

FLAGSTAR BANCORP INC  
Form 10-Q  
November 07, 2016  
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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<br>Incorporation or organization) | (I.R.S. Employer<br>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.

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## 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.



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

|   | Three Months<br>Ended September<br>30, |            | Nine Months<br>Ended September<br>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   | 56,580,278                             | 58,436,026 | 56,556,588                            | 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.

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

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2016 2015<br>(Unaudited) |      | Nine Months<br>Ended<br>September<br>30,<br>2016 2015<br>(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.

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Flagstar Bancorp, Inc.

Consolidated Statements of Stockholders' Equity

(In millions, except share data)

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

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

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Flagstar Bancorp, Inc.

Consolidated Statements of Cash Flows

(In millions)

|  | Nine Months<br>Ended September<br>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.

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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](http://flagstar.com), and on the SEC website, at [sec.gov](http://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<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>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.

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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.



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

| Type of Security              | Unrealized Loss Position<br>with<br>Duration 12 Months and<br>Over |                      |                 | Unrealized Loss Position<br>with<br>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<br>Available-for-Sale |            |                        |  | Investment Securities<br>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.

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## Note 4 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows:

|                                 | September 30,<br>2016 | December 31,<br>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

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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<br>First Mortgage<br>(1) | Second<br>Mortgage | HELOC | Other<br>Consumer | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Warehouse<br>Lending | Total |
|---|--------------------------------------|--------------------|-------|-------------------|---------------------------|---------------------------------|----------------------|-------|
| (Dollars in millions)                       |                                      |                    |       |                   |                           |                                 |                      |       |
| Three Months Ended September 30,<br>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,<br>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,<br>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,<br>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.

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

|                                 | Residential<br>First Mortgage<br>(1) | Second<br>Mortgage | HELOC  | Other<br>Consumer | Commercial<br>Real Estate | Commercial<br>and Industrial | Warehouse<br>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.

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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<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater Past<br>Due (1) | Total<br>Past<br>Due | Current | Total<br>Investment<br>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.





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## 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.

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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.

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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,<br>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.

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## 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      | Average Interest Income Recognized | Average Recorded Investment | Average Interest Income Recognized | Average Recorded Investment     | Average Interest Income Recognized | Average Recorded Investment | Average 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                               |



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### 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.

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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.

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## 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<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine Months<br>Ended<br>September<br>30,<br>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

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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<br>Months<br>Ended<br>September<br>30,<br>2016 | Three<br>Months<br>Ended<br>September<br>30,<br>2015 | Nine<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>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<br>Months<br>Ended<br>September<br>30,<br>2016 | Three<br>Months<br>Ended<br>September<br>30,<br>2015 | Nine<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>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.

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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<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 | Three<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |
|---|--|--|---|--|---|
| 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   |

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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.





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

(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.

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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            | Rate  |
|  | (Dollars in millions) |       |                   |       |
| Short-term adjustable rate (1)                             | \$20                  | 0.67% | \$—               | —%    |
| Short-term fixed rate term advances                        | 865                   | 0.37% | 2,116             | 0.32% |
| Other short-term (2)                                       | 20                    | 0.55% | —                 | —%    |
| Total Short-term Federal Home Loan Bank advances and other | \$905                 |       | \$2,116           |       |
| Long-term LIBOR adjustable advances                        | 1,025                 | 0.94% | 825               | 0.70% |
| Long-term fixed rate advances (3)                          | 552                   | 1.44% | 600               | 1.37% |
| Total Long-term Federal Home Loan Bank advances            | \$1,577               |       | \$1,425           |       |
| Total Federal Home Loan Bank advances and other            | \$2,482               |       | \$3,541           |       |

(1) Includes short-term adjustable rate federal funds line of credit.

(2) Other short-term debt consists of borrowings that settle through the Federal Reserve Bank.

(3) Includes the current portion of fixed rate advances of \$125 million and \$175 million at September 30, 2016 and December 31, 2015, respectively.

We settled \$375 million in long-term fixed rate Federal Home Loan Bank advances during the fourth quarter 2015, which resulted in a gain on extinguishment of debt of \$3 million, included in other noninterest income.

We are required to maintain a minimum amount of qualifying collateral. In the event of default, the Federal Home Loan Bank advance is similar to a secured borrowing, whereby the Federal Home Loan Bank has the right to sell the pledged collateral to settle the fair value of the outstanding advances.

At September 30, 2016, we had the authority and approval from the Federal Home Loan Bank to utilize a line of credit of up to \$7.0 billion and we may access that line to the extent that collateral is provided. At September 30, 2016, we had \$2.5 billion of advances outstanding and an additional \$2.0 billion of collateralized borrowing capacity available at the Federal Home Loan Bank. The advances can be collateralized by non-delinquent single-family residential first mortgage loans, loans with government guarantees, certain other loans and investment securities.

At September 30, 2016, \$1.0 billion of the outstanding advances were adjustable rate based on the three-month LIBOR index. Interest rates on these advances reset every three months and the advances may be prepaid without penalty, with notification at scheduled three month intervals after an initial 12 month lockout period.

The following table contains detailed information on our Federal Home Loan Bank advances and other borrowings:

| Three Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|---------------------------------------|------|--------------------------------------|------|
|                                       | 2015 | 2016                                 | 2015 |
|                                       |      |                                      |      |

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(Dollars in millions)

|                                      |         |         |         |          |
|--------------------------------------|---------|---------|---------|----------|
| Maximum outstanding at any month end | \$3,182 | \$2,127 | \$3,557 | \$2,198  |
| Average outstanding balance          | 2,649   | 1,798   | 2,777   | 1,610    |
| Average remaining borrowing capacity | 1,626   | 1,738   | 1,106   | 1,711    |
| Weighted average interest rate       | 1.26    | % 1.17  | % 1.25  | % 1.05 % |

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The following outlines our Federal Home Loan Bank advances and other final maturity dates as of September 30, 2016:

|            | September 30, 2016<br>(Dollars in millions) |
|------------|---|
| 2016       | \$ 1,030                                    |
| 2017       | 50  |
| 2018       | 125   |
| 2019       | —   |
| Thereafter | 1,277                                       |
| Total      | \$ 2,482                                    |

## Senior Notes and Trust Preferred Securities

The following table presents long-term debt:

|                                  | September 30, 2016    |         | December 31, 2015 |        |
|----------------------------------|-----------------------|---------|-------------------|--------|
|                                  | (Dollars in millions) |         |                   |        |
| Senior Notes                     |                       |         |                   |        |
| Senior notes, matures 2021       | \$246                 | 6.125 % | \$—               |        |
| Trust Preferred Securities       |                       |         |                   |        |
| Floating Three Month LIBOR       |                       |         |                   |        |
| Plus 3.25%, matures 2032         | \$26                  | 4.11 %  | \$26              | 3.85 % |
| Plus 3.25%, matures 2033         | 26                    | 3.93 %  | 26                | 3.57 % |
| Plus 3.25%, matures 2033         | 26                    | 3.88 %  | 26                | 3.85 % |
| Plus 2.00%, matures 2035         | 26                    | 2.68 %  | 26                | 2.32 % |
| Plus 2.00%, matures 2035         | 26                    | 2.68 %  | 26                | 2.32 % |
| Plus 1.75%, matures 2035         | 51                    | 2.60 %  | 51                | 2.26 % |
| Plus 1.50%, matures 2035         | 25                    | 2.18 %  | 25                | 1.82 % |
| Plus 1.45%, matures 2037         | 25                    | 2.30 %  | 25                | 1.96 % |
| Plus 2.50%, matures 2037         | 16                    | 3.35 %  | 16                | 3.01 % |
| Total Trust Preferred Securities | \$247                 |         | \$247             |        |
| Total long-term debt             | \$493                 |         | \$247             |        |

## Senior Notes

On July 11, 2016, we issued \$250 million of senior notes (“2021 Senior Notes”) which mature on July 15, 2021. The proceeds from these notes were used to bring current and redeem our outstanding Series C Preferred Stock. The notes are unsecured and rank equally and ratably with the unsecured senior indebtedness of Flagstar Bancorp, Inc.

Prior to June 15, 2021, we may redeem some or all of the 2021 Senior Notes at a redemption price equal to the greater of 100 percent of the aggregate principal amount of the notes to be redeemed or the sum of the present values of the remaining scheduled payments discounted to the redemption date on a semi-annual basis using a discount rate equal to the Treasury Rate plus 0.50 percent, plus, in each case accrued and unpaid interest.

## Trust Preferred Securities

We sponsor nine trust subsidiaries, which issued preferred stock to third party investors. We issued trust preferred securities to those trusts which we have included in long-term debt which are the sole assets of the trusts.

The trust preferred securities are callable by us at any time. Interest is payable quarterly; however, we may defer interest payments for up to 20 quarters without default or penalty. In January 2012, we exercised our contractual rights to defer interest payments. On July 14, 2016, we ended the deferral and made a \$34 million payment to bring current our previously deferred interest as of that date.

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## Note 10 - Representation and Warranty Reserve

At the time a loan is sold, an estimate of the fair value of the guarantee associated with the mortgage loans is recorded in the representation and warranty reserve in the Consolidated Statements of Financial Condition which reduces the net gain on loan sales in the Consolidated Statements of Operations. Subsequent to the sale, the liability is re-measured on an ongoing basis based on an estimate of probable losses. Changes in the estimate are recorded in the representation and warranty provision (benefit) on the Consolidated Statements of Operations.

The following table shows the activity impacting the representation and warranty reserve:

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |      | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |      |
|--|--|------|---|------|
|  | (Dollars in millions)                                |      |   |      |
| Balance, beginning of period                                     | \$36   | \$48 | \$40  | \$53 |
| Provision (benefit)  |  |      |   |      |
| Gain on sale reduction for representation and warranty liability | 1  | 2    | 4   | 6    |
| Representation and warranty provision (benefit)                  | (6)  | (6)  | (12)  | (13) |
| Total  | (5)  | (4)  | (8)   | (7)  |
| Charge-offs, net   | 1  | 1    | —   | (1)  |
| Balance, end of period   | \$32   | \$45 | \$32  | \$45 |

Due to our sustained low level of charge-offs and a lower level of demands received, we have reduced our estimate of probable losses related to our representation and warranty liability as of September 30, 2016 compared to September 30, 2015.

## Note 11 — Warrants

## May Investor Warrant

We granted warrants (the "May Investor Warrants") on January 30, 2009 under anti-dilution provisions applicable to certain investors (the "May Investors") in our May 2008 private placement capital raise.

For the nine months ended September 30, 2016, 32,721 May Investor Warrants were exercised resulting in the issuance of 21,068 shares of Common Stock. The May Investors held warrants to purchase 583,240 shares at an exercise price of \$10.00 at September 30, 2016.

The May Investor Warrants do not meet the definition of a contract that is indexed to our own stock under U.S. GAAP. Therefore, the May Investor Warrants are classified as other liabilities on the Consolidated Statements of Financial Condition and are measured at fair value. Warrant liabilities are valued using a Black Scholes model and are classified within Level 2 of the valuation hierarchy. Significant observable inputs include share price, expected volatility, a risk free rate and an expected life. The warrants are accounted for under the equity method.

At September 30, 2016 and December 31, 2015, the liability from May Investors Warrants amounted to \$10 million and \$8 million, respectively. See Note 17 of the Notes to the Consolidated Financial Statements, herein, for further recurring fair value disclosures.

TARP Warrant

On January 30, 2009, in conjunction with the sale of 266,657 shares of Series C fixed rate cumulative non-convertible perpetual preferred stock ("Series C Preferred Stock"), we issued a warrant to purchase up to approximately 645,138 shares of Common Stock at an exercise price of \$62.00 per share (the "Warrant") for \$267 million.

The Warrant is exercisable through 2019 and remains outstanding subsequent to the redemption of TARP, which occurred during the third quarter 2016.



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## Note 12 - Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss) for each type of investment securities available-for-sale, investment securities held-to-maturity, and cash flow hedges:

|  | Held-to-Maturity Securities | Available-for-Sale Securities | Cash Flow Hedges | Accumulated Other Comprehensive Income (Loss) Net of Tax |
|--|-----------------------------|-------------------------------|------------------|--|
| (Dollars in millions)                                  |                             |                               |                  |  |
| Accumulated other comprehensive income (loss) ("AOCI") |                             |                               |                  |  |
| Balance at December 31, 2015, net of tax               | \$5                         | \$ —                          | \$ (3 )          | \$ 2   |
| Net unrealized loss, net of tax                        | —                           | 17                            | (44 )            | (27 )  |
| Reclassifications out of AOCI                          | (1 )                        | (4 )                          | 10               | 5  |
| Balance at September 30, 2016, net of tax              | \$4                         | \$ 13                         | \$ (37 )         | \$ (20 )   |
| Balance at December 31, 2014, net of tax               | \$—                         | \$ 8                          | \$ —             | \$ 8   |
| Net unrealized gain, net of tax                        | —                           | 9                             | (5 )             | 4  |
| Transfer of net unrealized loss from AFS to HTM        | 5                           | (5 )                          | —                | —  |
| Balance at September 30, 2015, net of tax              | \$5                         | \$ 12                         | \$ (5 )          | \$ 12  |

## Note 13 – Earnings Per Share

Basic earnings per share, excluding dilution, is computed by dividing earnings available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock or resulted in the issuance of common stock that could then share in our earnings.

The following table sets forth the computation of basic and diluted earnings per share of common stock:

|   | Three Months Ended September 30, 2016 |            | Nine Months Ended September 30, 2015 |            |
|---|---------------------------------------|------------|--------------------------------------|------------|
| (Dollars in millions, except share data)      |                                       |            |                                      |            |
| Net income                                    | \$57                                  | \$ 47      | \$143                                | \$ 125     |
| Deferred cumulative preferred stock dividends | (2 )                                  | (8 )       | (18 )                                | (22 )      |
| Net income applicable to common stockholders  | \$55                                  | \$ 39      | \$ 125                               | \$ 103     |
| Weighted average shares                       |                                       |            |                                      |            |
| Weighted average common shares outstanding    | 56,580,264                            | 56,436,026 | 56,556,188                           | 56,419,354 |
| Effect of dilutive securities                 |                                       |            |                                      |            |
| May Investor warrants                         | 364,791                               | 339,478    | 339,893                              | 290,840    |
| Stock-based awards                            | 988,777                               | 7431,999   | 831,181                              | 340,595    |
| Weighted average diluted common shares        | 57,933,806                            | 57,207,503 | 57,727,262                           | 57,050,789 |
| Earnings per common share                     |                                       |            |                                      |            |
| Basic earnings per common share               | \$0.98                                | \$ 0.70    | \$2.21                               | \$ 1.82    |
| Effect of dilutive securities                 |                                       |            |                                      |            |
| May Investor warrants                         | —                                     | —          | (0.02 )                              | (0.01 )    |
| Stock-based awards                            | (0.02 )                               | (0.01 )    | (0.03 )                              | (0.01 )    |

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|                            |        |         |        |         |
|----------------------------|--------|---------|--------|---------|
| Diluted earnings per share | \$0.96 | \$ 0.69 | \$2.16 | \$ 1.80 |
|----------------------------|--------|---------|--------|---------|

On July 29, 2016, we completed the previously announced \$267 million redemption of our Series C Preferred Stock. This transaction reduced stockholders equity by approximately \$372 million with a \$267 million reduction in Preferred Stock and a \$105 million reduction related to the payment of deferred dividends.

