

FLAGSTAR BANCORP INC
Form 10-Q
November 07, 2016
Table of Contents

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

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	38-3150651
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

5151 Corporate Drive, Troy, Michigan	48098-2639
(Address of principal executive offices)	(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 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 No

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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
Non-accelerated filer (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 .

As of November 4, 2016, 56,606,499 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 SEPTEMBER 30, 2016
 TABLE OF CONTENTS

PART I. – FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Statements of Financial Condition – September 30, 2016 (unaudited) and December 31, 2015	4
Consolidated Statements of Operations – For the three and nine months ended September 30, 2016 and 2015 (unaudited)	5
Consolidated Statements of Comprehensive Income – For the three and nine months ended September 30, 2016 and 2015 (unaudited)	6
Consolidated Statements of Stockholders’ Equity – For the nine months ended September 30, 2016 and 2015 (unaudited)	6
Consolidated Statements of Cash Flows – For the nine months ended September 30, 2016 and 2015 (unaudited)	8
<u>Notes to the Consolidated Financial Statements (unaudited)</u>	
<u>Note 1 - Basis of Presentation</u>	9
<u>Note 2 - Investment Securities</u>	9
<u>Note 3 - Loans Held-for-Sale</u>	11
<u>Note 4 - Loans Held-for-Investment</u>	12
<u>Note 5 - Loans With Government Guarantees</u>	21
<u>Note 6 - Variable Interest Entities ("VIEs")</u>	21
<u>Note 7 - Mortgage Servicing Rights</u>	22
<u>Note 8 - Derivative Financial Instruments</u>	23
<u>Note 9 - Debt</u>	27
<u>Note 10 - Representation and Warranty Reserve</u>	29
<u>Note 11 - Warrants</u>	29
<u>Note 12 - Accumulated Other Comprehensive Income (Loss)</u>	29
<u>Note 13 - Earnings Per Share</u>	30
<u>Note 14 - Income Taxes</u>	31
<u>Note 15 - Regulatory Matters</u>	31
<u>Note 16 - Legal Proceeding, Contingencies, and Commitments</u>	32
<u>Note 17 - Fair Value Measurements</u>	34
<u>Note 18 - Segment Information</u>	45
<u>Note 19 - Recently Issued Accounting Pronouncements</u>	49

Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	51
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Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	91
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Item 4. <u>Controls and Procedures</u>	91
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Table of Contents

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2016
TABLE OF CONTENTS (continued)

PART II. – OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	<u>92</u>
Item 1A.	<u>Risk Factors</u>	<u>92</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>92</u>
Item 3.	<u>Defaults upon Senior Securities</u>	<u>92</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>92</u>
Item 5.	<u>Other Information</u>	<u>92</u>
Item 6.	<u>Exhibits</u>	<u>92</u>
	<u>SIGNATURES</u>	<u>93</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Flagstar Bancorp, Inc.

Consolidated Statements of Financial Condition

(In millions, except share data)

	September 30, December 31, 2016 2015 (Unaudited)	
Assets		
Cash	\$ 76	\$ 54
Interest-earning deposits	98	154
Total cash and cash equivalents	174	208
Investment securities available-for-sale	1,115	1,294
Investment securities held-to-maturity	1,156	1,268
Loans held-for-sale (\$3,352 and \$2,541 measured at fair value, respectively)	3,393	2,576
Loans held-for-investment (\$80 and \$111 measured at fair value, respectively)	6,290	6,352
Loans with government guarantees	404	485
Less: allowance for loan losses	(143	) (187
Total loans held-for-investment and loans with government guarantees, net	6,551	6,650
Mortgage servicing rights	302	296
Federal Home Loan Bank stock	172	170
Premises and equipment, net	271	250
Net deferred tax asset	305	364
Other assets	834	639
Total assets	\$ 14,273	\$ 13,715
Liabilities and Stockholders' Equity		
Noninterest bearing deposits	\$ 2,544	\$ 1,574
Interest bearing deposits	6,827	6,361
Total deposits	9,371	7,935
Short-term Federal Home Loan Bank advances and other	905	2,116
Long-term Federal Home Loan Bank advances	1,577	1,425
Other long-term debt	493	247
Representation and warranty reserve	32	40
Other liabilities (\$60 and \$84 measured at fair value, respectively)	609	423
Total liabilities	12,987	12,186
Stockholders' Equity		
Preferred stock \$0.01 par value, liquidation value \$1,000 per share, 25,000,000 shares authorized; 0 and 266,657 issued and outstanding, respectively	—	267
Common stock \$0.01 par value, 70,000,000 shares authorized; 56,597,271 and 56,483,258 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,494	1,486
Accumulated other comprehensive (loss) income	(20	) 2
Accumulated deficit	(189	) (227
Total stockholders' equity	1,286	1,529
Total liabilities and stockholders' equity	\$ 14,273	\$ 13,715

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

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest Income	(Unaudited)			
Loans	\$90	\$ 77	\$256	\$ 216
Investment securities	16	14	50	43
Interest-earning deposits and other	—	—	—	1
Total interest income	106	91	306	260
Interest Expense				
Deposits	12	10	34	30
Short-term debt	1	2	4	2
Long-term debt	7	4	22	11
Other debt	6	2	10	6
Total interest expense	26	18	70	49
Net interest income	80	73	236	211
Provision (benefit) for loan losses	7	(1	) (9	) (18
Net interest income after provision (benefit) for loan losses	73	74	245	229
Noninterest Income				
Net gain on loan sales	94	68	259	242
Loan fees and charges	22	17	56	53
Deposit fees and charges	5	7	17	19
Loan administration income	4	8	14	19
Net (loss) return on mortgage servicing rights	(11	) 12	(21	) 19
Net (loss) gain on sale of assets	—	1	(2	) (1
Representation and warranty benefit	6	6	12	13
Other noninterest income	36	9	54	9
Total noninterest income	156	128	389	373
Noninterest Expense				
Compensation and benefits	69	58	203	178
Commissions	16	10	40	31
Occupancy and equipment	21	20	64	60
Asset resolution	2	—	6	13
Federal insurance premiums	3	6	9	18
Loan processing expense	13	14	40	40
Legal and professional expense	5	10	20	27
Other noninterest expense	13	13	36	40
Total noninterest expense	142	131	418	407
Income before income taxes	87	71	216	195
Provision for income taxes	30	24	73	70
Net income	\$57	\$ 47	\$143	\$ 125
Income per share				
Basic	\$0.98	\$ 0.70	\$2.21	\$ 1.82
Diluted	\$0.96	\$ 0.69	\$2.16	\$ 1.80
Weighted average shares outstanding				
Basic	56,580,238	58,436,026	56,556,188	58,419,354

