FLAGSTAR BANCORP INC
Form 10-Q
August 06, 2015
Table of Contents

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015
OR
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

(Exact name of registrant as specified in its charter).

Michigan (State or other jurisdiction of Incorporation or organization)	38-3150651 (I.R.S. Employer Identification No.)
5151 Corporate Drive, Troy, Michigan (Address of principal executive offices)	48098-2639 (Zip code)

(248) 312-2000
(Registrant’s telephone number, including area code)

Not applicable
(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨.
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	o (Do not check if smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý.
As of August 4, 2015, 56,436,026 shares of the registrant's common stock, $0.01 par value, were issued and outstanding.

Table of Contents

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2015
TABLE OF CONTENTS

PART I. – FINANCIAL INFORMATION

Item 1.	Financial Statements	
	Consolidated Statements of Financial Condition – June 30, 2015 (unaudited) and December 31, 2014	4
	Consolidated Statements of Operations – For the three and six months ended June 30, 2015 and 2014 (unaudited)	5
	Consolidated Statements of Comprehensive Income (Loss) – For the three and six months ended June 30, 2015 and 2014 (unaudited)	6
	Consolidated Statements of Stockholders' Equity – For the six months ended June 30, 2015 and 2014 (unaudited)	6
	Consolidated Statements of Cash Flows – For the six months ended June 30, 2015 and 2014 (unaudited)	7
	Notes to the Consolidated Financial Statements (unaudited)	
	Note 1 - Basis of Presentation	8
	Note 2 - Investment Securities	8
	Note 3 - Loans Held-for-Sale	9
	Note 4 - Loans with Government Guarantees	9
	Note 5 - Loans Held-for-Investment	10
	Note 6 - Variable Interest Entities ("VIEs")	18
	Note 7 - Mortgage Servicing Rights	19
	Note 8 - Derivative Financial Instruments	21
	Note 9 - Federal Home Loan Bank Advances	24
	Note 10 - Long-Term Debt	25
	Note 11 - Representation and Warranty Reserve	27
	Note 12 - Stockholders' Equity	27
	Note 13 - Earnings (Loss) Per Share	28
	Note 14 - Income Taxes	29
	Note 15 - Regulatory Matters	30
	Note 16 - Legal Proceeding, Contingencies, and Commitments	31
	Note 17 - Fair Value Measurements	32
	Note 18 - Segment Information	45
	Note 19 - Recently Issued Accounting Standards	49
	Note 20 - Restatement of Consolidated Statements of Cash Flows	50
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	51
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	96
Item 4.	Controls and Procedures	96

Table of Contents

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2015
TABLE OF CONTENTS (continued)

PART II. – OTHER INFORMATION

Item 1.	Legal Proceedings	97
Item 1A.	Risk Factors	97
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	97
Item 3.	Defaults upon Senior Securities	97
Item 4.	Mine Safety Disclosures	97
Item 5.	Other Information	97
Item 6.	Exhibits	97

SIGNATURES 99

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Flagstar Bancorp, Inc.
Consolidated Statements of Financial Condition
(In millions, except share data)

	June 30, 2015	December 31, 2014
	(Unaudited)	
Assets		
Cash and cash equivalents		
Cash	$52	$47
Interest-earning deposits	194	89
Total cash and cash equivalents	246	136
Investment securities	2,272	1,672
Loans held-for-sale ($2,005 and $1,196 measured at fair value, respectively)	2,038	1,244
Loans with government guarantees	592	1,128
Loans held-for-investment, net		
Loans held-for-investment ($182 and $211 measured at fair value, respectively)	5,335	4,448
Less: allowance for loan losses	(222)	(297)
Total loans held-for-investment, net	5,113	4,151
Mortgage servicing rights	317	258
Federal Home Loan Bank stock	113	155
Premises and equipment, net	240	238
Net deferred tax asset	400	442
Other assets	808	416
Total assets	$12,139	$9,840
Liabilities and Stockholders’ Equity		
Deposits		
Noninterest bearing	$1,417	$1,209
Interest bearing	6,231	5,860
Total deposits	7,648	7,069
Federal Home Loan Bank advances (includes both short-term and long-term)	2,198	514
Long-term debt ($36 and $84 measured at fair value, respectively)	283	331
Representation and warranty reserve	48	53
Other liabilities ($84 and $82 measured at fair value, respectively)	511	500
Total liabilities	10,688	8,467
Stockholders’ Equity		
Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding, respectively	267	267
Common stock $0.01 par value, 70,000,000 shares authorized; 56,436,026 and 56,332,307 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,482	1,482
Accumulated other comprehensive income	8	8
Accumulated deficit	(307)	(385)
Total stockholders’ equity	1,451	1,373
Total liabilities and stockholders’ equity	$12,139	$9,840

The accompanying notes are an integral part of these Consolidated Financial Statements.

