied construction loans just a few months after approving and  
13 underwriting a first loan to the same borrower.

14 42. Former employees of WSB Financial confirm the Company's origination of  
15 high-end construction loans to numerous individuals with connections to a single contractor and  
16 no ability to independently finance the repayment of the construction loans. For example, CW#2  
17 stated that the majority of WSB Financial's high-end construction loans were originated by one  
18 loan officer in the Federal Way branch (the "Federal Way Loan Officer"). When applying for a  
19 construction loan, the borrower has to list the builder for the property. Ninety percent (90%) of  
20 the Federal Way Loan Officer's construction loans were originated for borrowers utilizing the  
21 same contractor. In addition, these borrowers had connections to this contractor and were  
22 employed in the construction trade industry. CW#2 stated that ninety percent (90%) of these  
23 high-end construction loans were stated income loans. According to CW#2, the Federal Way  
24 Loan Officer began originating these loans in early to mid-2006.

25 43. According to CW#2, the contractor used on ninety percent (90%) of the Federal  
26 Way Loan Officer's construction loans were two brothers who owned two construction  
27 companies. The brothers, in turn, would sub-contract all of the work on the project to their  
28

1 friends, who were all in the various construction trades. The brothers also had loans with WSB  
2 Financial, a personal (owner occupied) loan, an investment loan, and a “spec home” loan.

3 44. CW#2 started to question these owner occupied construction loans when she  
4 found that the same borrower was trying to get a second primary loan a year after the first.  
5 CW#2 recalled numerous construction loans from the Federal Way Loan Officer for borrowers  
6 with the same last name, but seven different first names.

7 45. CW#2 believed that the bank worked closely with the Federal Way Loan Officer  
8 on these high-end loans. CW#2 said that the stated income had to be “reasonably beyond” what  
9 the borrower made and that there had to be some justification for the salary.

10 46. CW#3, the branch manager at the Gig Harbor branch, and Operations Officer  
11 from August 2005 through June 2007, was responsible for opening checking accounts for WSB  
12 Financial’s construction loans. CW#3 confirmed that a large number of these construction loans  
13 were made to young individuals, barely in their 30s, working in the construction trade industry.  
14 The construction loans ranged from \$700,000 to \$1 million, despite the fact that most of the  
15 borrowers’ employers were trucking companies and other companies in similar construction  
16 trade industries.

17 47. The Federal Way branch did not open for regular banking business until  
18 January 22, 2007, therefore, the Gig Harbor branch had to open all of the draw accounts and  
19 checking accounts for the loans originated at the Federal Way branch, including the large volume  
20 of construction loans being originated by the Federal Way Loan Officer. The loan officer would  
21 fax over the account information, new account forms, and IDs from Federal Way to Gig Harbor.  
22 Gig Harbor would then open up the accounts without the customer coming into the branch. Gig  
23 Harbor faxed the signature cards to Federal Way, which would then interoffice the cards with  
24 signatures back to Gig Harbor. CW#3 recalled opening unprecedented numbers of these  
25 high-end construction loans from the Federal Way Loan Officer – sometimes two to three  
26 accounts a day. All of the construction loans that CW#3 handled were brought in by the Federal  
27 Way Loan Officer. According to CW#3, the Federal Way Loan Officer had a hand in all of the  
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1 loans with connections to this same contractor and knew all of them. The Federal Way Loan  
2 Officer was the “go-to person” for the group, and they all went through her for their construction  
3 loans.

4 48. Defendants failed to insure that the Company originated loans that complied with  
5 its stated underwriting standards. Indeed, as detailed above, the Company originated many  
6 construction loans that were not high quality, did not demonstrate the borrower’s proven cash  
7 flow to service the debt, and were not in compliance with the Company’s underwriting policies.

8 D. WSB Commences IPO

9 49. On August 31, 2006, WSB Financial filed an S-1 Registration Statement with the  
10 SEC as the first step towards the Company’s initial public offering. On December 8, 2006, WSB  
11 Financial filed its fifth and final amendment to the Registration Statement, which became  
12 effective on December 12, 2006. On December 15, 2006, WSB Financial filed with the SEC and  
13 released to the public a Prospectus covering the sale of 2.3 million shares of common stock by  
14 WSB Financial. On December 21, 2006, the Company announced the completion of its IPO of  
15 2,645,000 shares of common stock at a price of \$16.50, including 345,000 shares pursuant to the  
16 exercise in full of the underwriter’s over-allotment option. WSB Financial received net proceeds  
17 of approximately \$40.5 million in the IPO. WSB Financial’s IPO was registered with the SEC,  
18 and was made pursuant to a formal registration statement and prospectus.

19 E. WDFI’s Regular Review In Spring 2007  
20 Identifies Violations Of Banking Laws

21 50. According to the Registration Statement, WSB Financial is “regularly reviewed  
22 by the Federal Reserve, the FDIC, and the Washington Department of Financial Institutions,  
23 Division of Banks, or DFI, during which reviews such agencies assess our compliance with  
24 applicable laws and regulations.” During these regular reviews, the regulators typically look at,  
25 among others, the particular bank’s capital, asset quality and a sampling of the loan portfolio.  
26 The WDFI conducted a regular review of WSB Financial in the Spring of 2007.