Diluted

57,933,806 207,503 57,727,262 205,789

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

5

Table of Contents

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

	Three Months Ended September 30, 2016 2015 (Unaudited)		Nine Months Ended September 30, 2016 2015 (Unaudited)	
Net income	\$57	\$47	\$143	\$125
Other comprehensive income, net of tax				
Investment securities				
Unrealized gain (loss) (net of tax effect \$1, (\$5), (\$10) and (\$5), respectively)	(1)	9	17	9
Less: Reclassification of net (gain) on sale (net of tax effect \$2, \$0, \$3 and \$0, respectively)	(3)	—	(5)	—
Net change in unrealized gain (loss) on investment securities, net of tax	(4)	9	12	9
Derivatives and hedging activities				
Unrealized gain (loss) (net of tax effect \$0, \$2, \$23 and \$2, respectively)	—	(5)	(44)	(5)
Less: Reclassification of net loss (gain) on derivative instruments (net of tax effect (\$2), \$0, (\$6) and \$0, respectively)	3	—	10	—
Net change in derivatives and hedging activities, net of tax	3	(5)	(34)	(5)
Other comprehensive (loss) income, net of tax	(1)	4	(22)	4
Comprehensive income	\$56	\$51	\$121	\$129

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

Table of Contents

Flagstar Bancorp, Inc.

Consolidated Statements of Stockholders' Equity

(In millions, except share data)

	Preferred Stock		Common Stock			Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Number of Shares Outstanding	Amount of Preferred Stock	Number of Shares Outstanding	Amount of Common Stock					
Balance at December 31, 2014 (Unaudited)	266,657	\$ 267	56,332,307	\$ 1	\$ 1,482	\$ 8	\$ (385)	\$ 1,373	
Net income	—	—	—	—	—	—	125	125	
Total other comprehensive income	—	—	—	—	—	4	—	4	
Stock-based compensation	—	—	103,719	—	2	—	—	2	
Balance at September 30, 2015	266,657	\$ 267	56,436,026	\$ 1	\$ 1,484	\$ 12	\$ (260)	\$ 1,504	
Balance at December 31, 2015 (Unaudited)	266,657	\$ 267	56,483,258	\$ 1	\$ 1,486	\$ 2	\$ (227)	\$ 1,529	
Net income	—	—	—	—	—	—	143	143	
Total other comprehensive loss	—	—	—	—	—	(22)	—	(22)	
Preferred stock redemption	(266,657)	(267)	—	—	—	—	—	(267)	
Dividends on preferred stock	—	—	—	—	—	—	(105)	(105)	
Stock-based compensation	—	—	114,013	—	8	—	—	8	
Balance at September 30, 2016	—	\$ —	56,597,271	\$ 1	\$ 1,494	\$ (20)	\$ (189)	\$ 1,286	

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)

	Nine Months Ended September 30,	
	2016	2015
	(Unaudited)	
Operating Activities		
Net income	\$143	\$125
Adjustments to reconcile net income to net cash used in operating activities:		
(Benefit) provision for loan losses	(9	) (18
Representation and warranty (benefit) provision	(12	) (13
Depreciation and amortization	24	17
Deferred income taxes	59	68
Net gain on loan and asset sales	(257	) (241
Change in fair value and other non-cash changes	(268	) (231
Proceeds from sales of loans held-for-sale ("HFS")	14,097	15,247
Origination, premium paid and purchase of loans, net of principal repayments	(23,826	) (22,180
Decrease (increase) in accrued interest receivable	1	(6
(Increase) decrease in other assets, excluding purchase of other investments	(104	) 155
Increase in other liabilities	24	10
Net cash used in operating activities	(10,128	) (7,067
Investing Activities		
Proceeds from sale of available for sale securities including loans that have been securitized	10,876	6,603
Collection of principal on investment securities available-for-sale ("AFS")	116	185
Purchase of investment securities available-for-sale and other	(203	) (783
Collection of principal on investment securities held-to-maturity ("HTM")	126	38
Purchase of investment securities HTM	(15	) (10
Proceeds received from the sale of held-for-investment loans ("HFI")	228	788
Origination and purchase of loans HFI, net of principal repayments	(1,297	) (2,249
Purchase of bank owned life insurance	(85	) (175
Proceeds from the disposition of repossessed assets	14	19
Net (purchase) redemption of Federal Home Loan Bank stock	(2	) 42
Acquisitions of premises and equipment, net of proceeds	(44	) (28
Proceeds from the sale of mortgage servicing rights	35	183
Net cash provided by investing activities	9,749	4,613
Financing Activities		
Net increase in deposit accounts	1,436	1,068
Net change in short-term FHLB borrowings and other short-term debt	(1,211) —
Proceeds from long-term Federal Home Loan Bank advances and other debt	395	22,235
Repayment of long-term Federal Home Loan Bank advances	—	(20,725)
Repayment of long-term debt	—	(55
Net receipt (disbursement) of payments of loans serviced for others	91	(23
Preferred stock dividends	(105) —
Redemption of preferred stock	(267) —
Net receipt of escrow payments	6	13
Net cash provided by financing activities	345	2,513
Net (decrease) increase in cash and cash equivalents	(34) 59

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Beginning cash and cash equivalents	208	136
Ending cash and cash equivalents	\$174	\$195
Supplemental disclosure of cash flow information		
Interest paid on deposits and other borrowings	\$89	\$42
Income tax payments	\$3	\$3
Non-cash reclassification of investment securities AFS to HTM	\$—	\$1,136
Non-cash reclassification of loans originated HFI to loans HFS	\$1,331	\$1,113
Non-cash reclassification of mortgage loans originated HFS to HFI	\$2	\$30
Non-cash reclassification of mortgage loans HFS to AFS securities	\$10,588	\$6,617
Mortgage servicing rights resulting from sale or securitization of loans	\$173	\$220
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. Where we say "we," "us," or "our," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," or "our" will include our wholly owned subsidiary Flagstar Bank, FSB (the "Bank").