4

Table of Contents

Flagstar Bancorp, Inc.
Consolidated Statements of Operations
(In millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest Income	(Unaudited)			
Loans	$74	$62	$139	$121
Investment securities available-for-sale	15	10	29	17
Interest-earning deposits and other	1	—	1	—
Total interest income	90	72	169	138
Interest Expense				
Deposits	11	6	20	13
Federal Home Loan Bank advances	4	1	7	1
Other	2	2	4	3
Total interest expense	17	9	31	17
Net interest income	73	63	138	121
(Benefit) provision for loan losses	(13)	6	(17)	119
Net interest income after provision for loan losses	86	57	155	2
Noninterest Income				
Net gain on loan sales	83	55	174	100
Loan fees and charges	19	25	36	38
Deposit fees and charges	6	5	12	10
Loan administration income	7	6	11	13
Net return on the mortgage servicing asset	9	5	7	21
Net (loss) gain on sale of assets	(2)	4	(2)	6
Representation and warranty benefit (provision)	5	(5)	7	(4)
Other noninterest (loss) income	(1)	8	—	(7)
Total noninterest income	126	103	245	177
Noninterest Expense				
Compensation and benefits	59	55	120	120
Commissions	11	9	21	16
Occupancy and equipment	20	19	40	40
Asset resolution	5	18	13	29
Federal insurance premiums	6	7	12	12
Loan processing expense	14	8	26	16
Legal and professional expense	8	14	17	25
Other noninterest expense	15	(8)	27	1
Total noninterest expense	138	122	276	259
Income (loss) before income taxes	74	38	124	(80)
Provision (benefit) for income taxes	28	12	46	(28)
Net income (loss)	46	26	78	(52)
Preferred stock accretion	—	—	—	(1)
Net income (loss) from continuing operations	$46	$26	$78	$(53)
Income (loss) per share				
Basic	$0.69	$0.33	$1.12	$(1.17)
Diluted	$0.68	$0.33	$1.11	$(1.17)
Weighted average shares outstanding				
Basic	56,436,026	56,230,458	56,410,880	56,212,422
Diluted	57,165,072	56,822,102	56,971,133	56,212,422

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Flagstar Bancorp, Inc.
Consolidated Statements of Comprehensive Income (Loss)
(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)		(Unaudited)	
Net income (loss)	$46	$26	$78	$(52)
Other comprehensive income (loss), before tax				
Investment securities available-for-sale				
Unrealized (loss) gain	(25)	13	(1)	19
Reclassification of net loss on the sale	—	(1)	—	(1)
Total investment securities available-for-sale, before tax	(25)	12	(1)	18
Other comprehensive income, before tax				
Other comprehensive income, deferred tax expense				
Provision (benefit) for income taxes	(9)	4	(1)	6
Other comprehensive income, net of tax	(16)	8	—	12
Comprehensive income (loss)	$30	$34	$78	$(40)

Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders' Equity
(In millions)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2013	$266	$1	$1,479	$ (5)	$ (315)	$1,426
(Unaudited)						
Net loss	—	—	—	—	(52)	(52)
Total other comprehensive income	—	—	—	12	—	12
Accretion of preferred stock	1	—	—	—	(1)	—
Stock-based compensation	—	—	1	—	—	1
Balance at June 30, 2014	$267	$1	$1,480	$ 7	$ (368)	$1,387
Balance at December 31, 2014	267	1	1,482	8	$ (385)	$1,373
(Unaudited)						
Net income	—	—	—	—	78	78
Total other comprehensive income	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	—	—
Balance at June 30, 2015	$267	$1	$1,482	$ 8	$ (307)	$1,451

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Flagstar Bancorp, Inc.
Consolidated Statements of Cash Flows
(In millions)

	Six Months Ended June 30, 2015 (Unaudited)	2014 (Unaudited) As Restated
Operating Activities		
Net income (loss)	$78	$(52)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
(Benefit) provision for loan losses	(17)	119
Representation and warranty (benefit) provision	(7)	4
Depreciation and amortization	11	11
Deferred income taxes	43	(21)
Changes in fair value of MSRs, DOJ litigation settlement liability and long-term debt	26	12
Premium, change in fair value, and other non-cash changes	(520)	(378)
Net gain on loan and asset sales	(172)	(107)
Other changes:		
Proceeds from sales of loans held-for-sale ("HFS")	9,764	7,323
Origination and repurchase of loans, net of principal repayments	(14,297)	(10,565)
Increase in accrued interest receivable	(4)	(10)
Decrease (increase) in other assets, excludes purchase of other investments	43	(17)
Net charge-offs in representation and warranty reserve	(2)	(11)
Increase in other liabilities	8	10
Net cash used in operating activities	(5,046)	(3,682)
Investing Activities		
Proceeds from sale of available-for-sale securities including loans that have been securitized	4,558	4,168
Collection of principal on investment securities available-for-sale	124	69
Purchase of investment securities available-for-sale and other	(724)	(669)
Proceeds received from the sale of held-for-investment loans ("HFI")	710	35
Origination and purchase of loans HFI, net of principal repayments	(1,717)	(679)
Purchase of bank owned life insurance	(150)	—
Proceeds from the disposition of repossessed assets	13	21
Redemption of Federal Home Loan Bank stock	42	—
Acquisitions of premises and equipment, net of proceeds	(19)	(16)
Proceeds from the sale of mortgage servicing rights	100	104
Net cash provided by investing activities	2,937	3,033
Financing Activities		
Net increase in deposit accounts	580	504
Proceeds from increases in Federal Home Loan Bank advances	14,480	10,110
Repayment of Federal Home Loan Bank advances	(12,796)	(10,066)
Repayment of trust preferred securities and long-term debt	(50)	(11)
Net (reduction) receipt of payments of loans serviced for others	(3)	31
Net receipt of escrow payments	8	3
Net cash provided by financing activities	2,219	571
Net increase (decrease) in cash and cash equivalents	110	(78)
Beginning cash and cash equivalents	136	281