1           51. During its regular review of WSB Financial in the Spring of 2007, the WDFI  
2 identified hundreds of high-end home construction loans for which WSB Financial had not  
3 obtained proper stated income determination. Defendant Johnson later admitted that in response  
4 to the WDFI's investigation in the Spring of 2007, the Company "immediately" stopped making  
5 "stated income" loans and had not made any such loans since April 2007.

6           F. The Truth Starts To Emerge

7           52. On September 21, 2007, after the markets closed, WSB Financial announced in a  
8 press release that "due to a reduction in mortgage demand, and the uncertainty and elimination of  
9 various secondary marketing conduits, it is eliminating 33 jobs in its mortgage division. Jobs in  
10 administration, origination, production and servicing are affected." WSB Financial also  
11 announced that "Brett Green, Executive Vice President of Sales and Lending, is leaving the  
12 company to pursue the formation of an independent mortgage lending operation."

13           53. On September 22, 2007, the Kitsap Business Journal ran an article reporting on  
14 WSB Financial's announcement of 33 layoffs. The Business Journal article reported that:

15                   When the word hit the street about the layoffs - the day before the  
16                   official announcement - the rumor mill went into high gear. There  
17                   were rumors that federal auditors were looking into the bank's  
18                   operations. Johnson refused to answer questions about that, other  
19                   than to say, "The FDIC can come in and look at our books any  
20                   time they want." He declined to confirm or deny whether or not  
21                   they had been there more than once this year. He also was closed  
22                   mouthed on the subject of the rumor that some kind of fraud was  
23                   being investigated. "As the CEO of a publicly traded company, I  
24                   have to be careful about what I can and can't say," Johnson stated.

25           54. On this news, WSB Financial's stock fell \$2.90 per share in a single day, closing  
26 at \$12.40 on September 22, 2007.

27           55. On October 23, 2007, after the markets closed, WSB Financial issued a press  
28 release informing investors that the bank's regulators had identified "certain deficiencies in our  
origination, administration and servicing of certain lending products." The Company further  
revealed that "due to the recommendations of our bank regulators, it is likely that we will be  
adding to our reserves." The Company's Form 8-K, filed that same day, admitted that regulators



1 from the FDIC and WDFI had determined that WSB Financial “violated certain banking laws  
2 and regulations which are primarily related to the origination, administration and monitoring of  
3 construction and mortgage loans.” Lastly, the Company revealed that it “has been cooperating in  
4 an investigation by the regulators pertaining to certain past activities involving former employees  
5 and third parties, including possible fraud, misconduct and other violations with respect to the  
6 application, processing and approval of certain loans previously made.”

7 56. WSB Financial’s stock plummeted over the next two trading days, from a closing  
8 price of \$11.56 per share on October 23, 2007, to a closing price of \$4.73 per share on  
9 October 25, 2007.

10 57. On October 29, 2007, the Company held a conference call with analysts to discuss  
11 the regulatory investigation. Among other things, the Company publicly revealed for the first  
12 time that in the Spring of 2007, the WDFI had identified a number of high-end home  
13 construction loans for which WSB Financial had not obtained proper stated income  
14 determination. Defendant Johnson stated that WSB Financial had been selling these improperly  
15 documented loans on the secondary market, but since the secondary market had “dried up,” these  
16 improperly documented loans would remain on WSB Financial’s books. With respect to the  
17 regulatory investigation, Defendant Johnson admitted that there were at least 146 improper loans  
18 made by WSB Financial for a total amount of at least \$90 million. Defendant Johnson further  
19 stated that in response to the WDFI’s investigation in the Spring of 2007, the Company  
20 “immediately” stopped making “stated income documentation” loans and had not made any such  
21 loans since April 2007.

22 58. The Company further revealed:

23 Most of the loans in question are for high-end custom construction  
24 homes to owner occupants, who in many cases are acting as their  
25 own general contractor. Many of the borrowers are in the  
26 construction trades. While the borrowers indicated that their  
27 intentions were to live in the homes once they were completed, *on*  
*closer review*, we felt it was unlikely in many cases that the  
28 borrowers could service the long-term loans on the properties and  
that these loans were really more of a spec situation where they  
would sell the home as quickly as possible. And most, if not all of

1           these particular loans were made by the single loan officer who is  
2           no longer with the bank.

3           59.     CW#2 believes the majority of the 146 impaired loans indentified by the  
4     Company in October 2007 were first originated a year earlier. CW#2 also believes that ninety-  
5     eight percent (98%), if not all, of the 146 impaired loans involved the two brothers' building  
6     companies.

7           60.     CW#2 further confirmed that the Federal Way Loan Officer, her assistant and one  
8     of the brothers from the construction company were the former employees and third parties being  
9     investigated by the FDIC and WDFI.

10          61.     On February 1, 2008, WSB Financial filed its quarterly report on Form 10-Q for  
11     the period ended September 30, 2007 with the SEC. WSB Financial's unaudited 3Q 07 10-Q  
12     included a \$13.3 million increase in loan loss reserves. Specifically, the Company's 10-Q stated:  
13     "The Company's provision for loan losses, levels of non-performing loans and OREO property,  
14     allowance for loan losses, levels of impaired loans and non-accrual loans increased significantly  
15     in the quarter ended September 30, 2007, primarily as a result of the reassessment of the  
16     Company's real estate loan portfolio in light of recent deterioration in the local housing market,  
17     the current problems in the mortgage banking and lending market and the issues we have  
18     identified with respect to certain residential construction loans, as well as some commercial real  
19     estate, C&I and other loans."