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 ("SEC"). These interim financial statements are unaudited and include, in our opinion, all adjustments necessary for a fair statement 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 our Annual Report on Form 10-K for the year ended December 31, 2015, which is available on our 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 September 30, 2016 and December 31, 2015, investment securities were comprised of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
September 30, 2016				
Available-for-sale securities				
Agency - Commercial	\$ 500	\$ 10	\$ —	\$ 510
Agency - Residential	563	10	—	573
Municipal obligations	32	—	—	32
Total available-for-sale securities (1)	\$ 1,095	\$ 20	\$ —	\$ 1,115
Held-to-maturity securities				
Agency - Commercial	\$ 619	\$ 9	\$ —	\$ 628
Agency - Residential	537	12	—	549
Total held-to-maturity securities (1)	\$ 1,156	\$ 21	\$ —	\$ 1,177
December 31, 2015				
Available-for-sale securities				
Agency - Commercial	\$ 766	\$ 3	\$ (3)	\$ 766
Agency - Residential	514	2	(2)	514
Municipal obligations	14	—	—	14
Total available-for-sale securities (1)	\$ 1,294	\$ 5	\$ (5)	\$ 1,294
Held-to-maturity securities				
Agency - Commercial	\$ 634	\$ —	\$ (2)	\$ 632
Agency - Residential	634	—	(4)	630
Total held-to-maturity securities (1)	\$ 1,268	\$ —	\$ (6)	\$ 1,262

(1)

There were no securities of a single issuer, which are not governmental or government-sponsored, that exceeded 10 percent of stockholders' equity at September 30, 2016 or December 31, 2015.

Table of Contents

Credit related declines in the available-for-sale and held-to-maturity securities that are determined to be other than temporary 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) we intend to sell the security; (2) it is more likely than not we 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.

We evaluate our securities portfolio each quarter to determine if any security is considered to be other than temporarily impaired. In making this evaluation, management considers its ability and intent to hold securities to recover current market losses. During the three and nine months ended September 30, 2016 and September 30, 2015, we had no other than temporary impairments.

Available-for-sale securities

Securities available-for-sale are carried at fair value, with unrealized gains and unrealized losses, to the extent they are temporary in nature, reported as a component of other comprehensive income.

We purchased \$136 million and \$203 million, of available-for-sale securities, which included U.S. government sponsored agency mortgage-backed securities and municipal obligations, during the three and nine months ended September 30, 2016, respectively. We purchased \$59 million and \$783 million, of available-for-sale securities, which included U.S. government sponsored agencies comprised of mortgage-backed securities, collateralized mortgage and municipal obligations during the three and nine months ended September 30, 2015, respectively. During the third quarter 2015, we subsequently transferred \$462 million of the securities purchased to held-to-maturity investments.

Gains (losses) on sales of available-for-sale securities are reported in other noninterest income in the Consolidated Statements of Operations. During the three and nine months ended September 30, 2016, there were \$115 million and \$290 million, respectively, in sales of available-for-sale securities, which did not include those related to mortgage loans that had been securitized for sale in the normal course of business. These sales resulted in a realized gain of \$3 million and \$4 million during the three and nine months ended September 30, 2016, respectively. During both the three and nine months ended September 30, 2015 there were no sales of available-for-sale securities, except those related to mortgage loans that had been securitized for sale in the normal course of business.

Held-to-maturity securities

Investment securities held-to-maturity are carried at amortized cost and adjusted for amortization of premiums and accretion of discounts using the interest method. Unrealized losses are not recorded to the extent they are temporary in nature.

Transfers of investment securities into the held-to-maturity category from the available-for-sale category are accounted for at fair value on the date of transfer. The related unrealized gain, net of tax that was included in the transfer is retained in other comprehensive income amortizing as an adjustment to interest income over the remaining life of the securities. During the third quarter 2015, we transferred \$1.1 billion of available-for-sale securities to held-to-maturity securities at a premium of \$8 million, reflecting our intent and ability to hold those securities to maturity. The related \$5 million of unrealized holding gain, net of tax, that was included in the transfer is retained in other comprehensive income (loss) and is being amortized as an adjustment to interest income over the remaining life of the securities. There were no gains or losses recognized as a result of this transfer.

We purchased zero and \$15 million of held-to-maturity securities, which included U.S. government sponsored agency mortgage-backed securities during the three and nine months ended September 30, 2016, respectively. During both the

three and nine months ended September 30, 2015, we purchased \$10 million of held-to-maturity securities.

Gains (losses) on sales of held-to-maturity securities are reported in other noninterest income in the Consolidated Statements of Operations. During both the three and nine months ended September 30, 2016 and September 30, 2015, there were no sales of held-to-maturity securities. During both the three and nine months ended September 30, 2016 and September 30, 2015, there were no maturities and \$25 million of maturities in held-to-maturity securities, respectively.

Table of Contents

The following table summarizes by duration the unrealized loss positions on investment securities:

Type of Security	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
September 30, 2016						
Available-for-sale securities						
Agency - Commercial	\$6	1	\$ —	\$ —	—	\$ —
Agency - Residential	—	—	—	75	6	—
Municipal obligations	—	—	\$ —	—1	1	—
Held-to-maturity securities						
Agency - Commercial	\$ —	—	\$ —	\$20	2	\$ —
Agency - Residential	—	—	—	19	2	—
December 31, 2015						
Available-for-sale securities						
Agency - Commercial	\$ —	—	\$ —	\$482	27	\$ (3)
Agency - Residential	8	2	—	224	15	(2)
Held-to-maturity securities						
Agency - Commercial	\$ —	—	\$ —	\$471	27	\$ (2)
Agency - Residential	—	—	—	547	50	(4)

The amortized cost and estimated fair value of securities at September 30, 2016, are presented below by contractual maturity:

	Investment Securities Available-for-Sale				Investment Securities Held-to-maturity			
	Amortized Cost	Fair Value	Weighted Average Yield		Amortized Cost	Fair Value	Weighted Average Yield	
September 30, 2016								
Due after one year through five years	\$18	\$18	3.94 %		\$—	\$—	— %	
Due after five years through 10 years	7	7	2.64 %		61	63	2.50 %	
Due after 10 years	1,070	1,090	2.45 %		1,095	1,114	2.40 %	
Total	\$1,095	\$1,115			\$1,156	\$1,177		

We pledge investment securities, primarily municipal taxable and agency collateralized mortgage obligations, to collateralize lines of credit and/or borrowings. At September 30, 2016, we had pledged investment securities of \$918 million compared to \$14 million at December 31, 2015.