Ending cash and cash equivalents	$246	$203
Supplemental disclosure of cash flow information		
Interest paid on deposits and other borrowings	$26	$14
Income tax payments	$3	$—
Non-cash reclassification of loans HFI to loans HFS	$775	$314
Non-cash reclassification of loans HFS to HFI	$27	$7
Non-cash reclassification of loans HFS to AFS securities	$4,566	$4,120
Mortgage servicing rights resulting from sale or securitization of loans	$146	$120
Non-cash reclassification of loans with government guarantee to other assets	$373	$—

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The accompanying financial statements of Flagstar Bancorp, Inc. ("Flagstar" or the "Company"), including its wholly owned principal subsidiary, Flagstar Bank, FSB (the "Bank"), have been prepared using U.S. generally accepted accounting principles ("GAAP") for interim financial statements.

These consolidated financial statements do not include all of the information and footnotes required by GAAP for a full year presentation and certain disclosures have been condensed or omitted in accordance with rules and regulations of the Securities and Exchange Commission. These interim financial statements are unaudited and include, in the opinion of the Company, all adjustments necessary for a fair presentation of the results for the periods indicated, which are not necessarily indicative of results which may be expected for the full year. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, which is available on the Company’s website, at flagstar.com, and on the SEC website, at sec.gov. Certain prior period amounts have been reclassified to conform to the current period presentation.

Note 2 – Investment Securities

As of June 30, 2015 and December 31, 2014, investment securities were comprised of the following.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
June 30, 2015				
Available-for-sale securities				
Agency	$904	$6	$(3)	$907
Agency-collateralized mortgage obligations	1,358	11	(4)	1,365
Total available-for-sale securities	$2,262	$17	$(7)	$2,272
December 31, 2014				
Available-for-sale securities				
Agency	$925	$6	$(2)	$929
Agency-collateralized mortgage obligations	734	8	(1)	741
Municipal obligations	2	—	—	2
Total available-for-sale securities	$1,661	$14	$(3)	$1,672

Available-for-sale securities

Securities available-for-sale are carried at fair value, with unrealized gains reported as a component of other comprehensive income and unrealized losses reported as a component of other comprehensive income to the extent they are temporary in nature. Credit related declines in the securities are classified as other-than-temporary impairments ("OTTI") and are reported as a separate component of noninterest income within the Consolidated Statement of Operations. An impaired investment security is considered to be other than temporary if (1) the Company intends to sell the security; (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover all contractually required principal and interest payments.

The Company purchased $72 million and $724 million of investment securities, which included agency securities, comprised of mortgage-backed securities and collateralized mortgage obligations during the three and six months ended June 30, 2015, respectively. The Company purchased $464 million and $669 million of investment securities, which included agency securities comprised of mortgage-backed securities during the three and six months ended June 30, 2014, respectively.

Table of Contents

The following table summarizes by duration the unrealized loss positions on investment securities available-for-sale.

	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
	Fair Value	Number of Securities	Unrealized Loss	Fair Value	Number of Securities	Unrealized Loss
Type of Security	(Dollars in millions)					
June 30, 2015						
Agency	$13	3	$(1)	$244	16	$(2)
Agency-collateralized mortgage obligations	—	—	—	460	35	(4)
December 31, 2014						
Agency	$53	6	$—	$305	21	$(2)
Agency-collateralized mortgage obligations	98	10	(1)	38	4	—

Gains (losses) on sales of available-for-sale securities are reported in net gain on securities available-for-sale in the Consolidated Statements of Operations. During the three and six months ended June 30, 2015, there were no sales of investment securities except those related to loans that had been securitized for sale in the normal course of business, compared to $40 million and $58 million, respectively, sales of investment securities, resulting in a gain of $1 million during both the three and six months ended June 30, 2014.

The amortized cost and estimated fair value of securities, excluding trading securities, at June 30, 2015, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Investment Securities Available-for-Sale		
	Amortized Cost	Fair Value	Weighted-Average Yield
June 30, 2015	(Dollars in millions)		
Due in one year or less	$—	$—	— %
Due after one year through five years	10	10	2.05 %
Due after five years through 10 years	83	83	2.39 %
Due after 10 years	2,169	2,179	2.57 %
Total	$2,262	$2,272	

Note 3 – Loans Held-for-Sale

Essentially all of our mortgage loans originated as loans held-for-sale are sold into the secondary market on a whole loan basis or by securitizing the loans into securities. At June 30, 2015 and December 31, 2014, loans held-for-sale totaled $2.0 billion and $1.2 billion, respectively. For the three and six months ended June 30, 2015, the Company reported net gain on loan sales of $83 million and $174 million, respectively, as compared to $55 million and $100 million net gain on loan sales during the three and six months ended June 30, 2014, respectively.

At June 30, 2015 and December 31, 2014, $33 million and $48 million, respectively, of loans held-for-sale were recorded at lower of cost or fair value. The remainder of the loans in the portfolio are recorded at fair value as the Company elected the fair value option.