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Under the terms of the Series C Preferred Stock the Company was able to defer payments of dividends. We elected to defer dividend payments beginning with the February 2012 dividend. Although, while being deferred, the impact was not included in quarterly net income from continuing operations, the deferral still impacted net income applicable to common stock for the purpose of calculating earnings per share, as shown above.

## Note 14 – Income Taxes

The provision for income taxes in interim periods requires us to make a best estimate of the effective tax rate expected to be applicable for the full year. This estimated effective tax rate is then applied to interim consolidated pre-tax operating income to determine the interim provision for income taxes.

|                              | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |       |
|------------------------------|--|-------|---|-------|
|                              | 2016   | 2015  | 2016  | 2015  |
| Provision for income taxes   | \$30   | \$24  | \$73  | \$70  |
| Effective tax provision rate | 34.3%  | 34.4% | 33.8%   | 36.0% |

(Dollars in millions)

We believe that it is unlikely that the unrecognized tax benefits will change by a material amount during the next 12 months. We recognize interest and penalties related to unrecognized tax benefits in provision for income taxes.

## Note 15 — Regulatory Matters

## Regulatory Capital

We, along with the Bank, must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that could have a material effect on the Consolidated Financial Statements. On January 1, 2015, the Basel III rules became effective and include transition provisions through 2018.

To be categorized as "well-capitalized," the Company and the Bank must maintain minimum tangible capital, Tier 1 capital, common equity Tier 1, and total capital ratios as set forth in the table below. We, along with the Bank, are considered "well-capitalized" at both September 30, 2016 and December 31, 2015. There have been no conditions or events that management believes have changed our or the Bank's category.

The following table shows the regulatory capital ratios as of the dates indicated:

| Bancorp                                      | Actual                |        | For Capital Adequacy Purposes |        | Well Capitalized Under Prompt Corrective Action Provisions |        |
|--|-----------------------|--------|-------------------------------|--------|--|--------|
|  | Amount                | Ratio  | Amount                        | Ratio  | Amount   | Ratio  |
|  | (Dollars in millions) |        |                               |        |  |        |
| September 30, 2016                           |                       |        |                               |        |  |        |
| Tangible capital (to tangible assets)        | \$ 1,225              | 8.88 % | N/A                           | N/A    | N/A  | N/A    |
| Tier 1 capital (to adjusted tangible assets) | 1,225                 | 8.88 % | \$ 552                        | 4.00 % | \$ 690   | 5.00 % |

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|  |         |        |        |      |   |        |       |   |
|--|---------|--------|--------|------|---|--------|-------|---|
| Common equity Tier 1 capital (to RWA)        | 1,056   | 12.04% | 395    | 4.50 | % | 570    | 6.50  | % |
| Tier 1 capital (to risk-weighted assets)     | 1,225   | 13.98% | 526    | 6.00 | % | 701    | 8.00  | % |
| Total capital (to risk-weighted assets)      | 1,338   | 15.26% | 701    | 8.00 | % | 877    | 10.00 | % |
| December 31, 2015                            |         |        |        |      |   |        |       |   |
| Tangible capital (to tangible assets)        | \$1,435 | 11.51% | N/A    | N/A  |   | N/A    | N/A   |   |
| Tier 1 capital (to adjusted tangible assets) | 1,435   | 11.51% | \$ 499 | 4.0  | % | \$ 624 | 5.0   | % |
| Common equity Tier 1 capital (to RWA)        | 1,065   | 14.09% | 340    | 4.5  | % | 491    | 6.5   | % |
| Tier 1 capital (to risk-weighted assets)     | 1,435   | 18.98% | 454    | 6.0  | % | 605    | 8.0   | % |
| Total capital (to risk-weighted assets)      | 1,534   | 20.28% | 605    | 8.0  | % | 756    | 10.0  | % |
| N/A - Not applicable                         |         |        |        |      |   |        |       |   |

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| Bank   | Actual   |        | For Capital Adequacy Purposes |       |   | Well Capitalized Under Prompt Corrective Action Provisions |       |   |
|--|----------|--------|-------------------------------|-------|---|--|-------|---|
|  | Amount   | Ratio  | Amount                        | Ratio |   | Amount   | Ratio |   |
| (Dollars in millions)                        |          |        |                               |       |   |  |       |   |
| September 30, 2016                           |          |        |                               |       |   |  |       |   |
| Tangible capital (to tangible assets)        | \$ 1,459 | 10.55% | N/A                           | N/A   |   | N/A  | N/A   |   |
| Tier 1 capital (to adjusted tangible assets) | 1,459    | 10.55% | \$ 553                        | 4.00  | % | \$ 691   | 5.00  | % |
| Common equity tier 1 capital (to RWA)        | 1,459    | 16.59% | 396                           | 4.50  | % | 572  | 6.50  | % |
| Tier 1 capital (to risk-weighted assets)     | 1,459    | 16.59% | 528                           | 6.00  | % | 704  | 8.00  | % |
| Total capital (to risk-weighted assets)      | 1,571    | 17.87% | 704                           | 8.00  | % | 879  | 10.00 | % |
| December 31, 2015                            |          |        |                               |       |   |  |       |   |
| Tangible capital (to tangible assets)        | \$ 1,472 | 11.79% | N/A                           | N/A   |   | N/A  | N/A   |   |
| Tier 1 capital (to adjusted tangible assets) | 1,472    | 11.79% | \$ 500                        | 4.0   | % | \$ 625   | 5.0   | % |
| Common equity tier 1 capital (to RWA)        | 1,472    | 19.42% | 341                           | 4.5   | % | 493  | 6.5   | % |
| Tier 1 capital (to risk-weighted assets)     | 1,472    | 19.42% | 455                           | 6.0   | % | 607  | 8.0   | % |
| Total capital (to risk-weighted assets)      | 1,570    | 20.71% | 607                           | 8.0   | % | 758  | 10.0  | % |
| N/A - Not applicable                         |          |        |                               |       |   |  |       |   |

## Note 16 – Legal Proceedings, Contingencies and Commitments

## Legal Proceedings

We and our subsidiaries are subject to various pending or threatened legal proceedings arising out of the normal course of business operations. In addition, the Bank is routinely named in civil actions throughout the country by borrowers and former borrowers relating to the origination, purchase, sale, and servicing of mortgage loans. From time to time, governmental agencies also conduct investigations or examinations of various mortgage-related practices of the Bank. In the course of such investigations or examinations, the Bank cooperates with such agencies and provides information as requested.

We assess the liabilities and loss contingencies in connection with such pending or threatened legal and regulatory proceedings on at least a quarterly basis and establish accruals when we believe it is probable that a loss may be incurred and that the amount of such loss can be reasonably estimated. Once established, litigation accruals are adjusted, as appropriate, in light of additional information.

Management does not believe that the amount of any reasonably possible losses in excess of any amounts accrued with respect to ongoing proceedings or any other known claims will be material to our financial statements, or that the ultimate outcome of these actions will have a material adverse effect on our financial condition, results of operations or cash flows.

## DOJ litigation settlement

In 2012, the Bank entered into a Settlement Agreement with the United States Department of Justice ("DOJ") which meets the definition of a financial liability (the "DOJ Liability").

In accordance with the Settlement Agreement, we made an initial payment of \$15 million and agreed to make future annual payments totaling \$118 million. The Settlement Agreement provides that the Bank will make annual payments in increments of up to \$25 million towards the \$118 million still due upon meeting all conditions which are evaluated quarterly and include: (a) the reversal of the deferred tax asset valuation allowance, which occurred at the end of 2013;

(b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred"), which occurred in the current quarter, (or, in the absence of repayment, adjusting our Bank Tier 1 Capital Ratio for any unextinguished TARP Preferred); (c) our Bank's Tier 1 Leverage Capital Ratio is 11 percent or more. Additionally, if the Bank and Bancorp become party to a business combination in which the Bank or Bancorp represent less than 33.3 percent of the resulting company's assets, such annual payments must commence twelve months after the date of that business combination.

Within six months of satisfying the conditions specified above, the Bank would make an additional payment, to occur no more frequently than annually, provided that doing so would not violate any material banking regulatory requirement or the OCC does not object in writing. Consistent with our business and regulatory requirements, Flagstar shall seek in good faith to

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fulfill the conditions, and will not undertake any conduct or fail to take any action the purpose of which is to frustrate or delay our ability to fulfill any of the above conditions.

We elected to account for the DOJ Liability under the fair value option. To determine the fair value, we utilize a discounted cash flow model. Key assumptions for the discounted cash flow model include using a discount rate as of September 30, 2016 of 7.2 percent; probability weightings of multiple cash flow scenarios and possible outcomes which contemplate the above conditions and estimates of forecasted net income, size of the balance sheet, capital levels, dividends and their impact on the timing of cash payments and the assumptions we believe a market participant would make to transfer the liability. The fair value of the DOJ Liability was \$60 million and \$84 million at September 30, 2016 and December 31, 2015, respectively.

The lower value resulted from a change in the expectation as to the timing of payments to the DOJ as a result of a \$200 million dividend from the Bank to the Bancorp and the issuance of \$250 million in Senior Notes, both of which occurred in July 2016, to a) bring current the interest payments on our trust preferred securities, b) become current on our deferred interest and dividends related to our TARP Preferred and c) repay our TARP Preferred. To support the on-going debt service and other Bancorp expenses, we also intend to reduce our Bancorp double leverage and debt to equity ratios to be more consistent with such ratios at other mid-sized banks, which would likely require further dividend payments from the Bank to the Bancorp for the foreseeable future.

## Other litigation accruals

At September 30, 2016 and December 31, 2015, excluding the fair value liability relating to the DOJ litigation settlement, our total accrual for contingent liabilities and settled litigation was \$6 million and \$2 million, respectively.

## Commitments

A summary of the contractual amount of significant commitments is as follows:

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
|   | (Dollars in millions) |                      |
| Commitments to extend credit                  |                       |                      |
| Mortgage loans interest-rate lock commitments | \$6,503               | \$ 3,792             |
| HELOC commitments                             | 295                   | 150                  |
| Other consumer commitments                    | 9                     | 22                   |
| Warehouse loan commitments                    | 1,123                 | 871                  |
| Standby and commercial letters of credit      | 24                    | 13                   |
| Commercial and industrial commitments         | 165                   | 151                  |
| Other commercial commitments                  | 851                   | 497                  |

Commitments to extend credit are agreements to lend. Since many of these commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements. Commitments generally have fixed expiration dates or other termination clauses. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us, upon extension of credit is based on management's credit evaluation of the counterparties.

We enter into mortgage interest-rate lock commitments with our customers. These commitments are considered to be derivative instruments and changes in the fair value of these commitments are recorded in the Consolidated Statements of Financial Condition in other assets. Further discussion on derivative instruments is included in Note 8 of the Notes to the Consolidated Financial Statements, herein.

We have unfunded commitments under our contractual arrangement with the HELOC borrowers. Commitments to extend, originate or purchase credit are primarily lines of credit to consumers and have specified rates and maturity dates. Many of these commitments also have adverse change clauses, which allow us to cancel the commitment due to deterioration in the borrowers' creditworthiness.



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Other consumer commitments are conditional commitments issued to accommodate the financial needs of customers. The commitments are under various terms to lend funds to consumers, which include revolving credit agreements, term loan commitments and short-term borrowing agreements.

Warehouse loan commitments are lines of credit provided to mortgage originators to fund loans they originate and then sell. The proceeds of the sale of the loans are used to repay the draw on the line used to fund the loans.

Standby and commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party.

Commercial and industrial and other commercial commitments are conditional commitments issued under various terms to lend funds to business and other entities. These commitments include revolving credit agreements, term loan commitments and short-term borrowing agreements. Many of these loan commitments have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements.

These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the Consolidated Statements of Financial Condition. Our exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. We utilize the same credit policies in making commitments and conditional obligations as we do for balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract.

We maintain a reserve for the estimate of probable credit losses inherent in unfunded commitments to extend credit. Unfunded commitments to extend credit include unfunded loans with available balances, new commitments to lend that are not yet funded, and standby and commercial letters of credit. The balance of \$3 million and \$2 million for September 30, 2016 and December 31, 2015, respectively, is reflected in other liabilities on the Consolidated Statements of Financial Condition.

Note 17 – Fair Value Measurements

We utilize fair value measurements to record or disclose the fair value on certain assets and liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability through an orderly transaction between market participants at the measurement date. The determination of fair values of financial instruments often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation models rely on market-based parameters when available, such as interest rate yield curves or credit spreads. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, our future earnings, interest rates and other relevant inputs. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. Refer to Note 24 to the consolidated financial statements of the Annual Report on Form 10-K for the year ended December 31, 2015 for a description of our valuation methodologies and information about the fair value hierarchy.

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Assets and liabilities measured at fair value on a recurring basis.