Note 3 – Loans Held-for-Sale

The majority 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 and selling the securities. At September 30, 2016 and December 31, 2015, loans held-for-sale totaled \$3.4 billion and \$2.6 billion, respectively. For the three and nine months ended September 30, 2016, we had net gains on loan sales associated with loans held-for-sale, excluding the gains from the sale of mortgage loans transferred from loans held-for-investment, of \$94 million and \$244 million, respectively, as compared to \$68 million and \$242 million during the three and nine months ended September 30, 2015, respectively.

At September 30, 2016 and December 31, 2015, \$40 million and \$35 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 we have elected the fair value option for such loans.

Table of Contents

Note 4 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows:

	September 30, 2016	December 31, 2015
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	\$2,136	\$ 3,100
Second mortgage	127	135
HELOC	326	384
Other	30	31
Total consumer loans	2,619	3,650
Commercial loans		
Commercial real estate (1)	1,168	814
Commercial and industrial	708	552
Warehouse lending	1,795	1,336
Total commercial loans	3,671	2,702
Total loans held-for-investment	\$6,290	\$ 6,352

(1) Includes \$252 million and \$188 million of owner occupied commercial real estate loans at September 30, 2016 and December 31, 2015, respectively.

During the nine months ended September 30, 2016 and September 30, 2015, we transferred \$2 million and \$30 million, respectively, of loans held-for-sale to loans held-for-investment, based upon a change in our intent.

During the nine months ended September 30, 2016, we sold nonperforming, TDR and non-agency loans with unpaid principal balances of \$110 million. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a loss on sale of \$2 million during the nine months ended September 30, 2016, which is recorded in net loss on sale of assets on the Consolidated Statements of Operations. The loans sold also resulted in a charge-off of \$8 million during the nine months ended September 30, 2016.

Also, during the nine months ended September 30, 2016, we sold performing residential first mortgage loans with unpaid principal balances of \$1.2 billion. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain of \$14 million, which is recorded in net gain on loan sales on the Consolidated Statements of Operations.

During the nine months ended September 30, 2015, we sold or transferred interest-only residential first mortgage loans with unpaid principal balances totaling \$600 million, along with \$420 million of nonperforming troubled debt restructuring ("TDR") and non-agency first mortgage loans. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a net loss on sale of less than \$1 million during the nine months ended September 30, 2015. The loans sold also resulted in a charge-off of \$67 million.

During the nine months ended September 30, 2016, we purchased jumbo residential first mortgage loans with an unpaid principal balance of \$150 million and a premium of \$1 million. During the nine months ended September 30, 2015, we purchased \$197 million of home equity lines of credit ("HELOC") loans with a premium of \$7 million.

We have 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 Loan Bank of Indianapolis. At September 30, 2016 and December 31, 2015, we had pledged loans of \$5.6 billion and \$5.8 billion, respectively.

Allowance for Loan Losses

We determine the appropriate estimate of the allowance for loan losses on at least a quarterly basis. Refer to Note 1, "Description of Business, Basis of Presentation, and Summary of Significant Accounting Policies" to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2015, for a description of the methodology. The all

12

Table of Contents

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 common risk characteristics to determine our best estimate of incurred losses.

The allowance for loan losses by class of loan are summarized in the following table:

	Residential First Mortgage (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)								
Three Months Ended September 30, 2016								
Beginning balance allowance for loan losses	\$81	\$ 10	\$ 20	\$ 1	\$ 19	\$ 11	\$ 8	\$150
Charge-offs (2)	(7)	—	(1)	(1)	—	—	—	(9)
Recoveries	—	—	1	1	—	—	—	2
Provision (benefit) (3)	(4)	(1)	(4)	—	6	3	—	—
Ending balance allowance for loan losses	\$70	\$ 9	\$ 16	\$ 1	\$ 25	\$ 14	\$ 8	\$143
Three Months Ended September 30, 2015								
Beginning balance allowance for loan losses	\$151	\$ 14	\$ 25	\$ 1	\$ 15	\$ 12	\$ 4	\$222
Charge-offs (2)	(21)	(1)	(1)	(1)	—	(3)	—	(27)
Recoveries	1	1	—	1	—	—	—	3
Provision (benefit)	(2)	(1)	(1)	—	(2)	5	—	(1)
Ending balance allowance for loan losses	\$129	\$ 13	\$ 23	\$ 1	\$ 13	\$ 14	\$ 4	\$197
Nine Months Ended September 30, 2016								
Beginning balance allowance for loan losses	\$116	\$ 11	\$ 21	\$ 2	\$ 18	\$ 13	\$ 6	\$187
Charge-offs (2)	(26)	(2)	(2)	(3)	—	—	—	(33)
Recoveries	1	1	1	2	—	—	—	5
Provision (benefit) (3)	(21)	(1)	(4)	—	7	1	2	(16)
Ending balance allowance for loan losses	\$70	\$ 9	\$ 16	\$ 1	\$ 25	\$ 14	\$ 8	\$143
Nine Months Ended September 30, 2015								
Beginning balance allowance for loan losses	\$234	\$ 12	\$ 19	\$ 1	\$ 17	\$ 11	\$ 3	\$297
Charge-offs (2)	(80)	(2)	(2)	(3)	—	(3)	—	(90)
Recoveries	3	1	—	2	2	—	—	8
Provision (benefit)	(28)	2	6	1	(6)	6	1	(18)
Ending balance allowance for loan losses	\$129	\$ 13	\$ 23	\$ 1	\$ 13	\$ 14	\$ 4	\$197

(1) Includes allowance and charge-offs related to loans with government guarantees.