20          62.     On February 14, 2008, the Federal Reserve Bank of San Francisco notified WSB  
21     Financial that it had designated the Company to be in a "troubled condition" for purposes of  
22     Section 914 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

23           G.     WSB Financial Stipulates To A Cease And Desist Order

24          63.     On March 10, 2008, WSB Financial entered into a Stipulation and Consent to the  
25     Issuance of an Order to Cease and Desist with the FDIC and the WDFI. As a result of their  
26     review of WSB Financial in the Spring 2007, the FDIC and WDFI determined that WSB  
27     Financial "had engaged in unsafe or unsound banking practices," by (i) engaging in

1 unsatisfactory lending and collection practices; (ii) operating with inadequate management and  
2 board supervision, with less than satisfactory capital in relation to its large volume of poor  
3 quality loans and with an inadequate loan valuation reserve, and with inadequate provision for  
4 liquidity, inadequate internal routine and control policies; and (iii) was in violation of various  
5 banking laws and regulations relating to internal audits and controls, real estate appraisal and  
6 lending guidelines, and responsibilities of bank directors and officers.

7 64. The Cease and Desist Order requires WSB Financial to cease and desist from the  
8 following unsafe and unsound banking practices, among others:

9 (a) operating with management whose policies and practices are  
10 detrimental to the bank and jeopardize the safety of its deposits;

11 (b) operating with a board of directors which has failed to provide  
12 adequate supervision over and direction to the active management of the  
13 bank;

14 (c) operating with less than satisfactory capital in relation to the kind  
15 and quality of assets held by the bank;

16 (d) operating with an inadequate loan valuation reserve;

17 (e) operating with a large volume of poor quality loans;

18 (f) engaging in unsatisfactory lending and collection practices;

19 (g) operating in such a manner as to produce operating losses;

20 (h) operating in such a manner as to produce low earnings;

21 (i) operating with inadequate provisions for liquidity; and

22 (j) operating with inadequate internal routine and controls policies.

23 65. In addition, the Cease and Desist Order requires WSB Financial, within 60 days,  
24 to “revise, adopt, and implement written lending and collection policies and practices to provide  
25 effective guidance and control over the Bank’s lending function.”

26 66. The Cease and Desist Order mandates that within 30 days from the effective date  
27 of the Order, WSB Financial “increase its allowance for loan and lease losses as of third quarter  
28

2007 by \$13,300,000 and thereafter maintain its allowance for loan and lease losses at an adequate level.” Also within 45 days from the effective date of the Order, WSB Financial’s Board:

shall develop or revise, adopt and implement a comprehensive policy for determining the adequacy of the allowance for loans and lease losses. For the purpose of this determination, the adequacy of the reserve shall be determined after the charge-off of all loans or other items classified “Loss.” The policy shall provide for a review of the allowance at least once each calendar quarter. Said review should be completed at least ten (10) days prior to the end of each quarter, in order that the findings of the Bank’s Board with respect to the loan and lease loss allowance may be properly reported in the quarterly Reports of Condition and Income. The review should focus on the results of the Bank’s internal loan review, loan loss experience, trends of delinquent and nonaccrual loans, an estimate of potential loss exposure of significant credits, concentrations of credit, and present and prospective economic conditions.

67. The Cease and Desist Order further directs WSB Financial to:

[r]equire complete loan documentation for all loan originations, renewals, and extensions including establishing realistic repayment terms, and an analysis of current credit information adequate to support the outstanding or proposed indebtedness of the borrower. Such documentation shall include current financial information on borrowers and guarantors including profit and loss statements, copies of signed tax returns, cash flow projections . . . . Personal income shall be supported by verified signed tax returns or wage statements. In addition, management shall establish an accurate tickler system to ensure updated financial information and insurance is obtained as required by loan documents.

H. WSB Files Its 2007 10-K Admitting Lack Of Internal Controls And Violations Of Underwriting Policies

68. On March 31, 2008, WSB Financial filed its Form 10-K for the year ended December 31, 2007. In its Form 10-K, the Company made several admissions. With respect to the FDIC and WDFI investigation and the Cease and Desist Order, WSB Financial admitted:

our regulators found that the Bank had failed to adhere to these credit policies in certain respects resulting in significant provisioning to our allowance for loan loss. ***Specifically, internal routine policies and procedures were not followed resulting in violation of various banking laws and regulations relating to internal audits and controls, real estate appraisal and lending guidelines, and responsibilities of bank directors and officers.***

69. Further, the Form 10-K admits that the regulators:

identified deficiencies within credit administration in connection with a lack of sufficient or adequate policies, procedures, and control with respect to the underwriting, documentation and monitoring of loans, the detection of risks related to the concentration and other risks associated with the residential construction and other loans, the determination of our provision for loan losses and possible violations or contraventions of law.

70. In addition, based on management's review of the FDIC Cease and Desist Order and "their findings of control deficiencies that constituted material weakness in connection with a lack of sufficient or adequate policies, procedures, and controls with respect to the underwriting, documentation, and monitoring of loans, the detection of risks related to the concentration and other risks associated with the residential construction and other loans, and the determination of our provision for loan losses and related allowance for loan losses," that as of December 31, 2007, the Company's internal control over financial reporting was "not effective."