The following tables present the financial instruments carried at fair value as of September 30, 2016 and December 31, 2015, by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy.

|   | Level<br>1            | Level 2  | Level<br>3 | Total Fair<br>Value |
|---|-----------------------|----------|------------|---------------------|
| September 30, 2016                          | (Dollars in millions) |          |            |                     |
| Investment securities available-for-sale    |                       |          |            |                     |
| Agency - Commercial                         | \$—                   | \$510    | \$—        | \$ 510              |
| Agency - Residential                        | —                     | 573      | —          | 573                 |
| Municipal obligations                       | —                     | 32       | —          | 32                  |
| Loans held-for-sale                         |                       |          |            |                     |
| Residential first mortgage loans            | —                     | 3,352    | —          | 3,352               |
| Loans held-for-investment                   |                       |          |            |                     |
| Residential first mortgage loans            | —                     | 8        | —          | 8                   |
| Second mortgage loans                       | —                     | —        | 41         | 41                  |
| HELOC loans                                 | —                     | —        | 31         | 31                  |
| Mortgage servicing rights                   | —                     | —        | 302        | 302                 |
| Derivative assets                           |                       |          |            |                     |
| Rate lock commitments                       | —                     | —        | 63         | 63                  |
| U.S. Treasury, swap and euro dollar futures | 1                     | —        | —          | 1                   |
| Mortgage backed securities forwards         | —                     | 2        | —          | 2                   |
| Interest rate swaps and swaptions           | —                     | 53       | —          | 53                  |
| Total derivative assets                     | 1                     | 55       | 63         | 119                 |
| Total assets at fair value                  | \$1                   | \$4,530  | \$437      | \$ 4,968            |
| Derivative liabilities                      |                       |          |            |                     |
| Interest rate swap on FHLB advances         | \$—                   | \$(52 )  | \$—        | \$(52 )             |
| Mortgage backed securities forwards         | —                     | (24 )    | —          | (24 )               |
| Interest rate swaps and swaptions           | —                     | (17 )    | —          | (17 )               |
| Total derivative liabilities                | —                     | (93 )    | —          | (93 )               |
| Warrant liabilities                         | —                     | (10 )    | —          | (10 )               |
| DOJ litigation settlement                   | —                     | —        | (60 )      | (60 )               |
| Total liabilities at fair value             | \$—                   | \$(103 ) | \$(60 )    | \$(163 )            |

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|   | Level<br>1            | Level 2 | Level<br>3 | Total<br>Fair<br>Value |
|---|-----------------------|---------|------------|------------------------|
| December 31, 2015                           | (Dollars in millions) |         |            |                        |
| Investment securities available-for-sale    |                       |         |            |                        |
| Agency - Commercial                         | \$—                   | \$766   | \$—        | \$766                  |
| Agency - Residential                        | —                     | 514     | —          | 514                    |
| Municipal obligations                       | —                     | 14      | —          | 14                     |
| Loans held-for-sale                         |                       |         |            |                        |
| Residential first mortgage loans            | —                     | 2,541   | —          | 2,541                  |
| Loans held-for-investment                   |                       |         |            |                        |
| Residential first mortgage loans            | —                     | 6       | —          | 6                      |
| Second mortgage loans                       | —                     | —       | 42         | 42                     |
| HELOC loans                                 | —                     | —       | 64         | 64                     |
| Mortgage servicing rights                   | —                     | —       | 296        | 296                    |
| Derivative assets                           |                       |         |            |                        |
| Rate lock commitments                       | —                     | —       | 26         | 26                     |
| Mortgage backed securities forwards         | —                     | 7       | —          | 7                      |
| Interest rate swaps and swaptions           | —                     | 25      | —          | 25                     |
| Total derivative assets                     | —                     | 32      | 26         | 58                     |
| Total assets at fair value                  | \$—                   | \$3,873 | \$428      | \$4,301                |
| Derivative liabilities                      |                       |         |            |                        |
| U.S. Treasury, swap and euro dollar futures | \$(1)                 | \$—     | \$—        | \$(1)                  |
| Mortgage backed securities forwards         | —                     | (6)     | —          | (6)                    |
| Interest rate swap on FHLB advances         | —                     | (4)     | —          | (4)                    |
| Interest rate swaps                         | —                     | (7)     | —          | (7)                    |
| Total derivative liabilities                | (1)                   | (17)    | —          | (18)                   |
| Warrant liabilities                         | —                     | (8)     | —          | (8)                    |
| DOJ litigation settlement                   | —                     | —       | (84)       | (84)                   |
| Total liabilities at fair value             | \$(1)                 | \$(25)  | \$(84)     | \$(110)                |

We had no transfers of assets or liabilities recorded at fair value between fair value levels during the nine months ended September 30, 2016 and 2015.

We utilized swaptions, swap and euro dollars futures, forward agency and loan sales and interest rate swaps to manage the risk associated with mortgage servicing rights and rate lock commitments. Gains and losses for individual lines in the tables do not reflect the effect of our risk management activities related to such level 3 instruments.

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Fair value measurements using significant unobservable inputs

The tables below include a roll forward of the Consolidated Statement of Financial Condition amounts for the three and nine months ended September 30, 2016 and 2015 (including the change in fair value) for financial instruments classified by us within level 3 of the valuation hierarchy:

| Three Months Ended September 30,<br>2016         | Balance<br>at<br>Beginning<br>of<br>Period | Recorded in<br>Earnings                    |  | Recorded in<br>OCI                         |  | Purchases /<br>Originations | Sales   | Settlements | Transfer<br>In (Out) | Balance<br>at<br>End of<br>Period |
|--|--|--|--|--|--|-----------------------------|---------|-------------|----------------------|-----------------------------------|
|  |  | Total<br>Unrealized<br>Gains /<br>(Losses) | Total<br>Realized<br>Gains /<br>(Losses) | Total<br>Unrealized<br>Gains /<br>(Losses) | Total<br>Unrealized<br>Gains /<br>(Losses) |                             |         |             |                      |                                   |
| (Dollars in millions)                            |  |  |  |  |  |                             |         |             |                      |                                   |
| <b>Assets</b>                                    |  |  |  |  |  |                             |         |             |                      |                                   |
| Loans held-for-investment                        |  |  |  |  |  |                             |         |             |                      |                                   |
| Second mortgage loans                            | \$38                                       | \$ (2 )                                    | \$ —                                     | —  | —  | \$ —                        | \$ (3 ) | \$ 8        |                      | \$41                              |
| HELOC loans                                      | 44   | 6  | —  | —  | —  | —                           | (11 )   | (8 )        |                      | 31                                |
| Mortgage servicing rights                        | 301  | (33 )                                      | —  | —  | 51   | (17 )                       | —       | —           |                      | 302                               |
| Totals   | \$383                                      | \$ (29 )                                   | \$ —                                     | —  | \$ 51                                      | \$(17 )                     | \$(14 ) | \$ —        |                      | \$374                             |
| <b>Liabilities</b>                               |  |  |  |  |  |                             |         |             |                      |                                   |
| DOJ litigation settlement                        | \$(84 )                                    | \$ 24                                      | \$ —                                     | —  | —  | \$ —                        | \$ —    | \$ —        |                      | \$(60 )                           |
| Derivative financial instruments (net)           |  |  |  |  |  |                             |         |             |                      |                                   |
| Rate lock commitments                            | \$82                                       | \$ 33                                      | \$ —                                     | —  | 116  | \$(150)                     | \$(18 ) | \$ —        |                      | \$63                              |
| <b>Three Months Ended September 30,<br/>2015</b> |  |  |  |  |  |                             |         |             |                      |                                   |
| <b>Assets</b>                                    |  |  |  |  |  |                             |         |             |                      |                                   |
| Other investments                                |  |  |  |  |  |                             |         |             |                      |                                   |
|  | \$100                                      | \$ —                                       | \$ —                                     | —  | —  | \$ —                        | \$ —    | \$ —        |                      | \$100                             |
| Loans held-for-investment                        |  |  |  |  |  |                             |         |             |                      |                                   |
| Second mortgage loans                            | 48   | —  | —  | —  | —  | —                           | (3 )    | —           |                      | 45                                |
| HELOC loans                                      | 93   | 2  | —  | —  | —  | —                           | (15 )   | —           |                      | 80                                |
| Mortgage servicing rights                        | 317  | (24 )                                      | —  | —  | 74   | (73 )                       | —       | —           |                      | 294                               |
| Totals   | \$558                                      | \$ (22 )                                   | \$ —                                     | —  | \$ 74                                      | \$(73 )                     | \$(18 ) | \$ —        |                      | \$519                             |
| <b>Liabilities</b>                               |  |  |  |  |  |                             |         |             |                      |                                   |
| Long-term debt                                   | \$(36 )                                    | \$ —                                       | \$ —                                     | —  | —  | \$ —                        | \$ 4    | \$ —        |                      | \$(32 )                           |
| DOJ litigation settlement                        | (84 )                                      | —  | —  | —  | —  | —                           | —       | —           |                      | (84 )                             |
| Totals   | \$(120)                                    | \$ —                                       | \$ —                                     | —  | —  | \$ —                        | \$ 4    | \$ —        |                      | \$(116)                           |
| <b>Derivative financial instruments (net)</b>    |  |  |  |  |  |                             |         |             |                      |                                   |
| Rate lock commitments                            | \$30                                       | \$ 53                                      | \$ —                                     | —  | 81   | \$(104)                     | \$(16 ) | \$ —        |                      | \$44                              |

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| Nine Months Ended September 30,<br>2016     | Balance<br>at<br>Beginning<br>of<br>Period | Recorded in<br>Earnings                    |  | Recorded<br>in OCI                         |  | Purchases /<br>Originations | Sales   | Settlements | Transfer<br>In (Out) | Balance<br>at<br>End of<br>Period |
|---|--|--|--|--|--|-----------------------------|---------|-------------|----------------------|-----------------------------------|
|   |  | Total<br>Unrealized<br>Gains /<br>(Losses) | Total<br>Realized<br>Gains /<br>(Losses) | Total<br>Unrealized<br>Gains /<br>(Losses) | Total<br>Unrealized<br>Gains /<br>(Losses) |                             |         |             |                      |                                   |
| (Dollars in millions)                       |  |  |  |  |  |                             |         |             |                      |                                   |
| <b>Assets</b>                               |  |  |  |  |  |                             |         |             |                      |                                   |
| Loans held-for-investment                   |  |  |  |  |  |                             |         |             |                      |                                   |
| Second mortgage loans                       | \$42                                       | \$(1 )                                     | \$ —                                     | \$   | —  | \$ —                        | \$ —    | \$ (8 )     | 8                    | 41                                |
| HELOC loans                                 | 64   | 3  | —  | —  | —  | —                           | —       | (28 )       | (8 )                 | 31                                |
| Mortgage servicing rights                   | 296  | (126 )                                     | —  | —  | 173  | (41 )                       | —       | —           | —                    | 302                               |
| Totals                                      | \$402                                      | \$(124)                                    | \$ —                                     | \$   | —  | \$ 173                      | \$(41 ) | \$(36 )     | \$ —                 | \$ 374                            |
| <b>Liabilities</b>                          |  |  |  |  |  |                             |         |             |                      |                                   |
| DOJ litigation                              | \$(84 )                                    | \$24                                       | \$ —                                     | \$   | —  | \$ —                        | \$ —    | —           | —                    | \$(60 )                           |
| Derivative financial instruments (net)      |  |  |  |  |  |                             |         |             |                      |                                   |
| Rate lock commitments                       | \$26                                       | \$153                                      | \$ —                                     | \$   | —  | \$ 303                      | \$(371) | \$(48 )     | \$ —                 | \$ 63                             |
| <b>Assets</b>                               |  |  |  |  |  |                             |         |             |                      |                                   |
| Other investments                           |  |  |  |  |  |                             |         |             |                      |                                   |
| Investment securities<br>available-for-sale | \$100                                      | \$ —                                       | \$ —                                     | \$   | —  | \$ —                        | \$ —    | \$ —        | \$ —                 | \$ 100                            |
| Municipal obligation                        | 2  | —  | —  | —  | —  | —                           | —       | (2 )        | —                    | —                                 |
| Loans held-for-investment                   |  |  |  |  |  |                             |         |             |                      |                                   |
| Second mortgage loans                       | 53   | 2  | 1  | —  | —  | —                           | —       | (11 )       | —                    | 45                                |
| HELOC loans                                 | 132  | (4 )                                       | —  | —  | —  | —                           | —       | (48 )       | —                    | 80                                |
| Mortgage servicing rights                   | 258  | (40 )                                      | —  | —  | 220  | (144 )                      | —       | —           | —                    | 294                               |
| Totals                                      | \$545                                      | \$(42 )                                    | \$ 1                                     | \$   | —  | \$ 220                      | \$(144) | \$(61 )     | \$ —                 | \$ 519                            |
| <b>Liabilities</b>                          |  |  |  |  |  |                             |         |             |                      |                                   |
| Long-term debt                              | \$(84 )                                    | \$ —                                       | \$ (3 )                                  | \$   | —  | \$ 24                       | \$ 31   | \$ —        | \$ —                 | \$(32 )                           |
| DOJ litigation                              | (82 )                                      | (2 )                                       | —  | —  | —  | —                           | —       | —           | —                    | (84 )                             |
| Totals                                      | \$(166)                                    | \$(2 )                                     | \$(3 )                                   | \$   | —  | \$ 24                       | \$ 31   | \$ —        | \$ —                 | \$(116 )                          |
| Derivative financial instruments (net)      |  |  |  |  |  |                             |         |             |                      |                                   |
| Rate lock commitments                       | \$31                                       | \$60                                       | \$ —                                     | \$   | —  | \$ 272                      | \$(276) | \$(43 )     | \$ —                 | \$ 44                             |

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The following tables present the quantitative information about recurring level 3 fair value financial instruments and the fair value measurements as of September 30, 2016 and December 31, 2015:

|   | Fair Value | Valuation Technique   | Unobservable Input  | Range (Weighted Average)  |
|---|------------|-----------------------|---|---|
| September 30, 2016<br>(Dollars in millions) |            |                       |   |   |
| Assets                                      |            |                       |   |   |
| Second mortgage loans                       | \$41       | Discounted cash flows | Discount rate<br>Constant prepayment rate<br>Constant default rate                              | 8.0% - 12.0% (10.0%)<br>10.9% - 16.4% (13.6%)<br>2.7% - 4.1% (3.4%) |
| HELOC loans                                 | \$31       | Discounted cash flows | Discount rate   | 6.6% - 9.9% (8.2%)  |
| Mortgage servicing rights                   | \$302      | Discounted cash flows | Option adjusted spread<br>Constant prepayment rate<br>Weighted average cost to service per loan | 7.4% - 11.0% (9.2%)<br>12.8% - 18.5% (15.7%)<br>\$57 - \$85 (\$71)  |
| Liabilities                                 |            |                       |   |   |
| DOJ litigation settlement                   | \$(60)     | Discounted cash flows | Discount rate   | 5.7% - 8.5% (7.1%)  |
| Derivative financial instruments            |            |                       |   |   |
| Rate lock commitments                       | \$63       | Consensus pricing     | Origination pull-through rate   | 66.6% - 99.9% (83.3%)   |
| December 31, 2015<br>(Dollars in millions)  |            |                       |   |   |
| Assets                                      |            |                       |   |   |
| Second mortgage loans                       | \$42       | Discounted cash flows | Discount rate<br>Constant prepayment rate<br>Constant default rate                              | 7.2% - 10.8% (9.0%)<br>13.5% - 20.2% (16.9%)<br>2.6% - 4.0% (3.3%)  |
| HELOC loans                                 | \$64       | Discounted cash flows | Discount rate   | 6.8% - 10.1% (8.4%)   |
| Mortgage servicing rights                   | \$296      | Discounted cash flows | Option adjusted spread<br>Constant prepayment rate<br>Weighted average cost to service per loan | 6.6% - 9.9% (8.2%)<br>10.3% - 14.8% (12.6%)<br>\$57 - \$86 (\$72)   |
| Liabilities                                 |            |                       |   |   |
| DOJ litigation settlement                   | \$(84)     | Discounted cash flows | Discount rate   | 4.9% - 9.5% (7.2%)  |
| Derivative financial instruments            |            |                       |   |   |
| Rate lock commitments                       | \$26       | Consensus pricing     | Origination pull-through rate   | 67.6% - 101.5% (84.6%)  |

## Recurring Significant Unobservable Inputs

The significant unobservable inputs used in the fair value measurement of the second mortgage loans are discount rates, constant prepayment rates, and default rates. The constant prepayment and default rates are based on a 12 month historical average. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases (decreases) in prepay rates in isolation result in a higher (lower) fair value and increases (decreases) in default rates in isolation result in a lower (higher) fair value.