Note 4 – Loans with Government Guarantees

Substantially all of loans with government guarantees continue to be insured or guaranteed by the FHA. These loans earn interest at a rate based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent, which is not paid until claimed.

At June 30, 2015, loans with government guarantees actually repurchased totaled $592 million and were classified as loans with government guarantees. At December 31, 2014, loans with government guarantees actually repurchased totaled $1.1 billion and were classified as loans with government guarantees.

Table of Contents

The Company adopted ASU Update No. 2014-14, Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40) in the first quarter 2015 at which time repossessed assets and the associated claims were recorded separately from the associated loans. At June 30, 2015, repossessed assets and the associated claims recorded in other assets totaled $267 million and at December 31, 2014 repossessed assets and the associated claims were $373 million included in loans with government guarantees.

Note 5 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows.

	June 30, 2015	December 31, 2014
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	$2,495	$2,193
Second mortgage	143	149
HELOC	422	257
Other	31	31
Total consumer loans	3,091	2,630
Commercial loans		
Commercial real estate	629	620
Commercial and industrial	412	429
Warehouse lending	1,203	769
Total commercial loans	2,244	1,818
Total loans held-for-investment	5,335	4,448
Less allowance for loan losses	(222)	(297)
Loans held-for-investment, net	$5,113	$4,151

During the second quarter 2015, the Company sold interest-only residential first mortgage loans with unpaid principal balances totaling $386 million, along with $70 million of nonperforming and troubled debt restructured first mortgage loans. Upon a change in the Company’s intent, the loans were transferred to held-for-sale and subsequently sold resulting in a loss on sale of $1 million during the three months ended June 30, 2015.

At December 31, 2014, the Company had $350 million of troubled debt restructured residential first mortgage loans with a specifically identified reserve of $76 million. During the first quarter 2015, the Company re-measured this specifically identified reserve relating to the troubled debt restructured loans, resulting in a $36 million reduction in reserve based on a change in expected future cash flows. During the first quarter 2015, the Company changed its intent to hold these loans for investment and instead decided to hold these loans for sale. The loans for which the intent changed had an approximate unpaid principal balance of $331 million, including approximately $291 million of troubled debt restructured residential first mortgage loans, and $30 million in specifically identified reserves at the time this intent was changed. These loans were transferred to loans held-for-sale and subsequently sold resulting in a loss on sale of less than $1 million during the first quarter 2015.

During the six months ended June 30, 2014, the Company sold nonperforming, troubled debt restructured residential first mortgage and residential first mortgage jumbo loans with unpaid principal balances totaling $547 million. A portion of the allowance for loan losses associated with these loans was reduced, resulting in a $2 million reduction in allowance. Upon a change in the Company’s intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain on sale of $5 million.

During the six months ended June 30, 2015, the Company purchased $197 million of HELOC loans with a premium of $7 million.

The Company has pledged certain loans held-for-investment, loans held-for-sale, and loans with government guarantees to collateralize lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the Federal Home

10

Table of Contents

Loan Bank of Indianapolis. At June 30, 2015 and December 31, 2014, the Company pledged $5.0 billion and $4.1 billion, respectively.

The allowance for loan losses by class of loan is summarized in the following table.

	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
Three Months Ended June 30, 2015								
Beginning balance allowance for loan losses	$188	$12	$21	$—	$ 16	$ 12	$4	$253
Charge-offs (1)	(19)	(1)	—	(1)	—	—	—	(21)
Recoveries	1	1	—	1	—	—	—	3
Provision (benefit)	(19)	2	4	1	(1)	—	—	(13)
Ending balance allowance for loan losses	$151	$14	$25	$1	$ 15	$ 12	$4	$222
Three Months Ended June 30, 2014								
Beginning balance allowance for loan losses	$255	$14	$12	$1	$ 18	$ 5	$2	$307
Charge-offs (1)	(5)	(1)	(1)	(1)	(2)	—	—	(10)
Recoveries	1	—	—	—	2	—	—	3
Provision (benefit)	(2)	1	3	2	1	—	1	6
Ending balance allowance for loan losses	$249	$14	$14	$2	$ 19	$ 5	$3	$306
Six Months Ended June 30, 2015								
Beginning balance allowance for loan losses	$234	$12	$19	$1	$ 17	$ 11	$3	$297
Charge-offs (1)	(60)	(2)	(1)	(1)	—	—	—	(64)
Recoveries	2	1	—	1	2	—	—	6
Provision (benefit)	(25)	3	7	—	(4)	1	1	(17)
Ending balance allowance for loan losses	$151	$14	$25	$1	$ 15	$ 12	$4	$222
Six Months Ended June 30, 2014								
Beginning balance allowance for loan losses	$162	$12	$8	$2	$ 19	$ 3	$1	$207
Charge-offs (1)	(17)	(2)	(4)	(1)	(2)	—	—	(26)
Recoveries	2	—	—	1	3	—	—	6

Provision (benefit)	102	4	10	—	(1)	2	2	119
Ending balance allowance for loan losses	$249	$14	$14	$2	$ 19	$ 5	$ 3	$306

(1) Includes charge-offs of $15 million and $36 million related to the sale of loans during the three months ended June 30, 2015 and June 30, 2014, respectively, and $51 million and $2 million related to the sale of loans during the six months ended June 30, 2015 and June 30, 2014, respectively.