(2)

Includes charge-offs of zero and \$16 million related to the transfer and subsequent sale of loans during the three months ended September 30, 2016 and September 30, 2015, respectively, and \$8 million and \$67 million related to the sale of loans during the nine months ended September 30, 2016 and September 30, 2015, respectively. Also includes charge-offs related to loans with government guarantees of \$6 million and \$13 million during the three and nine months ended September 30, 2016, respectively.

Does not include \$7 million provision for loan losses recorded in the Consolidated Statements of Operations to (3) reserve for repossessed loans with government guarantees during the three and nine months ended September 30, 2016.

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 (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)								
September 30, 2016								
Loans held-for-investment								
Individually evaluated	\$42	\$ 26	\$ 4	\$ —	\$ —	\$ 1	\$ —	\$73
Collectively evaluated (2)	2,087	60	291	30	1,168	707	1,795	6,138
Total loans	\$2,129	\$ 86	\$ 295	\$ 30	\$ 1,168	\$ 708	\$ 1,795	\$6,211
Allowance for loan losses								
Individually evaluated	\$7	\$ 6	\$ 1	\$ —	\$ —	\$ —	\$ —	\$14
Collectively evaluated (2)	63	3	15	1	25	14	8	129
Total allowance for loan losses	\$70	\$ 9	\$ 16	\$ 1	\$ 25	\$ 14	\$ 8	\$143
December 31, 2015								
Loans held-for-investment								
Individually evaluated	\$87	\$ 28	\$ 3	\$ —	\$ —	\$ 2	\$ —	\$120
Collectively evaluated (2)	3,007	65	318	31	814	550	1,336	6,121
Total loans	\$3,094	\$ 93	\$ 321	\$ 31	\$ 814	\$ 552	\$ 1,336	\$6,241
Allowance for loan losses								
Individually evaluated	\$12	\$ 6	\$ 1	\$ 1	\$ —	\$ —	\$ —	\$20
Collectively evaluated (2)	104	5	20	1	18	13	6	167
Total allowance for loan losses	\$116	\$ 11	\$ 21	\$ 2	\$ 18	\$ 13	\$ 6	\$187

(1)Includes allowance related to loans with government guarantees.

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

Table of Contents

The following table sets forth the loans held-for-investment aging analysis as of September 30, 2016 and December 31, 2015, of past due and current loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due (1)	Total Past Due	Current	Total Investment Loans
(Dollars in millions)						
September 30, 2016						
Consumer loans						
Residential first mortgage	\$4	\$ 1	\$ 29	\$ 34	\$2,102	\$ 2,136
Second mortgage	—	—	4	4	123	127
HELOC	1	—	7	8	318	326
Other	1	1	—	2	28	30
Total consumer loans	6	2	40	48	2,571	2,619
Commercial loans						
Commercial real estate	—	—	—	—	1,168	1,168
Commercial and industrial	—	—	—	—	708	708
Warehouse lending	—	—	—	—	1,795	1,795
Total commercial loans	—	—	—	—	3,671	3,671
Total loans (2)	\$6	\$ 2	\$ 40	\$ 48	\$6,242	\$ 6,290
December 31, 2015						
Consumer loans						
Residential first mortgage	\$7	\$ 3	\$ 53	\$ 63	\$3,037	\$ 3,100
Second mortgage	—	—	2	2	133	135
HELOC	2	1	9	12	372	384
Other	1	—	—	1	30	31
Total consumer loans	10	4	64	78	3,572	3,650
Commercial loans						
Commercial real estate	—	—	—	—	814	814
Commercial and industrial	—	—	2	2	550	552
Warehouse lending	—	—	—	—	1,336	1,336
Total commercial loans	—	—	2	2	2,700	2,702
Total loans (2)	\$10	\$ 4	\$ 66	\$ 80	\$6,272	\$ 6,352

(1) Includes loans that are less than 90 days past due, which have been placed on nonaccrual.

(2) Includes \$12 million and \$10 million of loans 90 days or greater past due, accounted for under the fair value option at September 30, 2016 and December 31, 2015, respectively.

For all classes within the consumer and commercial loan portfolio, loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due (or are determined to be impaired), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. When a loan is placed on nonaccrual status, the accrued interest income is reversed. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Interest income is recognized on nonaccrual loans using a cash basis method. Interest that would have been accrued on impaired loans totaled \$1 million and \$2 million during the three and nine months ended September 30, 2016, respectively, and \$1 million and \$4 million during the three and nine months ended September 30, 2015, respectively. At September 30, 2016 and December 31, 2015, we had no loans 90 days past due and still accruing.

Table of Contents

Troubled Debt Restructuring

We may modify certain loans in both consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. We have 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. Our 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 or repossession of collateral. These loans are classified as nonperforming TDRs if the loan was nonperforming prior to the restructuring, or based upon the results of a contemporaneous credit evaluation. Such 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.

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. We measure impairments using a discounted cash flow method for performing TDRs and measure impairment based on collateral values for re-defaulted TDRs.

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

	TDRs		
	Performing	Nonperforming	Total
September 30, 2016	(Dollars in millions)		
Consumer loans			
Residential first mortgage	\$23	\$ 10	\$33
Second mortgage	33	3	36
HELOC	14	4	18
Total consumer loans	70	17	87
Commercial loans			
Commercial and industrial	1	—	1
Total commercial loans	1	—	1
Total TDRs (1)(2)	\$71	\$ 17	\$88

December 31, 2015

Consumer loans			
Residential first mortgage	\$49	\$ 27	\$76
Second mortgage	32	1	33
HELOC	20	7	27
Total TDRs (1)(2)	\$101	\$ 35	\$136

(1) The allowance for loan losses on consumer TDR loans totaled \$11 million and \$15 million at September 30, 2016 and December 31, 2015, respectively.

(2) Includes \$26 million and \$32 million of TDR loans accounted for under the fair value option at September 30, 2016 and December 31, 2015, respectively.

Table of Contents

The following table provides a summary of newly modified TDRs during the three and nine months ended September 30, 2016 and 2015.