The HELOC loans are valued utilizing a loan-level discounted cash flow model which projects expected cash flows given three potential outcomes: (1) paid-in-full at scheduled maturity, (2) default at scheduled maturity (foreclosure), and (3) modification at scheduled maturity into an amortizing HELOC. Loans are placed into the potential outcome buckets based on their underlying current delinquency, FICO scores and property CLTV all of which are unobservable inputs. Estimated cash flows are then discounted back using an unobservable discount rate. Loans within the loan portfolios contain FICO scores with a minimum of 447, maximum of 816, and a weighted average of 665. For the loans, increases (decreases) in the discount rate, in isolation, would lower (higher) the fair value measurement.

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The significant unobservable inputs used in the fair value measurement of the MSR are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation would result in a significantly lower (higher) fair value measurement. Additionally, the key economic assumptions used in determining the fair value of MSRs capitalized during the three and nine months ended September 30, 2016 and 2015 periods were as follows:

|   | Three Months<br>Ended<br>September 30,<br>2016 |       | Nine Months<br>Ended<br>September 30,<br>2015 |       |
|---|--|-------|---|-------|
| Weighted average life (in years)          | 6.7  | 7.9   | 6.9   | 7.9   |
| Weighted average constant prepayment rate | 13.4%  | 11.0% | 13.5%   | 11.2% |
| Weighted average option adjusted spread   | 11.8%  | 8.9 % | 9.5 %   | 8.7 % |

The key economic assumptions reflected in the overall fair value of the entire portfolio of MSRs were as follows:

|   | September 30,<br>2016 |   | December 31,<br>2015 |   |
|---|-----------------------|---|----------------------|---|
| Weighted average life (in years)          | 6.0                   |   | 7.3                  |   |
| Weighted average constant prepayment rate | 15.7                  | % | 12.6                 | % |
| Weighted average option adjusted spread   | 9.2                   | % | 8.2                  | % |

The significant unobservable input used in the fair value measurement of the DOJ litigation settlement is the discount rate. Significant increases (decreases) in the discount rate in isolation could result in a marginally lower (higher) fair value measurement. For further information on the fair value inputs related to the DOJ litigation, see Note 16 of the Notes to the Consolidated Financial Statements, herein.

The significant unobservable input used in the fair value measurement of the rate lock commitments is the pull through rate. The pull through rate is a statistical analysis of our actual rate lock fallout history to determine the sensitivity of the residential mortgage loan pipeline compared to interest rate changes and other deterministic values. New market prices are applied based on updated loan characteristics and new fallout ratios (i.e., the inverse of the pull through rate) are applied accordingly. Significant increases (decreases) in the pull through rate in isolation would result in a significantly higher (lower) fair value measurement.



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## Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We also have assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets are measured at the lower of cost or market and had a fair value below cost at the end of the period as summarized below:

|  | Total       | Level 2 | Level 3 |
|--|-------------|---------|---------|
|  | (1)         |         |         |
|  | (Dollars in |         |         |
|  | millions)   |         |         |
| September 30, 2016                     |             |         |         |
| Loans held-for-sale (2)                | \$10        | \$10    | \$—     |
| Impaired loans held-for-investment (3) |             |         |         |
| Residential first mortgage loans       | 22          | —       | 22      |
| Commercial and industrial loans        | 1           | —       | 1       |
| Repossessed assets (4)                 | 15          | —       | 15      |
| Totals                                 | \$48        | \$10    | \$38    |
| December 31, 2015                      |             |         |         |
| Loans held-for-sale (2)                | \$8         | \$8     | \$—     |
| Impaired loans held-for-investment (3) |             |         |         |
| Residential first mortgage loans       | 40          | —       | 40      |
| Commercial real estate loans           | 2           | —       | 2       |
| Repossessed assets (4)                 | 17          | —       | 17      |
| Totals                                 | \$67        | \$8     | \$59    |

(1) The fair values are obtained at various dates during the nine months ended September 30, 2016 and the year ended December 31, 2015, respectively.

(2) We recorded less than \$1 million in fair value losses on loans held-for-sale for which we did not elect the fair value option (included in interest income on the Consolidated Statements of Operations) during both the three and nine months ended September 30, 2016, respectively, compared to less than \$1 million in fair value losses on loans held-for-sale during both the three and nine months ended September 30, 2015, respectively.

(3) We recorded \$11 million and \$31 million in fair value losses on impaired loans (included in provision (benefit) for loan losses on Consolidated Statements of Operations) during the three and nine months ended September 30, 2016, respectively, compared to \$20 million and \$76 million in fair value losses on impaired loans during the three and nine months ended September 30, 2015, respectively.

(4) We recorded zero and \$2 million in losses related to write downs of repossessed assets based on the estimated fair value of the specific assets during the three and nine months ended September 30, 2016, respectively, and recognized net gain of \$1 million and \$2 million on sales of repossessed assets (both write downs and net gains/losses are included in assets resolution expense on the Consolidated Statements of Operations) during the three and nine months ended September 30, 2016. We recorded \$1 million and \$2 million in losses related to write downs of repossessed assets based on the estimated fair value of the specific assets during the three and nine months ended September 30, 2015, respectively, and recognized a net gain of \$1 million and \$2 million on sales of repossessed assets during the three and nine months ended September 30, 2015, respectively.

The following tables present the quantitative information about nonrecurring level 3 fair value financial instruments and the fair value measurements as of September 30, 2016 and December 31, 2015:

|                                    | Fair Value            | Valuation Technique      | Unobservable Input     | Range (Weighted Average) |
|------------------------------------|-----------------------|--------------------------|------------------------|--------------------------|
| September 30, 2016                 | (Dollars in millions) |                          |                        |                          |
| Impaired loans held-for-investment |                       |                          |                        |                          |
| Residential first mortgage loans   | \$22                  | Fair value of collateral | Loss severity discount | 23% - 28% (25.6%)        |

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|                                 |      |                          |                        |           |         |
|---------------------------------|------|--------------------------|------------------------|-----------|---------|
| Commercial and industrial loans | \$1  | Fair value of collateral | Loss severity discount | 50% - 55% | (53.4%) |
| Repossessed assets              | \$15 | Fair value of collateral | Loss severity discount | 35% - 98% | (61.7%) |

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|                                    | Fair Value            | Valuation Technique      | Unobservable Input     | Range (Weighted Average) |
|------------------------------------|-----------------------|--------------------------|------------------------|--------------------------|
| December 31, 2015                  | (Dollars in millions) |                          |                        |                          |
| Impaired loans held-for-investment |                       |                          |                        |                          |
| Residential first mortgage loans   | \$40                  | Fair value of collateral | Loss severity discount | 35% - 45% (35.2%)        |
| Commercial real estate loans       | \$2                   | Fair value of collateral | Loss severity discount | 45% - 55% (50.1%)        |
| Repossessed assets                 | \$17                  | Fair value of collateral | Loss severity discount | 16% - 100% (48.7%)       |

## Nonrecurring Significant Unobservable Inputs

The significant unobservable inputs used in the fair value measurement of the impaired loans and repossessed assets are appraisals or other third-party price evaluations which incorporate measures such as recent sales prices for comparable properties.

## Fair Value of Financial Instruments

The following table presents the carrying amount and estimated fair value of financial instruments that are carried either at fair value, cost, or amortized cost:

|   | September 30, 2016    |           |         |           |         |
|---|-----------------------|-----------|---------|-----------|---------|
|   | Carrying Value        | Total     | Level 1 | Level 2   | Level 3 |
|   | (Dollars in millions) |           |         |           |         |
| Assets  |                       |           |         |           |         |
| Cash and cash equivalents                     | \$174                 | \$174     | \$174   | \$—       | \$ —    |
| Investment securities available-for-sale      | 1,115                 | 1,115     | —       | 1,115     | —       |
| Investment securities held-to-maturity        | 1,156                 | 1,177     | —       | 1,177     | —       |
| Loans held-for-sale                           | 3,393                 | 3,394     | —       | 3,394     | —       |
| Loans with government guarantees              | 404                   | 391       | —       | 391       | —       |
| Loans held-for-investment, net                | 6,147                 | 6,134     | —       | 8         | 6,126   |
| Repossessed assets                            | 15                    | 15        | —       | —         | 15      |
| Federal Home Loan Bank stock                  | 172                   | 172       | —       | 172       | —       |
| Mortgage servicing rights                     | 302                   | 302       | —       | —         | 302     |
| Bank owned life insurance                     | 269                   | 269       | —       | 269       | —       |
| Other assets, foreclosure claims              | 152                   | 152       | —       | 152       | —       |
| Derivative financial instruments, assets      | 119                   | 119       | 1       | 55        | 63      |
| Liabilities                                   |                       |           |         |           |         |
| Retail deposits                               |                       |           |         |           |         |
| Demand deposits and savings accounts          | \$(5,204)             | \$(4,961) | \$—     | \$(4,961) | \$ —    |
| Certificates of deposit                       | (1,083)               | (1,095)   | —       | (1,095)   | —       |
| Government deposits                           | (1,176)               | (1,158)   | —       | (1,158)   | —       |
| Company controlled deposits                   | (1,908)               | (1,839)   | —       | (1,839)   | —       |
| Federal Home Loan Bank advances               | (2,482)               | (2,450)   | —       | (2,450)   | —       |
| Other long-term debt                          | (493)                 | (257)     | —       | (257)     | —       |
| Warrant liabilities                           | (10)                  | (10)      | —       | (10)      | —       |
| DOJ litigation settlement                     | (60)                  | (60)      | —       | —         | (60)    |
| Derivative financial instruments, liabilities | (93)                  | (93)      | —       | (93)      | —       |



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|   | December 31, 2015 |                      |         |           |       |
|---|-------------------|----------------------|---------|-----------|-------|
|   | Carrying Value    | Estimated Fair Value |         |           |       |
| Total   |                   | Level 1              | Level 2 | Level 3   |       |
| (Dollars in millions)                         |                   |                      |         |           |       |
| <b>Assets</b>                                 |                   |                      |         |           |       |
| Cash and cash equivalents                     | \$208             | \$208                | \$208   | \$—       | \$ —  |
| Investment securities available-for-sale      | 1,294             | 1,294                | —       | 1,294     | —     |
| Investment securities held-to-maturity        | 1,268             | 1,262                | —       | 1,262     | —     |
| Loans held-for-sale                           | 2,576             | 2,578                | —       | 2,578     | —     |
| Loans with government guarantees              | 485               | 469                  | —       | 469       | —     |
| Loans held-for-investment, net                | 6,165             | 6,121                | —       | 6         | 6,115 |
| Repossessed assets                            | 17                | 17                   | —       | —         | 17    |
| Federal Home Loan Bank stock                  | 170               | 170                  | —       | 170       | —     |
| Mortgage servicing rights                     | 296               | 296                  | —       | —         | 296   |
| Bank owned life insurance                     | 178               | 178                  | —       | 178       | —     |
| Other assets, foreclosure claims              | 210               | 210                  | —       | 210       | —     |
| Derivative financial instruments, assets      | 58                | 58                   | 7       | 25        | 26    |
| <b>Liabilities</b>                            |                   |                      |         |           |       |
| <b>Retail deposits</b>                        |                   |                      |         |           |       |
| Demand deposits and savings accounts          | \$(5,008)         | \$(4,744)            | \$—     | \$(4,744) | \$ —  |
| Certificates of deposit                       | (826 )            | (833 )               | —       | (833 )    | —     |
| Government deposits                           | (1,062 )          | (1,045 )             | —       | (1,045 )  | —     |
| Company controlled deposits                   | (1,039 )          | (947 )               | —       | (947 )    | —     |
| Federal Home Loan Bank advances               | (3,541 )          | (3,543 )             | —       | (3,543 )  | —     |
| Long-term debt                                | (247 )            | (89 )                | —       | (89 )     | —     |
| Warrant liabilities                           | (8 )              | (8 )                 | —       | (8 )      | —     |
| DOJ litigation settlement                     | (84 )             | (84 )                | —       | —         | (84)  |
| Derivative financial instruments, liabilities | (18 )             | (18 )                | (1 )    | (17 )     | —     |

The methods and assumptions used by us in estimating fair value of financial instruments which are required for disclosure only, are as follows:

Cash and cash equivalents. Due to their short-term nature, the carrying amount of cash and cash equivalents approximates fair value.

Investment securities held-to-maturity. Fair values are generated using market inputs, where possible, including quoted prices (the closing price in an exchange market), bid prices (the price at which a buyer stands ready to purchase), and other market information.

Loans with government guarantees. The fair value is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

Loans held-for-investment. The fair value is estimated using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

Federal Home Loan Bank stock. No secondary market exists for Federal Home Loan Bank stock. The stock is bought and sold at par by the Federal Home Loan Bank. Management believes that the recorded value equals the fair value.

Bank owned life insurance. The fair value of bank owned life insurance policies is based on the cash surrender values of the policies as reported by the insurance companies.

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Other assets, foreclosure claims. The fair value of foreclosure claims with government guarantees approximates the carrying amount.

Deposit accounts. The fair value of deposits with no defined maturity is estimated based on a discounted cash flow model that incorporates current market rates for similar products and expected attrition. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.

Federal Home Loan Bank advances. Rates currently available for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

Long-term debt. The fair value of the long-term debt is estimated based on a discounted cash flow model that incorporates current borrowing rates for similar types of borrowing arrangements.

## Fair Value Option

We elected the fair value option for certain items as discussed throughout the Notes to the Consolidated Financial Statements to mitigate a divergence between accounting losses and economic exposure. Interest income on loans held-for-sale is accrued on the principal outstanding primarily using the "simple-interest" method.