VI. THE FALSE AND MISLEADING STATEMENTS IN  
THE REGISTRATION STATEMENT AND PROSPECTUS

71. On August 31, 2006, in connection with the Company's IPO, WSB Financial filed with the SEC and released to the public a Registration Statement on the Form S-1 ("Registration Statement"). WSB Financial filed five amendments to the Registration Statement on October 11, 2006, November 1, 2006, November 14, 2006, November 27, 2006 and December 8, 2006. The Registration Statement covered the sale of up to 2,645,000 shares of WSB Financial common stock. On December 15, 2006, WSB Financial filed with the SEC and released to the public a Prospectus covering the sale of 2.3 million shares of common stock by WSB Financial at a price of \$16.50 per share. The Individual Defendants each signed the Registration Statement. The Registration Statement was declared effective on December 12, 2006. On December 21, 2006, WSB Financial completed its initial public offering of 2.645 million shares of its common stock at \$16.50 per share for proceeds of approximately \$40.5 million. Defendant D.A. Davidson served as the sole underwriter in the IPO.

72. The Registration Statement repeated the Company's year-end financial statements for years ended December 31, 2003, 2004 and 2005, and as of and for the nine-month periods ended September 30, 2006 and September 30, 2005. The Registration Statement also included summary consolidated financial data derived from the Company's year-end financial statements for years ended December 31, 2003, 2004 and 2005, summary consolidated balance sheet data as of December 31, 2004 and December 31, 2005, and summary consolidated financial data for the years ended December 31, 2001 and December 31, 2002. As of December 31, 2004, the Company's total assets were \$137.4 million and net loans were \$117.6 million. As of December 31, 2005, the Company's total assets were \$249.9 million and net loans were \$207.2 million. As of September 30, 2006, WSB Financial's total assets were \$338.1 million and net loans were \$306.1 million.

73. The Registration Statement, as amended, stated that "Since December 31, 2001, construction and development loans experienced the highest growth within our portfolio, growing from \$6.9 million to \$167.4 million at September 30, 2006."

74. The Registration Statement contained numerous false and misleading statements, including that the Company originated and maintained:

a high quality loan portfolio by employing focused credit analysts, applying disciplined underwriting standards, and benefiting from our directors' and officers' thorough knowledge of the markets we serve . . . Our loan approval process is highly collaborative, with the committee taking an active role in the structuring and pricing of loans . . .

75. In addition, the Registration Statement and Prospectus misleadingly and falsely assured investors that the Company had rigid underwriting policies designed to ensure the credit quality of the Company's portfolio:

Our risk management philosophy is to extend credit *only when an applicant has proven cash flow to service the proposed debt*. Additionally, it is generally necessary for the applicant to demonstrate an independent secondary source of repayment.

76. With respect to the Company's compliance with applicable laws and regulations, the Registration Statement contained the following false and misleading representation:

1 Based on the assessments of our outside compliance consultants  
2 and the FDIC, *we believe that we materially comply with all of the*  
3 *laws and regulations that apply to our operations.*

4 77. The Company either did not have, or defendants negligently disregarded, the  
5 Company's disclosure controls and procedures and other such internal controls over financial  
6 reporting, that resulted in the Company reporting false and misleading financial results.

7 78. The Registration Statement included false and misleading risk disclosures that  
8 failed to disclose that the Company had substantially deviated from its underwriting guidelines to  
9 dramatically increase its loan volume, particularly its construction loan volume, thereby making  
10 the risk disclosures misleading.

11 79. Further, GAAP required WSB Financial to establish a reserve for potential credit  
12 losses on the mortgage loans held for investment when the underlying borrowers default on their  
13 obligation to make monthly mortgage payments. This reserve is an allowance for loan losses or  
14 "ALLL." With respect to the Company's ALLL, WSB Financial made the following  
15 representation in the Registration Statement:

16 We maintain an ALLL based on a number of quantitative and  
17 qualitative factors, including levels and trends of past due and non-  
18 accrual loans, asset classifications, loan grades, change in volume  
19 and mix of loans, collateral value, historical loss experience, size  
20 and complexity of individual credits and economic conditions.  
21 Provisions for loan losses are provided on both a specific and  
22 general basis. Specific allowances are provided for impaired  
23 credits for which the expected/anticipated loss is measurable.  
24 General valuation allowances are based on a portfolio  
25 segmentation based on risk grading, with a further evaluation of  
26 various quantitative and qualitative factors noted above.

27 80. The Registration Statement included WSB Financial's false and misleading  
28 financial results that were false and/or misleading as a result of the Company's deviations from  
its underwriting policies and violations of banking laws and regulations, which resulted in the  
Company's failure to establish adequate ALLL.

81. Each of the representations referred to above in ¶¶74-80, was materially false and  
misleading, or omitted to state facts necessary to make the statements made, in light of the  
circumstances in which they were made, not misleading. Indeed, each of the above statements

1 were false and misleading because WSB Financial: (i) failed to disclose that its origination,  
2 administration and monitoring of its construction and mortgage loans violated applicable  
3 banking laws and regulations; (ii) operated with a large volume of poor quality loans; (iii) failed  
4 to disclose that the Company was in violation of banking laws and regulations; (iv) operated with  
5 inadequate internal routine and controls policies; (v) engaged in unsatisfactory lending and  
6 collection practices; (vi) operated with management whose policies and practices were  
7 detrimental to the bank and jeopardized the safety of its deposits; and (vii) as a result of these  
8 violations, WSB Financial underreserved its allowance for loan loss, as detailed in ¶¶88-100  
9 below.