Table of Contents

The loans held-for-investment and allowance for loan losses by class of loan is summarized in the following table.

	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
June 30, 2015								
Loans held-for-investment								
Individually evaluated	$94	$30	$2	$—	$ —	$ —	$—	$126
Collectively evaluated (1)	2,360	65	327	31	629	412	1,203	5,027
Total loans	$2,454	$95	$329	$31	$ 629	$ 412	$1,203	$5,153
Allowance for loan losses								
Individually evaluated	$14	$8	$1	$—	$ —	$ —	$—	$23
Collectively evaluated (1)	137	6	24	1	15	12	4	199
Total allowance for loan losses	$151	$14	$25	$1	$ 15	$ 12	$4	$222
December 31, 2014								
Loans held-for-investment								
Individually evaluated	$385	$31	$1	$—	$ —	$ —	$—	$417
Collectively evaluated (1)	1,782	65	124	31	620	429	769	3,820
Total loans	$2,167	$96	$125	$31	$ 620	$ 429	$769	$4,237
Allowance for loan losses								
Individually evaluated	$82	$5	$1	$—	$ —	$ —	$—	$88
Collectively evaluated (1)	152	7	18	1	17	11	3	209
Total allowance for loan losses	$234	$12	$19	$1	$ 17	$ 11	$3	$297

(1) Excludes loans carried under the fair value option.

The allowance for loan losses, other than for loans that have been identified for individual evaluation for impairment, is determined on a loan pool basis by grouping loan types with similar risk characteristics to determine the Company's best estimate of incurred losses. Management evaluates the results of the allowance for loan losses model and makes qualitative adjustments to the results of the model when it is determined that model results do not reflect all losses inherent in the loan portfolios due to changes in recent economic trends and conditions, or other relevant factors.

For those loans not individually evaluated for impairment, management has sub-divided the commercial and consumer loans into portfolios with common risk characteristics.

Table of Contents

The following table sets forth the loans held-for-investment aging analysis as of June 30, 2015 and December 31, 2014, of past due and current loans.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Investment Loans
	(Dollars in millions)					
June 30, 2015						
Consumer loans						
Residential first mortgage	$7	$4	$57	$68	$2,427	$2,495
Second mortgage	1	1	2	4	139	143
HELOC	2	1	6	9	413	422
Other	—	—	—	—	31	31
Total consumer loans	10	6	65	81	3,010	3,091
Commercial loans						
Commercial real estate	—	—	—	—	629	629
Commercial and industrial	—	—	—	—	412	412
Warehouse lending	—	—	—	—	1,203	1,203
Total commercial loans	—	—	—	—	2,244	2,244
Total loans (1)	$10	$6	$65	$81	$5,254	$5,335
December 31, 2014						
Consumer loans						
Residential first mortgage	$29	$8	$115	$152	$2,041	$2,193
Second mortgage	1	1	2	4	145	149
HELOC	4	1	3	8	249	257
Other	—	—	—	—	31	31
Total consumer loans	34	10	120	164	2,466	2,630
Commercial loans						
Commercial real estate	—	—	—	—	620	620
Commercial and industrial	—	—	—	—	429	429
Warehouse lending	—	—	—	—	769	769
Total commercial loans	—	—	—	—	1,818	1,818
Total loans (1)	$34	$10	$120	$164	$4,284	$4,448

(1) Includes $7 million and $5 million of loans 90 days or greater past due accounted for under the fair value option at June 30, 2015 and December 31, 2014, respectively.

Loans held-for-investment and loans held-for-sale on which interest accruals have been discontinued totaled approximately $79 million and $135 million at June 30, 2015 and December 31, 2014, respectively, and $120 million at June 30, 2014. Interest income is recognized on impaired loans using a cost recovery method unless amounts contractually due are not in doubt. Interest that would have been accrued on impaired loans totaled approximately $1 million and $3 million during the three and six months ended June 30, 2015, respectively, and $2 million and $3 million during the three and six months ended June 30, 2014, respectively. At June 30, 2015 and December 31, 2014, the Company had no loans 90 days past due and still accruing.

Troubled Debt Restructuring

The Company may modify certain loans in both consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. The Company has programs designed to assist borrowers by extending payment dates or reducing the borrower's contractual payments. All loan modifications are made on a case-by-case basis. The Company's standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. TDRs result in those instances in which a borrower demonstrates financial difficulty and for which a concession has been granted, which includes reductions of interest rate, extensions of amortization period, principal and/or interest forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure

13

Table of Contents

or repossession of collateral. These loans are classified as TDRs and are included in nonaccrual loans if the loan was nonperforming prior to the restructuring. These loans will continue on nonaccrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months, after which they will begin to accrue interest.

The following table provides a summary of TDRs outstanding by type and performing status.

	TDRs		
	Performing	Nonperforming	Total
June 30, 2015	(Dollars in millions)		
Consumer loans			
Residential first mortgage	$53	$19	$72
Second mortgage	35	1	36
HELOC	20	4	24
Total TDRs (1)(2)	$108	$24	$132
December 31, 2014			
Consumer loans			
Residential first mortgage	$306	$44	$350
Second mortgage	35	1	36
HELOC	20	1	21
Total consumer loans	361	46	407
Commercial loans			
Commercial real estate	1	—	1
Total TDRs (1)(2)	$362	$46	$408

(1) The allowance for loan losses on consumer TDR loans totaled $16 million and $81 million at June 30, 2015 and December 31, 2014, respectively.