The following table reflects the change in fair value included in earnings of financial instruments for which the fair value option has been elected:

|                             | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine Months<br>Ended<br>September<br>30,<br>2015 |       |
|-----------------------------|--|-------|--|-------|
|                             | 2016   | 2015  | 2016   | 2015  |
| (Dollars in millions)       |  |       |  |       |
| <b>Assets</b>               |  |       |  |       |
| Loans held-for-sale         |  |       |  |       |
| Net gain on loan sales      | \$151  | \$134 | \$440  | \$276 |
| Loans held-for-investment   |  |       |  |       |
| Interest income on loans    | \$—  | \$1   | \$(2)  | \$4   |
| Other noninterest income    | —  | (1)   | —  | (35)  |
| <b>Liabilities</b>          |  |       |  |       |
| Long-term debt              |  |       |  |       |
| Other noninterest income    | \$—  | \$3   | \$—  | \$28  |
| Litigation settlement       |  |       |  |       |
| Other noninterest income    | \$24   | \$—   | \$24   | \$2   |
| Other noninterest (expense) | \$—  | \$—   | \$—  | \$(2) |

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The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding as of September 30, 2016 and December 31, 2015 for assets and liabilities for which the fair value option has been elected:

|                              | September 30, 2016<br>(Dollars in millions) |               |  | December 31, 2015              |               |  |
|------------------------------|---|---------------|--|--------------------------------|---------------|--|
|                              | Unpaid<br>Principal<br>Balance              | Fair<br>Value | Fair<br>Value<br>Over /<br>(Under)<br>Unpaid<br>Principal<br>Balance | Unpaid<br>Principal<br>Balance | Fair<br>Value | Fair<br>Value<br>Over /<br>(Under)<br>Unpaid<br>Principal<br>Balance |
| <b>Assets</b>                |   |               |  |                                |               |  |
| Nonaccrual loans             |   |               |  |                                |               |  |
| Loans held-for-sale          | \$2   | \$2           | \$ —   | \$1                            | \$—           | \$ (1 )  |
| Loans held-for-investment    | 18  | 12            | (6 )   | 21                             | 10            | (11 )  |
| Total nonaccrual loans       | \$20  | \$14          | \$ (6 )  | \$22                           | \$10          | \$ (12 )   |
| Other performing loans       |   |               |  |                                |               |  |
| Loans held-for-sale          | \$3,217                                     | \$3,350       | \$ 133   | \$2,451                        | \$2,541       | \$ 90  |
| Loans held-for-investment    | 81  | 68            | (13 )  | 112                            | 101           | (11 )  |
| Total other performing loans | \$3,298                                     | \$3,418       | \$ 120   | \$2,563                        | \$2,642       | \$ 79  |
| Total loans                  |   |               |  |                                |               |  |
| Loans held-for-sale          | \$3,219                                     | \$3,352       | \$ 133   | \$2,452                        | \$2,541       | \$ 89  |
| Loans held-for-investment    | 99  | 80            | (19 )  | 133                            | 111           | (22 )  |
| Total loans                  | \$3,318                                     | \$3,432       | \$ 114   | \$2,585                        | \$2,652       | \$ 67  |
| <b>Liabilities</b>           |   |               |  |                                |               |  |
| Litigation settlement (1)    | \$(118 )                                    | \$(60 )       | \$ 58  | \$(118 )                       | \$(84 )       | \$ 34  |

(1) We are obligated to pay \$118 million in installment payments upon meeting certain performance conditions.

## Note 18 – Segment Information

Our operations are conducted through four operating segments: Mortgage Originations, Mortgage Servicing, Community Banking and Other, which includes the remaining reported activities. Operating segments are defined as components of an enterprise that engage in business activity from which revenues are earned and expenses incurred for which discrete financial information is available that is evaluated regularly by executive management in deciding how to allocate resources and in assessing performance. The operating segments have been determined based on the products and services offered and reflect the manner in which financial information is currently evaluated by management. Each segment operates under the same banking charter, but is reported on a segmented basis for this report. Each of the operating segments is complementary to each other and because of the interrelationships of the segments, the information presented is not indicative of how the segments would perform if they operated as



independent entities.

Effective January 1, 2016, we reorganized our reportable segments to align with our new management reporting structure and to align with our long-term strategy. Prior period segment financial information has been recast to conform to the current presentation. Prior to the reorganization, representation and warranty reserves were reported in the Mortgage Servicing segment and the MSR asset and associated costs were reported in the Other segment. As a result of this change, representation and warranty reserves, as well as the MSR asset and associated costs are now reported in the Mortgage Originations segment.

The Mortgage Originations segment originates, acquires and sells one-to-four family residential mortgage loans. The origination and acquisition of mortgage loans comprises the majority of the lending activity. Mortgage loans are originated through home loan centers, national call centers, the Internet and unaffiliated banks and mortgage banking and brokerage companies, where the net interest income and the gains from sales associated with these loans are recognized in the Mortgage Originations segment.

The Mortgage Servicing segment services and sub-services mortgage loans, on a fee basis, for others. Also, the Mortgage Servicing segment services, on a fee basis, residential mortgages held-for-investment by the Community Banking segment and mortgage servicing rights held by the Mortgage Originations segment. The Mortgage Servicing segment may also collect ancillary fees, such as late fees, and earns income through the use of noninterest-bearing escrows.

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The Community Banking segment originates loans, provides deposits and fee based services to consumer, business, and mortgage lending customers through its Branch Banking, Business Banking and Commercial Banking, Government Banking, Warehouse Lending and Held-for-Investment Portfolio groups. Products offered through these teams include checking accounts, savings accounts, money market accounts, certificates of deposit, consumer loans, commercial loans, home builder finance loans and warehouse lines of credit. Other financial services available to consumer and commercial customers include lines of credit, revolving credit, customized treasury management solutions, equipment leasing, inventory, and accounts receivable lending and capital markets services such as interest rate risk protection products.

The Other segment includes the treasury functions, funding revenue associated with stockholders' equity, the impact of interest rate risk management, the impact of balance sheet funding activities, and miscellaneous other expenses of a corporate nature. Treasury functions include administering the investment securities portfolios, balance sheet funding, and interest rate risk management. In addition, the Other segment includes revenue and expenses related to treasury and corporate assets and liabilities and equity not directly assigned or allocated to the Mortgage Originations, Mortgage Servicing or Community Banking operating segments.

Revenues are comprised of net interest income (before the provision (benefit) for loan losses) and noninterest income. Noninterest expenses are fully allocated to each operating segment. Allocation methodologies may be subject to periodic adjustment as the internal management accounting system is revised and the business or product lines within the segments change.

The following tables present financial information by business segment for the periods indicated:

|  | Three Months Ended September 30, 2016 |                       |                      |       |         |
|--|---------------------------------------|-----------------------|----------------------|-------|---------|
|  | Mortgage<br>Originations              | Mortgage<br>Servicing | Community<br>Banking | Other | Total   |
|  | (Dollars in millions)                 |                       |                      |       |         |
| Summary of Operations                            |                                       |                       |                      |       |         |
| Net interest income                              | \$21                                  | \$ 10                 | \$ 54                | \$(5) | \$80    |
| Net gain on loan sales                           | 95                                    | —                     | (1)                  | —     | 94      |
| Representation and warranty benefit              | 6                                     | —                     | —                    | —     | 6       |
| Other noninterest income                         | 4                                     | 13                    | 8                    | 31    | 56      |
| Total net interest income and noninterest income | 126                                   | 23                    | 61                   | 26    | 236     |
| (Provision) benefit for loan losses              | —                                     | —                     | (7)                  | —     | (7)     |
| Asset resolution                                 | —                                     | (2)                   | —                    | —     | (2)     |
| Depreciation and amortization expense            | (2)                                   | —                     | (1)                  | (5)   | (8)     |
| Other noninterest expense                        | (64)                                  | (25)                  | (43)                 | —     | (132)   |
| Total noninterest expense                        | (66)                                  | (27)                  | (44)                 | (5)   | (142)   |
| Income (loss) before income taxes                | 60                                    | (4)                   | 10                   | 21    | 87      |
| Provision for income taxes                       | —                                     | —                     | —                    | 30    | 30      |
| Net income (loss)                                | \$60                                  | \$(4)                 | \$ 10                | \$(9) | \$57    |
| Intersegment revenue                             | \$(1)                                 | \$ 5                  | \$ —                 | \$(4) | \$—     |
| Average balances                                 |                                       |                       |                      |       |         |
| Loans held-for-sale                              | \$3,400                               | \$ —                  | \$ 16                | \$ —  | \$3,416 |
| Loans with government guarantees                 | —                                     | 432                   | —                    | —     | 432     |
| Loans held-for-investment                        | 5                                     | —                     | 5,843                | —     | 5,848   |
| Total assets                                     | 4,238                                 | 623                   | 5,904                | 3,383 | 14,148  |
| Deposits   | —                                     | 1,853                 | 7,273                | —     | 9,126   |



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|  | Three Months Ended September 30, 2015 |                       |                      |        |         |
|--|---------------------------------------|-----------------------|----------------------|--------|---------|
|  | Mortgage<br>Origination               | Mortgage<br>Servicing | Community<br>Banking | Other  | Total   |
| Summary of Operations                            | (Dollars in millions)                 |                       |                      |        |         |
| Net interest income                              | \$18                                  | \$ 3                  | \$ 45                | \$7    | \$73    |
| Net gain on loan sales                           | 72                                    | —                     | (4 )                 | —      | 68      |
| Representation and warranty benefit              | 6                                     | —                     | —                    | —      | 6       |
| Other noninterest income                         | 26                                    | 15                    | 11                   | 2      | 54      |
| Total net interest income and noninterest income | 122                                   | 18                    | 52                   | 9      | 201     |
| (Provision) benefit for loan losses              | —                                     | —                     | 1                    | —      | 1       |
| Depreciation and amortization expense            | (1 )                                  | (1 )                  | (1 )                 | (3 )   | (6 )    |
| Other noninterest expense                        | (56 )                                 | (27 )                 | (39 )                | (3 )   | (125 )  |
| Total noninterest expense                        | (57 )                                 | (28 )                 | (40 )                | (6 )   | (131 )  |
| Income (loss) before income taxes                | 65                                    | (10 )                 | 13                   | 3      | 71      |
| Provision for income taxes                       | —                                     | —                     | —                    | 24     | 24      |
| Net income (loss)                                | \$65                                  | \$ (10 )              | \$ 13                | \$(21) | \$47    |
| Intersegment revenue                             | \$3                                   | \$ 5                  | \$ (4 )              | \$(4 ) | \$—     |
| Average balances                                 |                                       |                       |                      |        |         |
| Loans held-for-sale                              | \$2,179                               | \$ —                  | \$ 21                | \$—    | \$2,200 |
| Loans with government guarantees                 | —                                     | 547                   | —                    | —      | 547     |
| Loans held-for-investment                        | 4                                     | —                     | 5,348                | 60     | 5,412   |
| Total assets                                     | 2,709                                 | 860                   | 5,336                | 3,400  | 12,305  |
| Deposits   | —                                     | 1,487                 | 6,773                | —      | 8,260   |

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|  | Nine Months Ended September 30, 2016 |                       |                      |        |         |
|--|--------------------------------------|-----------------------|----------------------|--------|---------|
|  | Mortgage<br>Origination              | Mortgage<br>Servicing | Community<br>Banking | Other  | Total   |
| Summary of Operations                            | (Dollars in millions)                |                       |                      |        |         |
| Net interest income                              | \$61                                 | \$ 23                 | \$ 150               | \$2    | \$236   |
| Net gain (loss) on loan sales                    | 251                                  | —                     | 8                    | —      | 259     |
| Representation and warranty benefit              | 12                                   | —                     | —                    | —      | 12      |
| Other noninterest income (loss)                  | 17                                   | 39                    | 21                   | 41     | 118     |
| Total net interest income and noninterest income | 341                                  | 62                    | 179                  | 43     | 625     |
| (Provision) benefit for loan losses              | —                                    | —                     | 9                    | —      | 9       |
| Asset resolution                                 | —                                    | (6 )                  | —                    | —      | (6 )    |
| Depreciation and amortization expense            | (4 )                                 | (2 )                  | (5 )                 | (12 )  | (23 )   |
| Other noninterest expense                        | (182 )                               | (70 )                 | (131 )               | (6 )   | (389 )  |
| Total noninterest expense                        | (186 )                               | (78 )                 | (136 )               | (18 )  | (418 )  |
| Income (loss) before income taxes                | 155                                  | (16 )                 | 52                   | 25     | 216     |
| Provision for income taxes                       | —                                    | —                     | —                    | 73     | 73      |
| Net income (loss)                                | \$155                                | \$ (16 )              | \$ 52                | \$(48) | \$143   |
| Intersegment revenue                             | \$1                                  | \$ 16                 | \$ (1 )              | \$(16) | \$—     |
| Average balances                                 |                                      |                       |                      |        |         |
| Loans held-for-sale                              | \$2,988                              | \$ —                  | \$ 83                | \$—    | \$3,071 |
| Loans with government guarantees                 | —                                    | 450                   | —                    | —      | 450     |
| Loans held-for-investment                        | 6                                    | —                     | 5,689                | —      | 5,695   |
| Total assets                                     | 3,688                                | 676                   | 5,798                | 3,549  | 13,711  |
| Deposits   | —                                    | 1,523                 | 7,080                | —      | 8,603   |

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|  | Nine Months Ended September 30, 2015 |                       |                      |        |         |
|--|--------------------------------------|-----------------------|----------------------|--------|---------|
|  | Mortgage<br>Origination              | Mortgage<br>Servicing | Community<br>Banking | Other  | Total   |
|  | (Dollars in millions)                |                       |                      |        |         |
| Summary of Operations                            |                                      |                       |                      |        |         |
| Net interest income                              | \$52                                 | \$ 10                 | \$ 126               | \$23   | \$211   |
| Net gain (loss) on loan sales                    | 255                                  | —                     | (13 )                | —      | 242     |
| Representation and warranty benefit              | 13                                   | —                     | —                    | —      | 13      |
| Other noninterest income                         | 60                                   | 42                    | 19                   | (3 )   | 118     |
| Total net interest income and noninterest income | 380                                  | 52                    | 132                  | 20     | 584     |
| (Provision) benefit for loan losses              | —                                    | —                     | 18                   | —      | 18      |
| Asset resolution                                 | —                                    | (12 )                 | (1 )                 | —      | (13 )   |
| Depreciation and amortization expense            | (2 )                                 | (2 )                  | (4 )                 | (9 )   | (17 )   |
| Other noninterest expense                        | (174 )                               | (80 )                 | (116 )               | (7 )   | (377 )  |
| Total noninterest expense                        | (176 )                               | (94 )                 | (121 )               | (16 )  | (407 )  |
| Income (loss) before income taxes                | 204                                  | (42 )                 | 29                   | 4      | 195     |
| Provision for income taxes                       | —                                    | —                     | —                    | 70     | 70      |
| Net income (loss)                                | \$204                                | \$ (42 )              | \$ 29                | \$(66) | \$125   |
| Intersegment revenue                             | \$9                                  | \$ 13                 | \$ (13 )             | \$(9 ) | \$—     |
| <br>   |                                      |                       |                      |        |         |
| Average balances                                 |                                      |                       |                      |        |         |
| Loans held-for-sale                              | \$2,052                              | \$ —                  | \$ 36                | \$—    | \$2,088 |
| Loans with government guarantees                 | —                                    | 679                   | —                    | —      | 679     |
| Loans held-for-investment                        | 3                                    | —                     | 4,786                | 96     | 4,885   |
| Total assets                                     | 2,555                                | 1,004                 | 4,753                | 3,351  | 11,663  |
| Deposits   | —                                    | 1,189                 | 6,602                | —      | 7,791   |

## Note 19 – Recently Issued Accounting Pronouncements

Statement of Cash Flows - In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments. This amendment addresses eight issues which current GAAP does not include specific guidance or is unclear, pertaining to: Debt Prepayment or Debt Extinguishment Costs, Settlement of Zero-Coupon Debt Instruments, Contingent Consideration Payments Made after a Business Combination, Proceeds from the Settlement of Insurance Claims, Proceeds from the Settlement of Corporate-Owned or Bank-Owned Life Insurance Policies, Distributions Received from Equity Method Investees, Beneficial Interest in Securitization Transactions, and Separately Identifiable Cash Flows and Application of the Predominance Principle. ASU 2016-16 is effective for fiscal years beginning after December 15, 2018 and early adoption is permitted. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on our Consolidated Financial Statements.