	New TDRs			
	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase in Allowance at Modification
Three Months Ended September 30, 2016		(Dollars in millions)		
Residential first mortgages	1	\$ —	\$ —	\$ —
Second mortgages	16	1	1	—
HELOC (2)(3)	1	—	—	—
Total TDR loans	18	\$ 1	\$ 1	\$ —
Three Months Ended September 30, 2015				
Residential first mortgages	48	\$ 13	\$ 14	\$ —
Second mortgages	15	1	1	—
HELOC (2)	46	4	4	—
Total TDR loans	109	\$ 18	\$ 19	\$ —
Nine Months Ended September 30, 2016				
Residential first mortgages	17	\$ 3	\$ 4	\$ —
Second mortgages	42	2	2	—
HELOC (2)(3)	86	6	5	—
Commercial and industrial	1	2	1	—
Total TDR loans	146	\$ 13	\$ 12	\$ —
Nine Months Ended September 30, 2015				
Residential first mortgages	239	\$ 66	\$ 65	\$ (1)
Second mortgages	83	4	3	—
HELOC (2)(3)	204	12	11	—
Other consumer	3	—	—	—
Total TDR loans	529	\$ 82	\$ 79	\$ (1)

(1) Post-modification balances include past due amounts that are capitalized at modification date.

(2) HELOC post-modification unpaid principal balance reflects write downs.

(3) Includes loans carried at the fair value option.

Table of Contents

The following table provides a summary of TDR loans that were modified within the previous 12 months, which subsequently defaulted during the three and nine months ended September 30, 2016 and 2015. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when they are greater than 90 days past due.

	TDRs that were modified in the previous 12 months, which have subsequently defaulted				Increase in Allowance at Subsequent Default
	Number of Accounts	Unpaid Principal Balance			
Three Months Ended September 30, 2016	(Dollars in millions)				
HELOC (1)	3	\$	—	\$	—
Total TDR loans	3	\$	—	\$	—
Three Months Ended September 30, 2015					
Residential first mortgages	1	\$	—	\$	—
Total TDR loans	1	\$	—	\$	—
Nine Months Ended September 30, 2016					
Residential first mortgages	1	\$	—	\$	—
HELOC (1)	7	—	—	—	—
Total TDR loans	8	\$	—	\$	—
Nine Months Ended September 30, 2015					
Residential first mortgages	1	\$	—	\$	—
Second mortgages	1	—	—	—	—
Total TDR loans	2	\$	—	\$	—

(1)HELOC post-modification unpaid principal balance reflects write downs.

Table of Contents

Impaired Loans

Loans are considered impaired if it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement or when any portion of principal or interest is 90 days past due. The following table presents individually evaluated impaired loans and the associated allowance:

	September 30, 2016			December 31, 2015		
	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	\$2	\$ 1	\$ —	\$20	\$ 20	\$ —
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
	\$3	\$ 2	\$ —	\$25	\$ 22	\$ —
With an allowance recorded						
Consumer loans						
Residential first mortgage	\$40	\$ 41	\$ 7	\$65	\$ 67	\$ 12
Second mortgage	26	26	6	28	28	6
HELOC	4	4	2	3	3	1
Other consumer	—	—	—	—	—	1
	\$70	\$ 71	\$ 15	\$96	\$ 98	\$ 20
Total						
Consumer loans						
Residential first mortgage	\$42	\$ 42	\$ 7	\$85	\$ 87	\$ 12
Second mortgage	26	26	6	28	28	6
HELOC	4	4	2	3	3	1
Other consumer	—	—	—	—	—	1
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
Total impaired loans	\$73	\$ 73	\$ 15	\$121	\$ 120	\$ 20

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
	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	\$43	\$ —	\$ 96	\$ 1	\$55	\$ 1	\$ 172	\$ 4
Second mortgage	25	—	29	—	26	1	30	—
HELOC	5	—	15	—	5	—	6	—
Commercial loans								
Commercial and industrial	1	—	2	—	2	—	1	—
Total impaired loans	\$74	\$ —	\$ 142	\$ 1	\$88	\$ 2	\$ 209	\$ 4

Table of Contents

Credit Quality

We utilize 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. Descriptions of our 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 we will sustain some loss if the deficiencies are not corrected. For HELOC loans and other consumer loans, we evaluate credit quality based on the aging and status of payment activity and any other known credit characteristics that call into question full repayment of the asset. Nonperforming loans are classified as either substandard, doubtful or loss.

Doubtful. An asset classified as doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. A doubtful asset has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Because of high probability of loss, non-accrual accounting treatment is required for doubtful assets.

Loss. An asset classified as loss is considered uncollectible and of such little value that the continuance as a bankable asset is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but, rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

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 loan-to-value ("LTV"). The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship.

Consumer Loans

Consumer loans consist 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.

20

Table of Contents

In accordance with regulatory guidance, we assign 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.

Commercial Credit Loans	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial
September 30, 2016	(Dollars in millions)			
Grade				
Pass	\$ 1,122	\$ 654	\$ 1,659	\$ 3,435
Watch	37	20	86	143
Special mention	3	33	50	86
Substandard	6	1	—	7
Total loans	\$ 1,168	\$ 708	\$ 1,795	\$ 3,671

December 31, 2015

Grade				
Pass	\$ 766	\$ 492	\$ 1,181	\$ 2,439
Watch	42	30	155	227
Special mention	2	21	—	23
Substandard	4	9	—	13
Total loans	\$ 814	\$ 552	\$ 1,336	\$ 2,702

Consumer Credit Loans	Residential Mortgage	Secured First Mortgage	HELOC	Other Consumer	Total
September 30, 2016	(Dollars in millions)				
Grade					
Pass	\$ 2,081	\$ 90	\$ 305	\$ 29	\$ 2,505
Watch	24	33	14	1	72
Substandard	31	4	7	—	42
Total loans	\$ 2,136	\$ 127	\$ 326	\$ 30	\$ 2,619

December 31, 2015

Grade					
Pass	\$ 2,993	\$ 101	\$ 353	\$ 31	\$ 3,478
Watch	49	32	22	—	103
Substandard	58	2	9	—	69
Total loans	\$ 3,100	\$ 135	\$ 384	\$ 31	\$ 3,650

Note 5 – Loans with Government Guarantees

Substantially all loans with government guarantees are insured or guaranteed by the Federal Housing Administration ("FHA") and U.S. Department of Veterans Affairs. FHA 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 by the FHA until claimed. Certain loans within our portfolio may be subject to indemnifications and insurance limits which exposes us to limited credit risk. We have reserved for these risks within other assets and as a component of our allowance for loan losses on residential first mortgages.