(2) Includes $30 million of TDR loans accounted for under the fair value option at both June 30, 2015 and December 31, 2014.

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, but may give rise to potential incremental losses. Such losses are factored into the Company's allowance for loan losses estimate. Management evaluates loans for impairment both collectively and individually depending on the risk characteristics underlying the loan and the availability of data. The Company measures impairment using the discounted cash flow method for performing TDRs and measures impairment based on collateral values for re-defaulted TDRs.

Table of Contents

The following table provides a summary of newly modified TDRs and TDR loans in the past 12 months that have subsequently defaulted during the three and six months ended June 30, 2015 and 2014. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when greater than 90 days past due.

	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
Three Months Ended June 30, 2015		(Dollars in millions)		
Residential first mortgages	77	$23	$22	$(2)
Second mortgages	35	1	1	—
HELOC (2)	122	8	7	—
Consumer	3	—	—	—
Total TDR loans	237	$32	$30	$(2)
Three Months Ended June 30, 2014				
Residential first mortgages	46	$13	$13	$1
Second mortgages	112	3	3	—
HELOC (2)	6	—	—	—
Total TDR loans	164	$16	$16	$1
Six Months Ended June 30, 2015				
Residential first mortgages	191	$53	$52	$(1)
Second mortgages	68	3	2	—
HELOC (2)	158	8	7	—
Consumer	3	—	—	—
Total TDR loans	420	$64	$61	$(1)
Six Months Ended June 30, 2014				
Residential first mortgages	71	$20	$19	$1
Second mortgages	206	6	6	—
HELOC (2)	15	1	1	—
Total TDR loans	292	$27	$26	$1

TDRs that subsequently defaulted in previous 12 months	Number of Accounts	Unpaid Principal Balance	Increase in Allowance at Subsequent Default
Three Months Ended June 30, 2015		(Dollars in millions)	
Second mortgages	1	$—	$—
Total TDR loans	1	$—	$—
Three Months Ended June 30, 2014			
Residential first mortgages	1	$—	$—
Second mortgages	10	—	—
Total TDR loans	11	$—	$—
Six Months Ended June 30, 2015			
Second mortgages	1	$—	$—
Total TDR loans	1	$—	$—

Six Months Ended June 30, 2014			
Residential first mortgages	2	$—	$—
Second mortgages	13	—	—
HELOC (2)	5	—	—
Total TDR loans	20	$—	$—

(1) Post-modification balances include past due amounts that are capitalized at modification date.
(2) HELOC post-modification unpaid principal balance reflects write downs.

15

Table of Contents

The following table presents impaired loans and the associated allowance:

	June 30, 2015			December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in millions)					
With no related allowance recorded						
Consumer loans						
Residential first mortgage loans	$21	$24	$—	$63	$78	$—
Second mortgage	—	4	—	1	6	—
HELOC	—	1	—	—	1	—
	$21	$29	$—	$64	$85	$—
With an allowance recorded						
Consumer loans						
Residential first mortgage	$73	$78	$15	$321	$326	$82
Second mortgage	30	30	8	29	29	6
HELOC	2	2	1	1	1	1
	$105	$110	$24	$351	$356	$89
Total						
Consumer loans						
Residential first mortgage	$94	$102	$15	$384	$404	$82
Second mortgage	30	34	8	30	35	6
HELOC	2	3	1	1	2	1
Total impaired loans	$126	$139	$24	$415	$441	$89

The following table presents average impaired loans and the interest income recognized:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in millions)							
Consumer loans								
Residential first mortgage	$116	$ 1	$405	$ 3	$210	$ 2	$409	$ 5
Second mortgage	31	—	28	—	31	1	27	1
HELOC	2	—	1	—	2	—	—	—
Commercial loans								
Commercial real estate	—	—	1	—	—	—	2	—
Total impaired loans	$149	$ 1	$435	$ 3	$243	$ 3	$438	$ 6

Credit Quality

The Company utilizes an internal risk rating system in accordance with the Rating Credit Risk booklet of the Comptroller's Handbook, April 2011 and the Uniform Retail Credit classification and Account Management Policy issued June 20, 2000 by the Federal Financial Institution Examination Council (FFIEC) which is applied to all consumer and commercial loans. Commercial credits are classified using a risk-based approach by assigning a risk rating individually to each loan. Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net

16

Table of Contents

worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship. Descriptions of the Company's internal risk ratings as they relate to credit quality follow the ratings used by the U.S. bank regulatory agencies as listed below.

Pass. Pass assets are not impaired nor do they have any known deficiencies that could impact the quality of the asset.

Watch. Watch assets are defined as pass rated assets that exhibit elevated risk characteristics or other factors that deserve management’s close attention and increased monitoring. However, the asset does not exhibit a potential or well-defined weakness that would warrant a downgrade to criticized or adverse classification.