10 82. None of the defendants made a reasonable investigation or possessed reasonable  
11 grounds for the belief that the statements contained in the Registration Statement and Prospectus  
12 were accurate and complete in all material respects. Had they exercised reasonable care,  
13 defendants could have known of the material misstatements and omissions alleged herein.

14 83. At all relevant times, as detailed above, the price of the Company's common  
15 stock was artificially inflated as a direct result of defendants' misrepresentations and omissions  
16 regarding the Company. When the truth about the Company was revealed to the market, the  
17 inflation that had been caused by defendants' misrepresentations and omissions was eliminated  
18 from the price of the Company's common stock, causing significant damages to Lead Plaintiff  
19 and other members of the Class.

20 84. The decline in WSB Financial's stock price following these revelations, and the  
21 resulting damages suffered by plaintiffs, are directly attributable to the market's reaction to the  
22 disclosure of information that had previously been misrepresented or omitted by defendants, and  
23 to the market's adjustment of the Company's stock price to reflect the newly emerging truth  
24 about the Company's condition. Had Lead Plaintiff and the other members of the Class known  
25 of the material adverse information not disclosed by defendants named herein, or been aware of  
26 the truth behind these defendants' material misstatements, they would not have purchased or  
27



1 acquired their WSB Financial common stock pursuant to or traceable to the IPO at the artificially  
2 inflated price.

3 A. WSB Financial's Origination, Administration And Monitoring  
4 Of Construction Loans Violated Applicable Banking Laws And  
5 Regulations And The Company's Stated Underwriting Policies

6 85. As detailed above, during their regular review in the Spring of 2007, regulators  
7 from the FDIC and WDFI found that WSB Financial "violated certain banking laws and  
8 regulations which or primarily related to the origination, administration and monitoring of  
9 construction and mortgage loans." In addition, during the Spring 2007 review, the WDFI  
10 identified a number of high-end home construction loans for which WSB Financial had not  
11 obtained proper stated income determination. Indeed, the Company has now admitted that with  
12 respect to the regulatory investigation conducted in the Spring 2007, WSB Financial originated  
13 at least 146 improper loans for a total amount of at least \$90 million.

14 86. In addition, as detailed above, on March 10, 2008, WSB Financial entered into a  
15 Stipulation and Consent to the Issuance of an Order to Cease and Desist with the FDIC and the  
16 WDFI. The Cease and Desist Order requires WSB Financial to cease and desist from the  
17 following unsafe and unsound banking practices, among others: (i) operating with management  
18 whose policies and practices are detrimental to the bank and jeopardize the safety of its deposits;  
19 (ii) operating with a board of directors which has failed to provide adequate supervision over and  
20 direction to the active management of the bank; (iii) operating with less than satisfactory capital  
21 in relation to the kind and quality of assets held by the bank; (iv) operating with an inadequate  
22 loan valuation reserve; (v) operating with a large volume of poor quality loans; (vi) engaging in  
23 unsatisfactory lending and collection practices; (vii) operating in such a manner as to produce  
24 operating losses; and (viii) operating with inadequate internal routine and controls policies.

25 87. As a result of WSB Financial's violations of banking laws and regulations, and its  
26 stated underwriting policies, the Company was forced to increase its loan loss reserves by \$13.4  
27 million.

1           B.     WSB Financial's GAAP Violations

2           88.     The Company's financial statements included in the Registration Statement were  
3 false and misleading because they did not comply with Generally Accepted Accounting  
4 Principles ("GAAP"). GAAP are those principles recognized by the accounting profession as  
5 conventions, rules and procedures necessary to define accounting practices at a particular time.  
6 The SEC has the statutory authority for the promulgation of GAAP for public companies and has  
7 delegated that authority to the Financial Accounting Standards Board. SEC Regulation S-X  
8 (17 C.F.R. § 210.4-01(a)(1)) provides that financial statements filed with the SEC which are not  
9 presented in accordance with GAAP will be presumed to be misleading, despite footnotes or  
10 other disclosures.

11           89.     WSB Financial's primary income is derived from the origination of loans. WSB  
12 Financial refers to the loans it originates and maintains on its balance sheet as mortgage loans  
13 held for investment. GAAP required WSB Financial to establish a reserve for potential credit  
14 losses on the mortgage loans held for investment when the underlying borrowers default on their  
15 obligation to make monthly mortgage payments. This reserve is an allowance for loan losses or  
16 "ALLL."

17           90.     Statement of Financial Accounting Standards ("SFAS") No. 5, *Accounting for*  
18 *Contingencies*, requires that "an estimated loss from a loss contingency ... shall be accrued by a  
19 charge to income if *both* of the following conditions are met:

20                   a.     Information available prior to issuance of the financial  
21 statements indicates that it is probable that an asset had been  
22 impaired or a liability had been incurred at the date of the financial  
23 statements. It is implicit in this condition that it must be probable  
24 that one or more future events will occur confirming the fact of the  
25 loss.

26                   b.     The amount of loss can be reasonably estimated."