At September 30, 2016 and December 31, 2015, loans with government guarantees totaled \$404 million and \$485 million, respectively. At September 30, 2016 and December 31, 2015, repossessed assets and the associated claims

recorded in other assets totaled \$152 million and \$210 million, respectively.

Table of Contents

Note 6 – Variable Interest Entities ("VIEs")

In 2015, we executed clean-up calls of the FSTAR 2005-1 and FSTAR 2006-2 long-term debt associated with the HELOC securitization trusts. As a result, the FSTAR 2005-1 and FSTAR 2006-2 HELOC securitization trusts were dissolved and we have no consolidated VIEs as of September 30, 2016 and December 31, 2015.

We have a continuing involvement, but are not the primary beneficiary for one unconsolidated VIE related to the FSTAR 2007-1 mortgage securitization trust. In accordance with the settlement agreement with MBIA Insurance Corporation ("MBIA"), there is no further recourse to us related to FSTAR 2007-1, unless MBIA fails to meet their obligations. At September 30, 2016 and December 31, 2015, the FSTAR 2007-1 mortgage securitization trust included 2,608 loans and 3,061 loans, respectively, with an aggregate principal balance of \$96 million and \$117 million, respectively.

Note 7 – Mortgage Servicing Rights

We have investments in mortgage servicing rights ("MSRs") that result from the sale of loans to the secondary market for which we retain the servicing. The primary risk associated with MSRs is the potential reduction in fair value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates or government intervention. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. We utilize derivatives 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. There is also a risk of valuation decline due to higher than expected increases in default rates, which we do not believe can be effectively managed using derivatives. See Note 8 of the Notes to the Consolidated Financial Statements, herein, for further information regarding the derivative instruments utilized to manage our MSR risks.

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2016	2015	2016	2015
	(Dollars in millions)			
Balance at beginning of period	\$301	\$317	\$296	\$258
Additions from loans sold with servicing retained	51	74	173	220
Reductions from sales	(17)	(73)	(41)	(144)
Changes in fair value due to (1)				
Decrease in MSR due to pay-offs, pay-downs and run-off	(19)	(9)	(45)	(34)
Changes in estimates of fair value (2)	(14)	(15)	(81)	(6)
Fair value of MSRs at end of period	\$302	\$294	\$302	\$294

(1) Changes in fair value are included within net (loss) return on mortgage servicing rights on the Consolidated Statements of Operations.

(2) Represents estimated MSR value change resulting primarily from market-driven changes.

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:

September 30, 2016 December 31, 2015

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	Actual	Fair value impact due to 10% adverse change		Actual	Fair value impact due to 10% adverse change	
		20%	20%		20%	20%
Option adjusted spread	9.20	% \$295	\$ 288	8.24	% \$287	\$ 279
Constant prepayment rate	15.68	% 290	280	12.63	% 285	275
Weighted average cost to service per loan	\$70.75	299	295	\$71.86	292	288

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

Table of Contents

change, the fair value shock analysis is consistent with the identified adverse change, while holding all other assumptions constant. In practice, a change in one assumption generally impacts other assumptions, which may either magnify or counteract the effect of the change.

See Note 17 of the Notes to the Consolidated Financial Statements, herein, for further fair value disclosures relating to mortgage servicing rights.

Contractual servicing and subservicing fees. Contractual servicing and subservicing fees, including late fees and other ancillary income are presented below. Contractual servicing fees are included within net (loss) return on mortgage servicing rights 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.

The following table summarizes income and fees associated with contractual servicing rights:

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
	(Dollars in millions)			
Income on mortgage servicing rights				
Servicing fees, ancillary income and late fees (1)	\$22	\$18	\$60	\$52
Changes in fair value (2)	(33)	(24)	(126)	(38)
Gain on MSR derivatives (3)	(1)	15	44	10
Net transaction costs	1	3	1	(5)
Total (loss) return, included in net return on mortgage servicing rights	\$(11)	\$12	\$(21)	\$19

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

(2) Includes a \$2 million gain related to the sale of MSRs during the nine months ended September 30, 2015.

(3) Changes in the derivatives utilized as economic hedges to offset changes in fair value of the MSRs.

The following table summarizes income and fees associated with our mortgage loans subserviced:

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
	(Dollars in millions)			
Income on mortgage loans subserviced				
Subservicing fees, ancillary income and late fees (1)	\$7	\$8	\$21	\$24
Other servicing charges	(3)	—	(7)	(5)
Total income, included in loan administration	\$4	\$8	\$14	\$19

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

Note 8 – Derivative Financial Instruments

Derivative financial instruments are recorded at fair value in other assets and other liabilities on the Consolidated Statements of Financial Condition after taking into account the effects of legally enforceable bilateral collateral and

master netting agreements. We are exposed to non-performance risk by the counterparties to our various derivative financial instruments. We believe that the non-performance risk inherent in all our derivative contracts is minimal based on credit standards and the collateral provisions of the derivative agreements. A majority of our derivatives are centrally cleared through a Central Counterparty Clearing House or consist of residential mortgage interest rate lock commitments further limiting our exposure to non-performance risk.

Derivatives not designated as hedging instruments: We maintain 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. We also enter 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.

Table of Contents

Changes in fair value of derivatives not designated as hedging instruments are recognized in the Consolidated Statements of Income.

Derivatives designated as hedging instruments: We have designated certain interest rate swaps as cash flow hedges of certain interest rate payments of our variable-rate Federal Home Loan Bank advances.

Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income (loss) on the Consolidated Statement of Financial Condition and reclassified into interest expense in the same period in which the hedge transaction is recognized in earnings. At September 30, 2016, we had \$37 million (net-of-tax) recorded of unrealized losses on derivatives classified as cash flow hedges recorded in accumulated other comprehensive income (loss), compared to \$3 million at December 31, 2015. The estimated amount to be reclassified from other comprehensive income into earnings during the next 12 months represents \$7 million of losses (net-of-tax).