Special mention. Assets identified as special mention possess credit deficiencies or potential weaknesses deserving management's close attention. Special mention assets have a potential weakness or pose an unwarranted financial risk that, if not corrected, could weaken the assets and increase risk in the future. Special mention assets are criticized, but do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Assets identified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. For HELOC loans and other consumer loans, the Company evaluates credit quality based on the aging and status of payment activity and includes all nonperforming loans.

Commercial Loans

Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship.

Consumer Loans

The same rating principles are used for consumer and commercial loans, but the principles are applied differently for consumer loans. Consumer loans consists of open and closed end loans extended to individuals for household, family, and other personal expenditures, and includes consumer loans, loans to individuals secured by their personal residence, including first mortgage, home equity, and home improvement loans. Because consumer loans are usually relatively small-balance, homogeneous exposures, consumer loans are rated primarily on payment performance. Payment performance is a proxy for the strength of repayment capacity and loans are generally classified based on their payment status rather than by an individual review of each loan.
In accordance with regulatory guidance, the Company assigns risk ratings to consumer loans in the following manner:
•Consumer loans are classified as Watch once the loan becomes 60 days past due.
•Open and closed-end consumer loans 90 days or more past due are classified Substandard.

Table of Contents

Commercial Credit Loans	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial
June 30, 2015	(Dollars in millions)			
Grade				
Pass	$582	$366	$1,069	$2,017
Watch	41	19	117	177
Special mention	6	—	17	23
Substandard	—	27	—	27
Total loans	$629	$412	$1,203	$2,244
December 31, 2014				
Pass	$578	$398	$650	$1,626
Watch	29	10	119	158
Special mention	2	—	—	2
Substandard	11	21	—	32
Total loans	$620	$429	$769	$1,818

Consumer Credit Loans	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Total
June 30, 2015	(Dollars in millions)				
Grade					
Pass	$2,380	$106	$394	$31	$2,911
Watch	56	35	22	—	113
Substandard	59	2	6	—	67
Total loans	$2,495	$143	$422	$31	$3,091
December 31, 2014					
Pass	$1,764	$111	$233	$31	$2,139
Watch	314	36	21	—	371
Substandard	115	2	3	—	120
Total loans	$2,193	$149	$257	$31	$2,630

Note 6 – Variable Interest Entities ("VIEs")

Due to the Assured Settlement Agreement in 2013, the Company became the primary beneficiary and reconsolidated the FSTAR 2005-1 and the FSTAR 2006-2 HELOC securitization trust's assets and liabilities. The Company had elected the fair value option for these assets and liabilities.

The Company has consolidated VIEs, which consist of the HELOC securitization trusts formed in 2006. The Company has determined the trust is VIEs and has concluded that the Company is the primary beneficiary of this trust because it has the power to direct the activities of the entity that most significantly affect the entity's economic performance and has either the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. The Company has the power to select the servicer of the whole loans held in the HELOC securitization trust. The beneficial owners of the trust can look only to the assets of the securitization trust for satisfaction of the debt issued by the securitization trust.

In June 2015, the Company executed a clean-up call of the FSTAR 2005-1 long-term debt associated with the HELOC securitization trust. The transaction resulted in a cash payment of $24 million to the debt bondholders. After payment of the debt, the FSTAR 2005-1 HELOC securitization trust has been dissolved as of second quarter 2015.

Table of Contents

The following table provides a summary of the classifications of consolidated VIE assets and liabilities included in the Consolidated Financial Statements.

	2005-1	2006-2	Total
June 30, 2015	(Dollars in millions)		
HELOC Securitizations			
Assets			
Loans held-for-investment	$—	$61	$61
Liabilities			
Long-term debt	$—	$36	$36
	2005-1	2006-2	Total
December 31, 2014	(Dollars in millions)		
HELOC Securitizations			
Assets			
Loans held-for-investment	$63	$69	$132
Liabilities			
Long-term debt	$42	$42	$84

The economic performance of the VIE is most significantly impacted by the performance of the underlying loans. The principal risks to which the entities were exposed include credit risk and interest-rate risk.

FSTAR 2007-1 mortgage securitization trust is an unconsolidated VIE. The Company has a continuing involvement, but is not the primary beneficiary and de-recognized the assets upon transfer. In accordance with the settlement agreement with MBIA, there is no further recourse to the Company related to FSTAR 2007-1. At June 30, 2015 and December 31, 2014, the FSTAR 2007-1 mortgage securitization trust included 3,303 loans and 3,624 loans, respectively, with an aggregate principal balance of $128 million and $141 million, respectively.

Note 7 – Mortgage Servicing Rights

The Company has investments in mortgage servicing rights ("MSRs") to support mortgage strategies and to deploy capital at acceptable returns. The Company also utilizes derivatives and other fair value assets as economic hedges to offset changes in the fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. The Company's portfolio of MSRs is highly sensitive to movements in interest rates. The primary risk associated with MSRs is the potential value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. There is also a risk of valuation decline due to higher than expected increases in default rates, which the Company does not believe can be effectively hedged. See Note 8 of the Notes to the Consolidated Financial Statements, herein, for additional information regarding the instruments utilized to hedge the risks of MSRs.