Credit Losses - In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The ASU alters the current method for recognizing credit losses within the reserve account. Currently, an institution uses the incurred loss method, the new guidance will require the allowance to be recorded on day one for the contractual term of the financial asset. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019. Management is currently evaluating this guidance and the impact it will have on our Consolidated Financial Statements.

Stock Compensation - In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments in ASU 2016-09 affect all entities that issue share-based payment awards to their employees. The areas for simplification in ASU 2016-09 involve several aspects of the accounting for share-based payment transactions, including the income tax

consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective retrospectively for fiscal years beginning after December 15, 2016 and early adoption is permitted. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on our Consolidated Financial Statements.

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Derivatives and Hedging - In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815) - Contingent Put and Call Options in Debt Instruments. The amendments in ASU 2016-06 clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. An entity performing the assessment under the amendments in ASU 2016-06 is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. ASU 2016-06 is effective retrospectively for fiscal years beginning after December 15, 2016 and early adoption is permitted. This guidance is not expected to have a material impact upon adoption on our Consolidated Financial Statements, but disclosures to the Notes thereto will be updated per the requirements.

Leases - In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842): Section A - Leases: Amendments to the FASB Accounting Standards Codification, Section B - Conforming Amendments Related to Leases: Amendment to the FASB Accounting Standards Codification, Section C - Background Information and Basis For Conclusions. Lessees will need to recognize almost all leases on their balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Classification will be based on criteria that are largely similar to those applied in current lease accounting. ASU 2016-02 is effective retrospectively for fiscal years beginning after December 15, 2019 and early adoption is permitted. The guidance in ASU 2016-02 supersedes Topic 840, Leases. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on our Consolidated Financial Statements.

Financial Instruments - In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The new standard significantly revises an entity's accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 is effective retrospectively for fiscal years beginning after December 15, 2017 and early adoption is permitted. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on our Consolidated Financial Statements, if any.

Revenue from Contracts with Customers - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under the amended guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The FASB has voted to approve a year deferral of the effective date from January 1, 2017 to January 1, 2018, while allowing for early adoption. In April 2016, the FASB clarified the following two aspects: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas. In May 2016, the FASB issued ASU 2016-12 Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, to provide a limited number of changes to its revenue recognition standard. The amendments clarify the assessment of the likelihood that revenue will be collected from a contract, the guidance for presenting sales taxes and similar taxes, and the timing for measuring customer payments that are not in cash. The amendment also says a contract should be considered complete if all, or substantially all, of its revenue has been collected prior to making the transition to the new standard. In addition, the update clarifies the disclosure requirements for businesses and other organizations that make the transition to the new standard by adjusting amounts from prior reporting periods. The effects have to be disclosed for prior periods that were adjusted. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on our Consolidated Financial Statements; however, changes to disclosures in the Notes thereto will be required.



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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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").

**FORWARD – LOOKING STATEMENTS**

Certain statements in this Form 10-Q, including but not limited to statements included within the Management's Discussion and Analysis of Financial Condition and Results of Operations, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. In addition, Flagstar Bancorp, Inc. also may make forward-looking statements in our other documents filed with or furnished to the SEC, and our management may make forward-looking statements orally to analysts, investors, representatives of the media and others.

Generally, forward-looking statements are not based on historical facts but instead represent management's beliefs regarding future events. Such statements may be identified by words such as believe, expect, anticipate, intend, plan, estimate, may increase, may fluctuate, and similar expressions or future or conditional verbs such as will, should, would and could. Such statements are based on management's current expectations and are subject to risks, uncertainties and changes in circumstances. Actual results and capital and other financial conditions may differ materially from those included in these statements due to a variety of factors, including without limitation the precautionary statements included within each individual business' discussion and analysis of our results of operations and the risk factors listed and described in Item 1A to Part I of our Annual Report on Form 10-K for the year ended December 31, 2015 and Item 1A to Part II of this Quarterly Report on Form 10-Q, which are incorporated by reference herein, for further information on these and other factors affecting us.

Any forward-looking statements made by or on behalf of Flagstar Bancorp, Inc. speak only as to the date they are made, and we do not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made.

## General

We are a Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. At September 30, 2016, based on our assets, we are one of the largest banks headquartered in Michigan, providing commercial, small business, and consumer banking services. We have three major operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. Through these lines of business, we emphasize the delivery of a complete set of mortgage and banking products and services and are distinguished by local delivery, customer service and product pricing. Our common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "FBC." We are considered a controlled company for NYSE purposes, because MP Thrift Investments, L.P. ("MP Thrift") held approximately 62.9 percent of our common stock as of September 30, 2016.

Effective January 1, 2016, we reorganized our reportable segments to align with our new management reporting structure and to align with our long-term strategy. Prior period segment financial information has been recast to conform to 2016 presentation. Prior to the reorganization, representation and warranty reserves were reported in the Mortgage Servicing segment and the MSR asset and associated costs were reported in the Other segment. As a result of this change, representation and warranty reserves, as well as the MSR asset and associated costs are now reported in the Mortgage Originations segment.

Our Community Banking segment provides deposits and fee based services to consumer, business, and mortgage lending customers through our Branch Banking, Business Banking, Commercial Banking, Government Banking, Warehouse Lending and Held-for-Investment Portfolio groups. We maintain a portfolio of commercial and industrial, commercial real estate and builder finance loans with our commercial customers and we originate or purchase residential mortgage loans through referrals from our branches, consumer direct call center and our website, flagstar.com. At September 30, 2016, we operated 99 branches in Michigan. We leverage the customer relationships we have gained throughout our branch network to cross-sell products to existing customers and increase our customer base. In 2016, we also began to offer new MSR lending and equipment finance lease products.

Through our Mortgage Origination segment, we originate or purchase residential mortgage loans throughout the country and sell them into securitization pools, primarily to Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Government National Mortgage Association ("Ginnie Mae") (collectively, the "Agencies") or as whole loans. In addition, we originate or purchase residential first mortgage loans and other consumer loans, and commercial loans to our held-for-investment loan portfolios. Our revenues include net interest income, income from banking services we provide to customers, and noninterest income from sales of residential first mortgage loans to the Agencies, and the servicing of loans for others. The combination of our retail, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our residential mortgage loan products.

The majority of our total loan originations during the nine months ended September 30, 2016 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale to the Agencies. At September 30, 2016, we originated or purchased residential mortgage loans in all 50 states, the U.S. Virgin Islands, and the District of Columbia through relationships with 556 mortgage brokers and 729 correspondents. At September 30, 2016, we also operated 31 retail locations located in 21 states, which primarily originate one-to-four family residential mortgage loans as part of our Mortgage Originations segment. In addition, we originate other consumer and commercial loans through our Community Banking segment. We continue to expand existing business lines, such as our distributed retail and direct-to-consumer mortgage origination businesses.

Our Mortgage Servicing segment services and subservices mortgage loans for others on a fee for service basis and may also collect ancillary fees, such as late fees and earn income through the use of noninterest bearing escrows. Revenue on our subserviced loans is earned on a contractual fee basis, with the fees varying based on the status of the

underlying loans.

At September 30, 2016, we had 2,881 full-time equivalent employees inclusive of account executives and loan officers.

#### Critical Accounting Policies

Various elements of our accounting policies, by their nature, are subject to estimation techniques, valuation assumptions and other subjective assessments. Certain accounting policies that, due to the judgment, estimates and assumptions in those policies are critical to an understanding of our Consolidated Financial Statements, in Item 1. Financial Statements herein. These policies relate to: (a) fair value measurements; (b) the determination of our allowance for loan losses; (c) the

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accounting for income taxes; and (d) the determination of our representation and warranty reserve. We believe the judgment, estimates and assumptions used in the preparation of our Consolidated Financial Statements and the Notes, in Item 1, are appropriate given the factual circumstances at the time. However, given the sensitivity of our Consolidated Financial Statements and the Notes, in Item 1, herein, to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations and/or financial condition. For further information on our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2015, which is available on our website, [flagstar.com](http://flagstar.com), under the Investor Relations section, or on the website of the Securities and Exchange Commission, at [sec.gov](http://sec.gov).

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## Selected Financial Ratios

(Dollars in millions, except share data)

|   | Three Months Ended |            | Nine Months Ended                        |            |            |
|---|--------------------|------------|--|------------|------------|
|   | September 30,      |            | September 30,                            |            |            |
|   | 2016               | 2015       | 2016                                     | 2015       |            |
| Mortgage loans originated (1)   | \$9,198            | \$7,876    | \$23,880                                 | \$23,578   |            |
| Mortgage loans sold and securitized   | \$8,723            | \$7,318    | \$23,611                                 | \$21,143   |            |
| Interest rate spread  | 2.36               | % 2.56     | % 2.43                                   | % 2.59     |            |
| Net interest margin   | 2.58               | % 2.75     | % 2.62                                   | % 2.76     |            |
| Average common shares outstanding   | 56,580,238         | 56,436,026 | 56,556,188                               | 56,419,354 |            |
| Average fully diluted shares outstanding  | 57,933,806         | 57,207,503 | 57,727,262                               | 57,050,789 |            |
| Average interest earning assets   | \$12,318           | \$10,693   | \$11,944                                 | \$10,165   |            |
| Average interest paying liabilities   | \$9,773            | \$8,354    | \$9,600                                  | \$8,044    |            |
| Average stockholders' equity  | \$1,379            | \$1,510    | \$1,515                                  | \$1,466    |            |
| Return on average assets  | 1.61               | % 1.52     | % 1.40                                   | % 1.43     |            |
| Return on average equity  | 16.53              | % 12.41    | % 12.59                                  | % 11.36    |            |
| Return on average common equity   | 17.45              | % 15.08    | % 14.52                                  | % 13.88    |            |
| Efficiency ratio  | 59.9               | % 65.0     | % 66.9                                   | % 69.6     |            |
| Equity-to-assets ratio (average for the period)                                     | 9.75               | % 12.27    | % 11.05                                  | % 12.56    |            |
| Charge-offs to average LHFI (2)   | 0.51               | % 1.84     | % 0.66                                   | % 2.34     |            |
| Charge-offs to average LHFI, adjusted (2)(3)  | 0.15               | % 0.61     | % 0.15                                   | % 0.43     |            |
|   |                    |            | September 30, December 31, September 30, |            |            |
|   |                    |            | 2016                                     | 2015       | 2015       |
| Book value per common share   |                    |            | \$ 22.72                                 | \$ 22.33   | \$ 21.91   |
| Number of common shares outstanding   |                    |            | 56,597,271                               | 56,483,258 | 56,436,026 |
| Mortgage loans serviced for others  |                    |            | \$ 31,372                                | \$ 26,145  | \$ 26,306  |
| Mortgage loans subserviced for others   |                    |            | \$ 38,801                                | \$ 40,244  | \$ 42,282  |
| Weighted average service fee (basis points)   |                    |            | 28.1                                     | 27.7       | 28.3       |
| Capitalized value of mortgage servicing rights                                      |                    |            | 0.96                                     | % 1.13     | % 1.12     |
| Mortgage servicing rights to Tier 1 capital   |                    |            | 24.60                                    | % 20.63    | % 21.10    |
| Ratio of allowance for loan losses to LHFI (2)                                      |                    |            | 2.30                                     | % 3.00     | % 3.66     |
| Ratio of allowance for loan losses to LHFI and loans with government guarantees (2) |                    |            | 2.16                                     | % 2.78     | % 3.34     |
| Ratio of nonperforming assets to total assets                                       |                    |            | 0.39                                     | % 0.61     | % 0.64     |
| Equity-to-assets ratio  |                    |            | 9.01                                     | % 11.14    | % 12.01    |
| Common equity-to-assets ratio   |                    |            | 9.01                                     | % 9.20     | % 9.88     |
| Tier 1 leverage ratio (to adjusted total assets)                                    |                    |            | 8.88                                     | % 11.51    | % 11.65    |
| Common equity Tier 1 capital ratio (to risk-weighted assets)                        |                    |            | 12.04                                    | % 14.09    | % 14.93    |
| Total risk-based capital ratio (to risk-weighted assets)                            |                    |            | 15.26                                    | % 20.28    | % 21.64    |
| Number of bank branches   |                    |            | 99                                       | 99         | 99         |
| Number of FTE employees   |                    |            | 2,881                                    | 2,713      | 2,677      |

(1) Includes residential first mortgage and second mortgage loans.

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

Excludes charge-offs of zero and \$16 million related to the 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 transfer (3) and subsequent sale of loans during the nine months ended September 30, 2016 and September 30, 2015, respectively. Also excludes charge-offs related to loans with government guarantees of \$6 million and \$13 million during the three and nine months ended September 30, 2016.



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## Summary of Operations

|                                     | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |        | Nine Months<br>Ended<br>September 30,<br>2015 |        |
|-------------------------------------|--|--------|---|--------|
|                                     | 2016   | 2015   | 2016  | 2015   |
|                                     | (Dollars in millions)                                |        |   |        |
| Net interest income                 | \$80   | \$73   | \$236   | \$211  |
| Provision (benefit) for loan losses | 7  | (1)    | (9)   | (18)   |
| Total noninterest income            | 156  | 128    | 389   | 373    |
| Total noninterest expense           | 142  | 131    | 418   | 407    |
| 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 |

Our net income increased \$10 million for the three months ended September 30, 2016, compared to the three months ended September 30, 2015. The increase was primarily due to a \$28 million improvement in noninterest income, driven by higher net gain on loan sales, while a decrease in fair value of the DOJ settlement liability was offset by higher loss on mortgage servicing rights. The noninterest income improvement was primarily offset by higher performance driven expenses and provision for income taxes.