27           91.     SFAS No. 114, *Accounting by Creditors for Impairment of a Loan an amendment*  
28 *of FASB Statement No. 5 and 15*, states that "[a] loan is impaired when, based on current  
information and events, it is probable that a creditor will be unable to collect all amounts due

1 according to the contractual terms of the loan agreement ... This Statement does not specify how  
2 a creditor should determine that it is probable that it will be unable to collect all amounts due  
3 according to the contractual terms of a loan. A creditor should apply its normal loan review  
4 procedures in making that judgment.”

5 92. SFAS No. 114 also states that “[m]easuring impairment of a loan requires  
6 judgment and estimates, and the eventual outcomes may differ from those estimates. Creditors  
7 should have latitude to develop measurement methods that are practical in their  
8 circumstances . . .”

9 93. SFAS No. 114 further provides:

10 Some impaired loans have risk characteristics that are unique to an  
11 individual borrower, and the creditor will apply the measurement  
12 methods . . . on a loan-by-loan basis. However, some impaired  
13 loans may have risk characteristics in common with other impaired  
14 loans. A creditor may aggregate those loans and may use historical  
statistics, such as average recovery period and average amount  
recovered, along with a composite effective interest rate as a  
means of measuring impairment of those loans.

15 94. The SEC provided explicit guidance on the proper accounting that WSB Financial  
16 should have followed, but did not. SEC Staff Accounting Bulletin: No. 102 – Selected Loan  
17 Loss Allowance Methodology and Documentation Issues, states in part:

18 The staff normally would expect a registrant that engages in lending activities to  
19 develop and document a systematic methodology to determine its provision for  
20 loan losses and allowance for loan losses as of each financial reporting date. It is  
21 critical that loan loss allowance methodologies incorporate management's current  
22 judgments about the credit quality of the loan portfolio through a disciplined and  
23 consistently applied process. A registrant's loan loss allowance methodology is  
24 influenced by entity-specific factors, such as an entity's size, organizational  
structure, business environment and strategy, management style, loan portfolio  
characteristics, loan administration procedures, and management information  
systems. However, as indicated in the AICPA Audit and Accounting Guide,  
*Banks and Savings Institutions* (Audit Guide), “[w]hile different institutions may  
use different methods, there are certain common elements that should be included  
in any [loan loss allowance] methodology for it to be effective.” A registrant's  
loan loss allowance methodology generally should:

- 25 • Include a detailed analysis of the loan portfolio, performed on a regular  
26 basis;
- 27 • Consider all loans (whether on an individual or group basis);

- Identify loans to be evaluated for impairment on an individual basis under SFAS No. 114 and segment the remainder of the portfolio into groups of loans with similar risk characteristics for evaluation and analysis under SFAS No. 5;
- Consider all known relevant internal and external factors that may affect loan collectibility;
- Be applied consistently but, when appropriate, be modified for new factors affecting collectibility;
- Consider the particular risks inherent in different kinds of lending;
- Consider current collateral values (less costs to sell), where applicable;
- Require that analyses, estimates, reviews and other loan loss allowance methodology functions be performed by competent and well-trained personnel;
- Be based on current and reliable data;
- Be well documented, in writing, with clear explanations of the supporting analyses and rationale . . .; and
- Include a systematic and logical method to consolidate the loss estimates and ensure the loan loss allowance balance is recorded in accordance with GAAP.

For many entities engaged in lending activities, the allowance and provision for loan losses are significant elements of the financial statements. Therefore, the staff believes it is appropriate for an entity's management to review, on a periodic basis, its methodology for determining its allowance for loan losses.

95. The SEC provides additional guidance in Financial Reporting Release ("FRR") 28 *Accounting for Loan Losses by Registrants Engaged in Lending Activities*, (§ 401.09), which states, in relevant part:

[a]rriving at an appropriate reported allowance for loan losses necessarily involves a high degree of management judgement. Because the allowance and the related provision for loan losses are key elements of financial statements of registrants engaged in lending activities, it is critical that those judgements be exercised in a disciplined manner that is based on and reflective of adequate detailed analyses of the loan portfolio.

Accordingly, in conducting an investigation, the Commission's staff normally would expect to find that the books and records of registrants engaged in lending activities include documentation of: (a) systematic methodology to be employed each period in determining the amount of loan losses to be reported, and (b) rationale supporting each period's determination that the amounts

1 reported were adequate. The systematic methodology to be  
2 employed each period would be documented not so that reported  
3 amounts will be the result of routine mathematical exercise, but to  
4 help ensure that all relevant matters affecting loan collectibility  
5 will consistently be identified in the detailed review process, and  
6 that the findings of the detailed review will be considered in an  
7 appropriately disciplined manner by persons exercising judgement  
8 in determining the amounts to be reported. The specific rationale  
9 upon which the amount actually reported in each individual period  
10 is based -- i.e., the bridge between the findings of the detailed  
11 review and the amount actually reported in each period -- would be  
12 documented to help ensure the adequacy of the reported amount, to  
13 improve auditability, and to serve as a benchmark for exercise of  
14 prudent judgement in future periods.