Table of Contents

Changes in the carrying value of residential first mortgage MSRs, accounted for at fair value, were as follows.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Balance at beginning of period	$279	$320	$258	$285
Additions from loans sold with servicing retained	77	68	146	119
Reductions from sales	(49)	(85)	(71)	(91)
Changes in fair value due to (1)				
Decrease in MSR due to pay-offs, pay-downs and run-off	(11)	(7)	(26)	(12)
Changes in valuation inputs or assumptions (2)	21	(7)	10	(12)
Fair value of MSRs at end of period	$317	$289	$317	$289

(1) Changes in fair value are included within net return on mortgage servicing asset on the Consolidated Statements of Operations.
(2) Represents estimated MSR value change resulting primarily from market-driven changes in interest rates.

The fair value of residential MSRs is estimated using a valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. The Company obtains independent third-party valuations of its residential MSRs on a quarterly basis to assess the reasonableness of the fair value calculated by the valuation model. In certain circumstances, based on the probability of the completion of a sale of MSRs pursuant to a bona-fide purchase offer, the Company considers the bid price of that offer and identifiable transaction costs in comparison to the calculated fair value and may adjust the estimate of fair value to reflect the terms of the pending transaction.

The following table summarizes income and fees associated with the mortgage servicing asset.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Income on mortgage servicing asset				
Servicing fees, ancillary income and late fees (1)	$17	$17	$34	$34
Fair value adjustments (2)	12	(14)	(14)	(24)
(Loss) gain on hedging activity (3)	(14)	5	(5)	10
Net transaction costs	(6)	(3)	(8)	1
Total income on mortgage servicing asset, included in net return on mortgage servicing asset	$9	$5	$7	$21

(1) Servicing fees are recorded on the accrual basis. Ancillary income and late fees are recorded on cash basis.
(2) Includes a $2 million gain related to the sale of MSRs during the three and six months ended June 30, 2015.
(3) Changes in the derivatives utilized as economic hedges to offset changes in fair value of the MSRs.

Contractual servicing and subservicing fees. Contractual servicing and subservicing fees, including late fees and other ancillary income, for each type of loan serviced are presented below. Contractual servicing fees are included within net return on mortgage servicing asset on the Consolidated Statements of Operations. Contractual subservicing fees including late fees and other ancillary income are included within loan administration income on the Consolidated Statements of Operations. Subservicing fee income is recorded for fees earned, net of third-party subservicing costs, for loans subserviced.

20

Table of Contents

The following table summarizes income and fees associated with the mortgage loans subserviced.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Income on mortgage loans subserviced				
Servicing fees, ancillary income and late fees (1)	$9	$7	$16	$14
Other servicing charges	(2)	(1)	(5)	(1)
Total income on mortgage loans subserviced, included in loan administration	$7	$6	$11	$13

(1) Servicing fees are recorded on the accrual basis. Ancillary income and late fees are recorded on cash basis.

The following table summarizes the hypothetical effect on the fair value of servicing rights carried at fair value using adverse changes of 10 percent and 20 percent to the weighted-average of certain significant assumptions used in valuing these assets.

	June 30, 2015			December 31, 2014		
		Fair value due to			Fair value due to	
	Actual	10% adverse change	20% adverse change	Actual	10% adverse change	20% adverse change
		(Dollars in millions)				
Option adjusted spread	8.19%	$310	$303	8.88%	$250	$243
Constant prepayment rate	12.26%	309	301	14.98%	253	245
Weighted average cost to service per loan	$72.15	314	311	$74.49	258	255

The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. Changes in fair value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. To isolate the effect of the specified change, the fair value shock analysis is consistent with the identified adverse change, while holding all other assumptions impacting the fair value constant on the fair value of the servicing rights. In practice, changes in one assumption generally impacts other assumptions, which may either magnify or counteract the effect of the change.

Table of Contents

Note 8 – Derivative Financial Instruments

The Company maintains a derivative portfolio of interest rate swaps, futures and forward commitments used to manage exposure to changes in interest rates, MSR asset values and to meet the needs of customers. The Company also enters into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Market risk on interest rate lock commitments and mortgage loans held-for-sale is managed using corresponding forward sale commitments.

The Company is exposed to credit loss in the event of nonperformance by the counterparties to its various derivative financial instruments. The Company believes that the credit risk inherent in all its derivative contracts is minimal based on credit standards and the netting and collateral provisions of the interest rate swap agreements. The contracts in this portfolio do not qualify for hedge accounting and are marked-to-market through earnings and included in other assets and other liabilities at fair value on the Consolidated Statements of Financial Condition, after taking into account the effects of legally enforceable bilateral collateral and master netting agreements.

Fair values of derivative instruments represent the net unrealized gains or losses on such contracts and are recorded in the consolidated balance sheets. Changes in fair value are recognized in the consolidated statements of income. The net gains recognized in income on derivative instruments, net of the impact of offsetting positions, were as follows.

		Three Months Ended June 30,		Six Months Ended June 30,	
	Location of Gain/(Loss)	2015	2014	2015	2014
		(Dollars in millions)			
U.S. Treasury and euro dollars futures	Net return on mortgage servicing asset	$(3)	$3	$3	$6
Swap futures	Net return on mortgage servicing asset	(9)	—	(8)	—
Mortgage backed securities forwards	Net return on mortgage servicing asset	(2)	2	—	4
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	9	(2)	20	(7)
Interest rate swaps	Other noninterest income	—	1	—	1
Total derivative gain (loss)					