Net income increased \$18 million for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015. The increase was primarily driven by a \$25 million increase in net interest income and \$16 million increase in noninterest income partially offset by higher performance driven expenses and a lower benefit for loan losses. Net interest income increased as a result of asset growth and our strategic initiative to replace lower credit quality assets with higher quality residential and commercial loans. As a result of this initiative, we grew average interest earning assets by 19 percent from \$10.2 billion during the nine months ended September 30, 2015 to \$11.9 billion during the nine months ended September 30, 2016. Within noninterest income, net gain on loan sales increased \$17 million while a decrease in fair value of the DOJ settlement liability was offset by a higher loss on mortgage servicing rights driven by low interest rates which result in higher prepayments and a more competitive market.

## Net Interest Income

The following tables present on a consolidated basis interest income from average assets and liabilities, expressed in dollars and yields:

|  | Three Months Ended September 30, |                                      |       |   |                    |                                      |       |   |
|--|----------------------------------|--------------------------------------|-------|---|--------------------|--------------------------------------|-------|---|
|  | 2016                             |                                      | 2015  |   | 2016               |                                      | 2015  |   |
|  | Average<br>Balance               | Annualized<br>InterestYield/<br>Rate |       |   | Average<br>Balance | Annualized<br>InterestYield/<br>Rate |       |   |
|  | (Dollars in millions)            |                                      |       |   |                    |                                      |       |   |
| <b>Interest-Earning Assets</b>   |                                  |                                      |       |   |                    |                                      |       |   |
| Loans held-for-sale  | \$3,416                          | \$ 30                                | 3.51  | % | \$2,200            | \$ 22                                | 3.94  | % |
| Loans held-for-investment  |                                  |                                      |       |   |                    |                                      |       |   |
| Consumer loans (1)   | 2,580                            | 23                                   | 3.52  | % | 3,367              | 30                                   | 3.67  | % |
| Commercial loans (1)   | 3,268                            | 33                                   | 3.96  | % | 2,045              | 20                                   | 3.80  | % |
| Loans held-for-investment  | 5,848                            | 56                                   | 3.77  | % | 5,412              | 50                                   | 3.72  | % |
| Loans with government guarantees   | 432                              | 4                                    | 3.88  | % | 547                | 5                                    | 3.37  | % |
| Investment securities  | 2,516                            | 16                                   | 2.55  | % | 2,313              | 14                                   | 2.50  | % |
| Interest-earning deposits  | 106                              | —                                    | 0.48  | % | 221                | —                                    | 0.53  | % |
| Total interest-earning assets  | 12,318                           | 106                                  | 3.42  | % | 10,693             | 91                                   | 3.42  | % |
| Other assets   | 1,830                            |                                      |       |   | 1,612              |                                      |       |   |
| Total assets   | \$14,148                         |                                      |       |   | \$12,305           |                                      |       |   |
| <b>Interest-Bearing Liabilities</b>                                      |                                  |                                      |       |   |                    |                                      |       |   |
| <b>Retail deposits</b>   |                                  |                                      |       |   |                    |                                      |       |   |
| Demand deposits  | \$509                            | \$ —                                 | 0.20  | % | \$429              | \$ —                                 | 0.14  | % |
| Savings deposits   | 3,751                            | 8                                    | 0.77  | % | 3,732              | 8                                    | 0.84  | % |
| Money market deposits  | 250                              | —                                    | 0.41  | % | 262                | —                                    | 0.33  | % |
| Certificates of deposit  | 1,071                            | 3                                    | 1.05  | % | 785                | 2                                    | 0.80  | % |
| Total retail deposits  | 5,581                            | 11                                   | 0.75  | % | 5,208              | 10                                   | 0.75  | % |
| <b>Government deposits</b>   |                                  |                                      |       |   |                    |                                      |       |   |
| Demand deposits  | 243                              | —                                    | 0.39  | % | 286                | —                                    | 0.39  | % |
| Savings deposits   | 478                              | 1                                    | 0.52  | % | 445                | 1                                    | 0.52  | % |
| Certificates of deposit  | 355                              | —                                    | 0.52  | % | 335                | —                                    | 0.40  | % |
| Total government deposits  | 1,076                            | 1                                    | 0.49  | % | 1,066              | 1                                    | 0.45  | % |
| Total deposits   | 6,657                            | 12                                   | 0.71  | % | 6,274              | 11                                   | 0.70  | % |
| Short-term debt  | 1,073                            | 1                                    | 0.44  | % | 12                 | —                                    | 4.50  | % |
| Long-term debt   | 1,576                            | 7                                    | 1.81  | % | 1,786              | 5                                    | 1.17  | % |
| Other debt   | 467                              | 6                                    | 4.86  | % | 282                | 2                                    | 2.53  | % |
| Total interest-bearing liabilities                                       | 9,773                            | 26                                   | 1.06  | % | 8,354              | 18                                   | 0.86  | % |
| Noninterest-bearing deposits (2)   | 2,469                            |                                      |       |   | 1,986              |                                      |       |   |
| Other liabilities  | 527                              |                                      |       |   | 455                |                                      |       |   |
| Stockholders' equity   | 1,379                            |                                      |       |   | 1,510              |                                      |       |   |
| Total liabilities and stockholders' equity                               | \$14,148                         |                                      |       |   | \$12,305           |                                      |       |   |
| Net interest-earning assets  | \$2,545                          |                                      |       |   | \$2,339            |                                      |       |   |
| Net interest income  |                                  | \$ 80                                |       |   |                    | \$ 73                                |       |   |
| Interest rate spread (3)   |                                  |                                      | 2.36  | % |                    |                                      | 2.56  | % |
| Net interest margin (4)  |                                  |                                      | 2.58  | % |                    |                                      | 2.75  | % |
| Ratio of average interest-earning assets to interest-bearing liabilities |                                  |                                      | 126.0 | % |                    |                                      | 128.0 | % |

(1)



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Consumer loans include: residential first mortgage, second mortgage, HELOC, and other consumer loans.

Commercial loans include: commercial real estate, commercial and industrial, and warehouse lending loans.

(2) Includes company controlled deposits that arise due to the servicing of loans for others.

(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

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Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

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### Comparison to Prior Year Quarter

Net interest income increased \$7 million for the three months ended September 30, 2016, compared to the same period in 2015, primarily due to growth in interest earning assets, partially offset by a decrease in net interest margin driven by a lower interest rate environment.

Our net interest margin for the three months ended September 30, 2016 was 2.58 percent, compared to 2.75 percent for the three months ended September 30, 2015. The decrease from 2015 was driven primarily by higher interest rates on fixed rate long term debt used to match-fund our longer duration asset growth and increased interest expense on senior debt issued in conjunction with the TARP redemption.

Interest income increased \$15 million for the three months ended September 30, 2016, compared to the same period in 2015, primarily driven by higher average loans held-for-sale and loans held-for-investment partially offset by lower interest rates on loans held-for-sale. Average loans held-for-sale increased \$1.2 billion or 55.3 percent compared to the same period in 2015, primarily due to slower deliveries of saleable mortgage loans to the Agencies during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. Average loans held-for-investment for the three months ended September 30, 2016, increased \$0.4 billion or 8.1 percent, compared to the three months ended September 30, 2015. This was primarily due to a continued shift in mix, consistent with our strategy, of \$1.3 billion in average balance of high quality, higher yielding commercial loans and corresponding decrease of \$0.8 billion in average balance of primarily lower yielding residential first mortgage loans.

Interest expense increased \$8 million for the three months ended September 30, 2016, compared to the same period in 2015, primarily driven by higher interest rates from longer term fixed rate debt taken to match-fund our longer duration asset growth and interest expense as a result of the senior debt issued in conjunction with the TARP redemption. Also impacting the increase was a \$383 million increase in interest-bearing deposits driven by growth in deposits which has been used to fund our loan growth.

### Comparison to Prior Year to Date

Net interest income increased \$25 million for the nine months ended September 30, 2016, compared to the same period in 2015, primarily driven by continued growth in interest earning assets partially offset by a decrease in the net interest margin driven by a lower interest rate environment and issuance of senior debt used for TARP redemption.

Our net interest margin for the nine months ended September 30, 2016 was 2.62 percent, compared to 2.76 percent for the nine months ended September 30, 2015. The decrease for the nine months ended September 30, 2016 was driven by higher interest rates from longer term fixed rate debt taken to match-fund our longer duration asset growth, interest expense on senior debt issued for TARP redemption and lower interest rate environment experience in 2016, partially offset from a rotation of lower spread residential mortgage loans into higher spread commercial loans.

Interest income increased \$46 million for the nine months ended September 30, 2016, compared to the same period in 2015, primarily driven by higher average loans held-for-sale and loans held-for-investment partially offset by lower interest rates. Average loans held-for-sale increased \$1.0 billion for the nine months ended September 30, 2016, compared to the same period in 2015, primarily due to an increase in average volume, partially offset by a decrease in average yield resulting from a more competitive pricing market. Average loans held-for-investment increased \$0.8 billion for the nine months ended September 30, 2016, compared to the same period in 2015, primarily due to growth in warehouse, commercial and HELOC loans, partially offset by a decrease in average yield from more competitive pricing in the residential and consumer markets.

Interest expense increased \$21 million for the nine months ended September 30, 2016, compared to the same period in 2015, primarily driven by an increase in the average balance and higher rates on debt to match-fund our longer duration asset growth. Also impacting the increase was a \$4 million increase due to \$372 million higher average

interest-bearing deposits for the nine months ended September 30, 2016, compared to the same period in 2015 and a \$4 million increase in interest expense as a result of the senior debt issued in conjunction with the TARP redemption.

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## Rate/Volume Analysis

The following tables present the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities that are presented in the preceding table. The table below distinguishes between the changes related to average outstanding balances (changes in volume while holding the initial rate constant) and the changes related to average interest rates (changes in average rates while holding the initial balance constant). The rate/volume variances are allocated to variances due to rate.

|                                     | Three Months<br>Ended September<br>30,<br>2016 Versus 2015<br>Increase (Decrease)<br>Due to: |        |       |
|-------------------------------------|--|--------|-------|
|                                     | Rate   | Volume | Total |
|                                     | (Dollars in<br>millions)   |        |       |
| <b>Interest-Earning Assets</b>      |  |        |       |
| Loans held-for-sale                 | \$(4)  | \$ 12  | \$ 8  |
| Loans held-for-investment           |  |        |       |
| Consumer loans (1)                  | (1 )   | (6 )   | (7 )  |
| Commercial loans (2)                | 2  | 11     | 13    |
| Total loans held-for-investment     | 1  | 5      | 6     |
| Loans with government guarantees    | —  | (1 )   | (1 )  |
| Investment securities               | (4 )   | 6      | 2     |
| Total other interest-earning assets | \$(7)  | \$ 22  | \$ 15 |
| <b>Interest-Bearing Liabilities</b> |  |        |       |
| Retail deposits                     |  |        |       |
| Certificates of deposit             | \$—  | \$ 1   | \$ 1  |
| Total deposits                      | —  | 1      | 1     |
| Short-term debt                     | (15)   | 16     | 1     |
| Long-term debt                      | 3  | (1 )   | 2     |
| Other debt                          | 3  | 1      | 4     |
| Total interest-bearing liabilities  | \$(9)  | \$ 17  | \$ 8  |
| Change in net interest income       | \$2  | \$ 5   | \$ 7  |

(1) Consumer loans include residential first mortgage, second mortgage, HELOC, and other consumer loans.

(2) Commercial loans include commercial real estate, commercial and industrial, and warehouse lending.

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|                                     | Nine Months Ended<br>September 30,<br>2016 Versus 2015<br>Increase (Decrease)<br>Due to: |        |       |
|-------------------------------------|--|--------|-------|
|                                     | Rate   | Volume | Total |
|                                     | (Dollars in millions)  |        |       |
| <b>Interest-Earning Assets</b>      |  |        |       |
| Loans held-for-sale                 | \$(7 )   | \$ 29  | \$ 22 |
| <b>Loans held-for-investment</b>    |  |        |       |
| Consumer loans (1)                  | (5 )   | (2 )   | (7 )  |
| Commercial loans (2)                | 1  | 26     | 27    |
| Total loans held-for-investment     | (4 )   | 24     | 20    |
| Loans with government guarantees    | 2  | (5 )   | (3 )  |
| Investment securities               | (88 )  | 95     | 7     |
| Total other interest-earning assets | \$(97)   | \$ 143 | \$ 46 |
| <b>Interest-Bearing Liabilities</b> |  |        |       |
| <b>Retail deposits</b>              |  |        |       |
| Demand deposits                     | \$—  | \$ 1   | \$ 1  |
| Savings deposits                    | (1 )   | —      | (1 )  |
| Certificates of deposit             | 2  | 1      | 3     |
| Total retail deposits               | 1  | 2      | 3     |
| <b>Government deposits</b>          |  |        |       |
| Savings deposits                    | —  | 1      | 1     |
| Total government deposits           | —  | 1      | 1     |
| Total deposits                      | 1  | 3      | 4     |
| Short-term debt                     | (49 )  | 53     | 4     |
| Long-term debt                      | 9  | —      | 9     |
| Other debt                          | 4  | —      | 4     |
| Total interest-bearing liabilities  | \$(35)   | \$ 56  | \$ 21 |
| Change in net interest income       | \$(62)   | \$ 87  | \$ 25 |

(1) Consumer loans include residential first mortgage, second mortgage, HELOC, and other consumer loans.

(2) Commercial loans include commercial real estate, commercial and industrial, and warehouse lending.

## Provision (Benefit) for Loan Losses

## Comparison to Prior Year Quarter

The provision (benefit) for loan losses was a provision of \$7 million during the three months ended September 30, 2016, compared to a benefit of \$1 million during the three months ended September 30, 2015. During the three months ended September 30, 2016, the \$7 million provision was largely to reserve for repossessed loans with government guarantees. During the three months ended September 30, 2015, the benefit for loan losses included charge-offs of \$24 million and net originations of \$5 million offset by a release of reserves of \$30 million related to loan sales.

Net charge-offs for the three months ended September 30, 2016 decreased to \$7 million, compared to \$24 million for the three months ended September 30, 2015. For the three months ended September 30, 2016 and September 30, 2015, net charge-offs included \$6 million and zero of net charge-offs associated with loans with government guarantees,

respectively. For the three months ended September 30, 2015, net charge-offs included \$16 million associated with the sale or transfer of \$233 million unpaid principal balance of interest-only and non-agency loans. As a percentage of the average loans held-for-investment, net charge-offs for the three months ended September 30, 2016 decreased to 0.51 percent from 1.84 percent for the three months ended September 30, 2015. Excluding the charge-offs associated with loan sales or transfers and loans with government guarantees, net charge-offs as a percentage of the average loans held-for-investment were 0.15 percent during the three months ended September 30, 2016, compared to 0.61 percent during the three months ended September 30, 2015.