15 96. As detailed herein, during its routine review in the Spring of 2007, the WDFI  
16 identified numerous problems with WSB Financial's loan portfolio and asset quality indicating  
17 that WSB Financial was not in compliance with GAAP. In particular, the Cease and Desist  
18 Order required, within 45 days from the effective date of the Order, that WSB Financial's Board:

19 develop or revise, adopt and implement a comprehensive policy for  
20 determining the adequacy of the allowance for loans and lease  
21 losses. For the purpose of this determination, the adequacy of the  
22 reserve shall be determined after the charge-off of all loans or  
23 other items classified "Loss." The policy shall provide for a  
24 review of the allowance at least once each calendar quarter. Said  
25 review should be completed at least ten (10) days prior to the end  
26 of each quarter, in order that the findings of the Bank's Board with  
27 respect to the loan and lease loss allowance may be properly  
28 reported in the quarterly Reports of Condition and Income. The  
review should focus on the results of the Bank's internal loan  
review, loan loss experience, trends of delinquent and nonaccrual  
loans, an estimate of potential loss exposure of significant credits,  
concentrations of credit, and present and prospective economic  
conditions.

97. Moreover, prior to April 2007, WSB Financial originated 146 high-end  
construction loans worth more than \$90 million that the Company has now admitted are  
"impaired." Indeed, as required by the FDIC and WDFI, the Company increased its ALLL by  
\$13.9 million in the 3Q '07.

98. Significantly, WSB Financial did not disclose in any public filing any change in  
its methodology between the issuance of its Registration Statement and the WDFI review in the

Spring of 2007. Indeed, as Defendant Johnson admitted, WSB Financial did not cease its origination of “stated income” construction loans until *after* the regulators’ review in April 2007.

99. WSB Financial did not establish an adequate ALLL in direct violation of GAAP and, therefore, reported inflated net income in the financial statements included in the Registration Statement and Prospectus.

100. This, along with the facts alleged concerning the Company’s deviation from its underwriting policies and procedures, demonstrates the Company did not take adequate ALLL reserves in violation of GAAP, and did not exercise its judgments on the Company’s allowance for loan losses based on and reflective of adequate detailed analysis of the Company’s loan portfolio.

## VII. COUNTS

### COUNT I

#### Against All Defendants For Violations Of Section 11 Of The Securities Act In Connection With The IPO

101. Lead Plaintiff incorporates each and every allegation of ¶¶1-100 by reference as if set forth fully herein.

102. This Count is brought pursuant to § 11 of the Securities Act, 15 U.S.C. § 77k, against all defendants on behalf of Lead Plaintiff and other members of the Class who purchased or acquired the common stock of WSB Financial pursuant to or traceable to the Company’s Registration Statement and Prospectus issued in connection with the IPO. Lead Plaintiff acquired WSB Financial common stock both pursuant to and traceable to the Company’s Registration Statement and Prospectus issued in connection with the IPO.

103. The Registration Statement and Prospectus set forth in ¶¶71-80, above, was inaccurate and misleading, contained untrue statements of material facts, and omitted to state other facts necessary to make the statements contained therein not misleading. Specifically, as set forth above, the Registration Statement and Prospectus was untrue and misleading in that it failed to disclose that the Company’s origination, administration and monitoring of its

1 construction and mortgage loans violated applicable banking laws and regulations and that the  
2 Company was operating with a large volume of poor quality loan, as set forth above. These  
3 misstatements and violations of banking laws and the Company's stated underwriting policies  
4 rendered the statements made in the IPO Registration Statement and Prospectus concerning the  
5 Company's financial results materially false and misleading.

6 104. All defendants in this Count, with the exception of WSB Financial, the issuer  
7 (whose liability for the misstatements is absolute), owed to the acquirers of the stock, including  
8 Lead Plaintiff and the other members of the Class who acquired WSB Financial's common stock  
9 pursuant to or traceable to the Registration Statement and Prospectus, the duty to make a  
10 reasonable and diligent investigation of the statements contained in the Registration Statement  
11 and Prospectus at the time they became effective, to assure that those statements were true and  
12 that there was no omission to state material facts required to be stated in order to make the  
13 statements contained therein not misleading. As such, these defendants are liable to Lead  
14 Plaintiff and the other members of the Class.

15 105. The Company is the registrant for the WSB Financial shares of common stock  
16 issued in the IPO. As the issuer of these shares of common stock, WSB Financial is liable to  
17 Lead Plaintiff and the other members of the Class who acquired WSB Financial's common stock  
18 pursuant to the Registration Statement and Prospectus for the misstatements and omissions  
19 contained therein under Section 11 of the Securities Act.

20 106. All of the other defendants named in this Count: (i) signed the Registration  
21 Statement; or (ii) were directors of WSB Financial at the time the Registration Statement was  
22 filed with the SEC. Further, none of the defendants named in this Count made a reasonable  
23 investigation or possessed reasonable grounds for believing that the statements contained in the  
24 Registration Statement and Prospectus were true and devoid of any misstatements or omissions  
25 of material fact. Therefore, each of the defendants named in this Count is liable to Lead  
26 Plaintiff, and the other members of the Class, who acquired WSB Financial common stock  
27  
28

1 pursuant to or traceable to the Registration Statement and Prospectus for the various  
2 misstatements and omissions contained therein under Section 11 of the Securities Act.

3 107. WSB Financial issued the shares registered by the Registration Statement on  
4 December 14, 2006, in connection with the Company's IPO. Plaintiffs acquired their WSB  
5 Financial common stock without knowledge of the false statements and omissions alleged  
6 herein. As a direct and proximate result, Lead Plaintiff and the other members of the Class have  
7 suffered substantial damages.