Derivatives that are designated in hedging relationships are assessed for effectiveness using regression analysis at inception and throughout the hedge period. All hedge relationships were and are expected to be highly effective as of September 30, 2016. Cash flows and the profit impact associated with designated hedges are reported in the same category as the underlying hedged item.

The net gain (loss) recognized in income on derivative instruments, net of the impact of offsetting positions, were as follows:

	Location of Gain/(Loss)	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2015	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2015
		(Dollars in millions)			
Derivatives not designated as hedging instruments:					
U.S. Treasury, swap and euro dollar futures	Net (loss) return on mortgage servicing rights	\$4	\$3	\$8	\$6
Interest rate swaps and swaptions	Net (loss) return on mortgage servicing rights	(7)	10	21	2
Mortgage backed securities forwards	Net (loss) return on mortgage servicing rights	2	2	15	2
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	15	(24)	14	(4)
Rate lock commitments	Other noninterest income	—	1	1	(1)
Interest rate swaps	Other noninterest income	2	2	3	2
Total derivative (loss) gain		\$16	\$(6)	\$62	\$7

Table of Contents

The notional amount, estimated fair value and maturity of our derivative financial instruments were as follows:

	Notional Amount	Fair Value	Expiration Dates
	(Dollars in millions)		
September 30, 2016			
Derivatives designated as hedging instruments:			
Assets			
Interest rate swaps on FHLB advances	\$200	\$ 3	2026
Liabilities (1)			
Interest rate swaps on FHLB advances	\$825	\$ 55	2023-2025
Derivatives not designated as hedging instruments:			
Assets (2)			
U.S. Treasury, swap and euro dollar futures	\$5,450	\$ 1	2016-2019
Mortgage backed securities forwards	1,317	2	2016
Rate lock commitments	6,357	63	2016
Interest rate swaps and swaptions	2,273	53	2016-2046
Total derivative assets	\$15,397	\$ 119	
Liabilities (1)			
U.S. Treasury, swap and euro dollar futures	\$635	\$ —	2019-2020
Mortgage backed securities forwards	5,849	24	2016
Rate lock commitments	87	—	2016
Interest rate swaps	558	17	2016-2026
Total derivative liabilities	\$7,129	\$ 41	
December 31, 2015			
Derivatives designated as hedging instruments:			
Liabilities (1)			
Interest rate swaps on FHLB advances	\$825	\$ 4	2023-2025
Derivatives not designated as hedging instruments:			
Assets (2)			
U.S. Treasury, swap and euro dollar futures	\$1,892	\$ —	2016-2019
Mortgage backed securities forwards	1,931	7	2016
Rate lock commitments	3,593	26	2016
Interest rate swaps and swaptions	1,554	25	2016-2035
Total derivative assets	\$8,970	\$ 58	
Liabilities (1)			
U.S. Treasury, swap and euro dollar futures	\$768	\$ 1	2016-2019
Mortgage backed securities forwards	2,655	6	2016
Rate lock commitments	168	—	2016
Interest rate swaps	422	7	2016-2025
Total derivative liabilities	\$4,013	\$ 14	

(1) Derivative liabilities are included in other liabilities on the Consolidated Statements of Financial Condition.

(2) Derivative assets are included in other assets on the Consolidated Statements of Financial Condition.

Table of Contents

The following tables present the derivatives subject to a master netting arrangement, including the cash pledged as collateral:

	Gross Amounts	Net Amount	Gross Amounts	Gross Amounts Not Offset in the Statement of Financial Position
	Not Netted in the Statement of Financial Position	Presented in the Statement of Financial Position	Not Netted in the Statement of Financial Position	Offset in the Statement of Financial Position
			Cash Collateral	
September 30, 2016				
Derivatives designated as hedging instruments:				
Assets				
Interest rate swaps on FHLB advances (1)	\$3	\$ 3	\$ —	\$ —
Liabilities				
Interest rate swaps on FHLB advances (1)	\$55	\$ 3	\$ 52	\$ 34
Derivatives not designated as hedging instruments:				
Assets				
U.S. Treasury, swap and euro dollar futures	\$1	\$ —	\$ 1	\$ —
Mortgage backed securities forwards	2	—	2	—
Interest rate swaps and swaptions (1)	53	—	53	24
Total derivative assets	\$56	\$ —	\$ 56	\$ 24
Liabilities				
U.S. Treasury, swap and euro dollar futures	\$—	\$ —	\$ —	\$ 2
Mortgage backed securities forwards	24	—	24	41
Interest rate swaps and swaptions (1)	17	—	17	7
Total derivative liabilities	\$41	\$ —	\$ 41	\$ 50
December 31, 2015				
Derivatives designated as hedging instruments:				
Liabilities				
Interest rate swaps on FHLB advances	\$4	\$ —	\$ 4	\$ 19
Derivatives not designated as hedging instruments:				
Assets				
Mortgage backed securities forwards	\$7	\$ —	\$ 7	\$ 4
Interest rate swaps and swaptions (1)	25	—	25	10
Total derivative assets	\$32	\$ —	\$ 32	\$ 14
Liabilities				

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U.S. Treasury, swap and euro dollar futures	\$1	\$ —	\$ 1	\$ 2
Mortgage backed securities forwards	6	—	6	— 8
Interest rate swaps and swaptions (1)	7	—	7	— 12
Total derivative liabilities	\$14	\$ —	\$ 14	\$ 22

(1) Additional funds are pledged to a central counterparty clearing house in the amount of \$56 million as of September 30, 2016 and \$7 million as of December 31, 2015 to maintain initial margin requirements. This collateral is in addition to the amount required to be maintained for potential market changes shown in the cash collateral column above.

Table of Contents

We pledged a total of \$84 million of cash collateral to counterparties and had an obligation to return cash of \$24 million at September 30, 2016 for derivative activities. We pledged a total of \$41 million of cash collateral to counterparties and had an obligation to return cash of \$14 million at December 31, 2015 for derivative activities. The net cash pledged is restricted and is included in other assets on the Consolidated Statements of Financial Condition.

Note 9 – Debt

Federal Home Loan Bank Advances and other

The following is a breakdown of our Federal Home Loan Bank advances and other short-term debt outstanding:

September 30, 2016	December 31, 2015
Amount	Rate Amount