8 108. In connection with the issuing of the Registration Statement, defendants, directly  
9 or indirectly, used the means and instrumentalities of interstate commerce, including, but not  
10 limited to, the United States mails, interstate telephone communications and the facilities of  
11 national securities exchanges.

12 109. This action was brought within one year after the discovery of the untrue  
13 statements and omissions (and within one year after such discovery should have been made in  
14 the exercise of reasonable diligence) and within three years after the IPO.

## 15 **COUNT II**

### 16 Against WSB Financial And D.A. Davidson For Violations Of 17 Section 12(a)(2) Of The Securities Act In Connection With The IPO

18 110. Lead Plaintiff incorporates each and every allegation of ¶¶1-109 by reference as if  
19 set forth fully herein.

20 111. This Count is brought pursuant to Section 12(a)(2) of the Securities Act on behalf  
21 of all purchasers of WSB Financial common stock pursuant to or traceable to the Prospectus  
22 filed in connection with the IPO, against WSB Financial and D.A. Davidson. Defendants named  
23 in this Count caused plaintiffs in the Class to acquire their WSB Financial common stock by use  
24 of the Prospectus, included as part of the Registration Statement.

25 112. Each of the defendants named in this Count was a seller of a security, specifically  
26 WSB Financial common stock sold in the IPO.



1           113. By means of the Prospectus, WSB Financial sold shares of the Company's  
2 common stock to Lead Plaintiff and the members of the Class in return for proceeds in excess of  
3 \$40 million. The Company's actions of solicitation consisted primarily of the preparation and  
4 dissemination of the Prospectus.

5           114. The WSB Financial common stock sold in the IPO by defendants named in this  
6 Count were sold through the use of interstate communication, the use of interstate commerce,  
7 and the use of the United States mails.

8           115. The WSB Financial common stock was sold through the use of the Prospectus  
9 which contained untrue statements of material fact or omitted to state material facts necessary in  
10 order to make the statements made not misleading.

11           116. The defendants named in this Count cannot prove that they did not know or, in the  
12 exercise of reasonable care, could not have known of the untruth or omission described in the  
13 preceding paragraph.

14           117. By reason of the conduct alleged herein, the defendants named in this Count  
15 violated Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(a)(2). As a direct and proximate  
16 cause of defendants' violation of Section 12(a)(2), Lead Plaintiff and other members of the Class  
17 have sustained damages. These plaintiffs seek rescission to recover the consideration paid for  
18 their WSB Financial common stock. These plaintiffs hereby tender their WSB Financial  
19 common stock, or proceeds from the sale thereof, to defendants named in this Count in exchange  
20 for the value of the consideration paid for such shares, plus interest. In the alternative, these  
21 plaintiffs seek recovery of damages in an amount to be proven at trial.

22           118. This action was brought within one year after the discovery of the untrue  
23 statements and omissions (and within one year after such discovery should have been made in  
24 the exercise of reasonable diligence) and within three years after the shares were sold to Lead  
25 Plaintiff and other members of the Class.

1 **COUNT III**

2 Against All Defendants, Except D.A. Davidson, For Violations  
3 Of Section 15 Of The Securities Act In Connection With The IPO

4 119. Lead Plaintiff incorporates each and every allegation of ¶¶1-118 by reference as if  
5 set forth fully herein. This Count is brought pursuant to Section 15 of the Securities Act on  
6 behalf of all persons who acquired WSB Financial common stock pursuant to or traceable to the  
7 Registration Statement and Prospectus in connection with the IPO.

8 120. The defendants named in this Count were each control persons of WSB Financial  
9 by virtue of their executive and/or directorial positions. The defendants named in this Count had  
10 the power, and exercised the same, to cause WSB Financial to engage in the violations of law  
11 complained of herein and were able to and did control the contents of the Registration Statement  
12 and Prospectus.

13 121. None of the defendants named in this Count made a reasonable investigation or  
14 possessed reasonable grounds for the belief that the statements contained in the Registration  
15 Statement and Prospectus were true and devoid of any omissions of material fact. By reason of  
16 their top executive positions at WSB Financial and their actual control over the Company's day-  
17 to-day operations, financial statements, public filings and their intimate involvement and control  
18 over the Registration Statement and Prospectus, each of the defendants named in this Count is  
19 liable jointly and severally with and to the same extent as WSB Financial is liable to Lead  
20 Plaintiff and the other members of the Class as a result of the wrongful conduct alleged herein.

21 **VIII. PRAYER FOR RELIEF**

22 WHEREFORE, Lead Plaintiff prays for relief and judgment, as follows:

23 (i) Determining that this action is a proper class action and certifying Lead Plaintiff  
24 as class representative under Rule 23 of the Federal Rules of Civil Procedure;

25 (ii) Awarding compensatory and/or recessionary damages in favor of Lead Plaintiff  
26 and the other Class members against all defendants, jointly and severally, for all damages  
27

1 sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including  
2 prejudgment and post-judgment interest thereon;

3 (iii) Awarding Lead Plaintiff and the Class their reasonable costs, expenses and  
4 attorneys' fees incurred in connection with this action; and

5 (iv) Awarding such other and further relief as the Court finds just and proper.

6 JURY TRIAL DEMANDED

7 Lead Plaintiff demands a trial by jury of all issues so triable.

8 Dated: April 11, 2008

Respectfully submitted,

9 BRESKIN JOHNSON & TOWNSEND PLLC

10  
11 /s/ Roger M. Townsend

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