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## Comparison to Prior Year to Date

The provision (benefit) for loan losses was a benefit of \$9 million during the nine months ended September 30, 2016, compared to an \$18 million benefit during the nine months ended September 30, 2015. The \$9 million benefit resulted primarily from the sale of \$1.2 billion unpaid principal balance of performing residential first mortgage loans and \$110 million of unpaid principal balance of nonperforming, TDR and non-agency loans during the nine months ended September 30, 2016. During the nine months ended September 30, 2015, the provision (benefit) for loan losses included a net reduction in the allowance for loan losses relating to several loan sales, including a net reduction in the allowance relating to interest-only residential first mortgage loans, partially offset by an increase related to the growth in average loans held-for-investment loan portfolio.

Net charge-offs for the nine months ended September 30, 2016 decreased to \$28 million, compared to \$82 million for the nine months ended September 30, 2015. For the nine months ended September 30, 2016, net charge-offs included \$8 million associated with the sale of \$110 million unpaid principal balance of nonperforming, TDR and non-agency loans and \$13 million of net charge-offs associated with loans with government guarantees. For the nine months ended September 30, 2015, net charge-offs included \$67 million associated with the sale or transfer of interest-only residential first mortgage loans with unpaid principal balances totaling \$600 million, along with \$420 million of nonperforming, TDR and non-agency first mortgage loans. As a percentage of the average loans held-for-investment, net charge-offs for the nine months ended September 30, 2016 decreased to 0.66 percent from 2.34 percent for the nine months ended September 30, 2015. Excluding the charge-offs associated with loan sales or transfers and loans with government guarantees, net charge-offs as a percentage of the average loans held-for-investment were 0.15 percent during the nine months ended September 30, 2016, compared to 0.43 percent during the nine months ended September 30, 2015.

See the section captioned "Allowance for Loan Losses" in this discussion for further analysis of the provision (benefit) for loan losses.

## Noninterest Income

The following table sets forth the components of our noninterest income:

|  | Three<br>Months<br>Ended<br>September<br>30, |       | Nine Months<br>Ended<br>September<br>30, |       |
|--|--|-------|--|-------|
|  | 2016   | 2015  | 2016                                     | 2015  |
|  | (Dollars in millions)                        |       |  |       |
| 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 |



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The following loans held-for-sale table provides information on our net gain on loan sales reported in our consolidated financial statements and loans sold within the period:

|   | Three Months Ended    |               |                |                   |                    |   |
|---|-----------------------|---------------|----------------|-------------------|--------------------|---|
|   | September 30, 2016    | June 30, 2016 | March 31, 2016 | December 31, 2015 | September 30, 2015 |   |
|   | (Dollars in millions) |               |                |                   |                    |   |
| Mortgage rate lock commitments (fallout-adjusted) (1)                   | \$8,291               | \$8,127       | \$6,863        | \$5,027           | \$6,495            |   |
| Net margin on mortgage rate lock commitments (fallout-adjusted) (1) (2) | 1.13                  | % 1.04        | % 0.96         | % 0.92            | % 1.05             | % |
| Net gain on loan sales on HFS   | \$94                  | \$85          | \$66           | \$46              | \$68               |   |
| Net (loss) return on the mortgage servicing rights                      | \$(11)                | \$(4)         | \$(6)          | \$9               | \$12               |   |
| Gain on loan sales HFS + net (loss) return on the MSR                   | \$83                  | \$81          | \$60           | \$55              | \$80               |   |
| Residential loans serviced (number of accounts - 000's) (3)             | 366                   | 358           | 340            | 361               | 369                |   |
| Capitalized value of mortgage servicing rights                          | 0.96                  | % 0.99        | % 1.06         | % 1.13            | % 1.12             | % |
| Mortgage loans sold and securitized                                     | 8,723                 | 7,940         | 6,948          | 5,164             | 7,318              |   |
| Net margin on loan sales  | 1.08                  | % 1.07        | % 0.94         | % 0.90            | % 0.93             | % |

(1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on our historical experience and the level of interest rates.

(2) Gain on sale margin is based on net gain on loan sales related to held-for-sale loans to fallout-adjusted mortgage rate lock commitments.

(3) Includes serviced for own loan portfolio, serviced for others and subserviced for others loans.

### Comparison to Prior Year Quarter

Total noninterest income was \$156 million during the three months ended September 30, 2016, which was a \$28 million increase from \$128 million during the three months ended September 30, 2015.

Net gain on loan sales increased \$26 million to \$94 million during the three months ended September 30, 2016, compared to \$68 million for the three months ended September 30, 2015. The increase was primarily due to higher fallout-adjusted locks which increased to \$8.3 billion during the three months ended September 30, 2016, compared to \$6.5 billion in the three months ended September 30, 2015 driven by a low interest rate environment in the third quarter of 2016. The fallout-adjusted net margin on mortgage rate lock commitments, excluding loans held-for-investment, increased 8 basis points to 1.13 percent during the three months ended September 30, 2016, compared to 1.05 percent for the three months ended September 30, 2015.

For the three months ended September 30, 2016, loan fees and charges increased \$5 million to \$22 million, as compared to \$17 million for the three months ended September 30, 2015. The increase in loan fees and charges during the three months ended September 30, 2016, primarily reflects higher mortgage loan closings.

For the three months ended September 30, 2016, loan administration income decreased \$4 million to \$4 million, as compared to \$8 million for the three months ended September 30, 2015. The decrease was primarily due to a decrease in fees charged on loans serviced for others.

Net loss on mortgage servicing rights was \$11 million for the three months ended September 30, 2016, compared to a return of \$12 million during the three months ended September 30, 2015. The \$23 million decrease was primarily due to higher prepayments and higher prepayment assumptions resulting in changes in fair value related to sales including a \$7 million change associated with pending MSR sales with a fair value of \$50 million expected to close in the fourth

quarter 2016.

Other noninterest income increased \$27 million to \$36 million during the three months ended September 30, 2016, compared to \$9 million for the three months ended September 30, 2015. The increase was almost entirely due to a \$24 million reduction in the fair value of the Company's DOJ settlement liability. The reduction of the DOJ liability was a result of a change in the expectation as to the timing of payments.

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Comparison to Prior Year to Date

Total noninterest income was \$389 million during the nine months ended September 30, 2016, which was a \$16 million increase from \$373 million during the nine months ended September 30, 2015.

Net gain on loan sales increased \$17 million during the nine months ended September 30, 2016, as compared to the same period in 2015. The increase was primarily due to higher fallout-adjusted lock volume and a \$14 million gain resulting from the sale of performing loans held-for-investment, partially offset by lower margin. The fallout-adjusted net margin on mortgage rate lock commitments, excluding loans held-for-investment decreased 13 basis points to 1.05 percent during the nine months ended September 30, 2016, compared to 1.18 percent for the nine months ended September 30, 2015.

Loan fees and charges increased \$3 million during the nine months ended September 30, 2016 to \$56 million, as compared to \$53 million during the nine months ended September 30, 2015. The increase is primarily due to higher mortgage loan closings.

Loan administration income decreased \$5 million during the nine months ended September 30, 2016 to \$14 million, as compared to \$19 million during the nine months ended September 30, 2015. The decrease was primarily due to a decrease in fee revenue from loans subserviced for others.

Net loss on mortgage servicing rights was \$21 million for the nine months ended September 30, 2016, compared to a return of \$19 million during the nine months ended September 30, 2015. The \$40 million decrease was primarily due to higher prepayments and a decrease in fair value driven by pending MSR sales.

Other noninterest income increased \$45 million during the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015. The increase was primarily due to the benefit related to the decrease in the fair value of the DOJ settlement liability, gain on sale of available-for-sale investment securities and income earned on our bank owned life insurance whose average balances increased along with lower adjustments related to assets and liabilities held at fair value.

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## Noninterest Expense

The following table sets forth the components of our noninterest expense:

|                                | Three Months<br>Ended<br>September 30,<br>2016 |        | Nine Months<br>Ended<br>September 30,<br>2015 |        |
|--------------------------------|--|--------|---|--------|
|                                | 2016   | 2015   | 2016  | 2015   |
|                                | (Dollars in millions)                          |        |   |        |
| 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  |
| Efficiency ratio               | 59.9 %   | 65.0 % | 66.9 %  | 69.6 % |

## Comparison to Prior Year Quarter

Noninterest expense increased \$11 million to \$142 million during the three months ended September 30, 2016, compared to \$131 million during the three months ended September 30, 2015. The increase was primarily driven by investment in new strategic initiatives, higher stock compensation expense and increased business activity, primarily offset by a decrease in legal and professional expense.

## Comparison to Prior Year to Date

Noninterest expense was \$418 million for the nine months ended September 30, 2016 and \$407 million during the nine months ended September 30, 2015. The increase was primarily due to a \$25 million increase in compensation and benefits, and \$9 million in commissions driven by investment in new strategic initiatives, higher stock compensation expense and increased business activity. This increase was partially offset by a \$9 million decrease in federal insurance premiums due to an improvement in our risk profile along with a \$7 million decrease in asset resolution expense primarily due to a decrease in default servicing and foreclosure costs and a \$7 million decrease in legal and professional expense.

Other noninterest expense decreased \$4 million for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015, primarily driven by lower litigation settlement expenses. Additionally, in the second quarter 2016, we had a litigation settlement expense of \$6 million related to the settlement of a class action lawsuit during the period which was offset by a favorable settlement with a vendor for which we were the plaintiff.

## Provision for Income Taxes

Our provision for income taxes for the three and nine months ended September 30, 2016 was \$30 million and \$73 million, respectively, compared to a provision of \$24 million and \$70 million during the three and nine months ended September 30, 2015, respectively. Our effective tax rate for the three and nine months ended September 30, 2016 was 34.3 percent and 33.8 percent, respectively, compared to 34.4 percent and 36.0 percent for the three and nine months ended September 30, 2015, respectively. The effective rate for the three and nine months ended September 30, 2016 differs from the combined federal and state statutory tax rate primarily due to benefits associated with state tax

settlements and non-taxable bank owned life insurance earnings, partially offset by an increase in warrant expense and other nondeductible expenses.

For further information relating to income taxes, see Note 14 of the Notes to the Consolidated Financial Statements, herein.

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## OPERATING SEGMENTS

## Overview

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 18 of the Notes to Consolidated Financial Statements, herein, for a full understanding of our consolidated financial performance.

Effective January 1, 2016, we reorganized our reportable segments to align with our new management reporting structure and to align with our long-term strategy. All prior periods were reclassified to be consistent with the current presentation. Prior to the reorganization, representation and warranty reserves were reported in the Mortgage Servicing segment and the MSR asset and associated costs were reported in the Other segment. As a result of this change, representation and warranty reserves, as well as the MSR asset and associated costs are now reported in the Mortgage Originations segment.

The net income (loss) by operating segment is presented in the following table:

|                       | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine Months<br>Ended<br>September<br>30,<br>2015 |       |
|-----------------------|--|-------|--|-------|
|                       | 2016   | 2015  | 2016   | 2015  |
|                       | (Dollars in millions)                                |       |  |       |
| Mortgage Originations | \$60   | \$65  | \$155  | \$204 |
| Mortgage Servicing    | (4 )   | (10 ) | (16 )  | (42 ) |
| Community Banking     | 10   | 13    | 52   | 29    |
| Other                 | (9 )   | (21 ) | (48 )  | (66 ) |
| Total net income      | \$57   | \$47  | \$143  | \$125 |

## Mortgage Originations

## Comparison to Prior Year Quarter

The Mortgage Originations segment net income decreased \$5 million to \$60 million during the three months ended September 30, 2016, compared to \$65 million in the three months ended September 30, 2015. The decrease was primarily due to a \$23 million lower net return on MSR's resulting from increased runoff related to lower interest rates, primarily offset by a \$24 million increase in net gain on loan sales resulting from a \$1.5 billion increase in fallout-adjusted locks and a higher margin.

## Comparison to Prior Year to Date

The Mortgage Originations segment reported net income of \$155 million for the nine months ended September 30, 2016, compared to net income of \$204 million for the nine months ended September 30, 2015. The decrease was primarily driven by \$40 million lower net return on MSR's resulting from increased runoff related to lower interest rates and increased expectations for prepayments, as well as \$7 million higher commissions related to higher mortgage originations.

## Mortgage Servicing



Comparison to Prior Year Quarter

The Mortgage Servicing segment reported a net loss of \$4 million for the three months ended September 30, 2016, compared to a net loss of \$10 million for the three months ended September 30, 2015. The \$6 million improvement was primarily due to a \$6 million increase in interest income on company controlled deposits as a result of higher average balances and a decrease in loan processing expense.

Comparison to Prior Year to Date

The Mortgage Servicing segment reported a net loss of \$16 million for the nine months ended September 30, 2016, compared to a net loss of \$42 million for the nine months ended September 30, 2015. The \$26 million improvement was primarily due to \$13 million increase in interest income on company controlled deposits resulting from higher average balances, a \$6 million decrease in asset resolution expense and a decrease in loan processing expense.

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### Community Banking

#### Comparison to Prior Year Quarter

During the three months ended September 30, 2016, the Community Banking segment reported net income of \$10 million, compared to \$13 million for the three months ended September 30, 2015. The \$3 million decrease in net income was primarily due to an increase of \$10 million in net interest income due to growth in warehouse, commercial, and home builder finance loan balances, partially offset by a higher provision expense on higher loan balances and charge-offs.

#### Comparison to Prior Year to Date

During the nine months ended September 30, 2016, the Community Banking segment reported net income of \$52 million, compared to \$29 million for the nine months ended September 30, 2015. The \$23 million increase in net income was primarily due to a \$24 million increase in net interest income resulting from growth in our warehouse, commercial, and home builder finance loan balances. In addition, we had a net gain on loan sales of \$21 million which was primarily driven by the sale of performing residential first mortgage loans out of the held-for-investment portfolio during the nine months ended September 30, 2016. These increases were primarily offset by a \$15 million increase in other noninterest expenses and a \$9 million increase in provision for loan losses.

### Other

#### Comparison to Prior Year Quarter

For the three months ended September 30, 2016, the Other segment net loss was \$9 million, as compared to a net loss of \$21 million for the three months ended September 30, 2015. The \$12 million improvement was primarily due to an increase in noninterest income due to a \$24 million decrease in the fair value of the DOJ settlement liability, partially offset by an increase in interest expenses on higher average outstanding FHLB advances and senior debt issued for TARP redemption.

#### Comparison to Prior Year to Date

For the nine months ended September 30, 2016, the Other segment net loss was \$48 million compared to \$66 million for the nine months ended September 30, 2015. The \$18 million improvement was primarily due to an increase in noninterest income due to a \$24 million decrease in the fair value of the DOJ settlement liability, primarily offset by higher average outstanding FHLB advances and senior debt issued for TARP redemption.

## RISK MANAGEMENT

Like all financial services companies, we engage in certain business activities and assume the related risks. The risks we are subject to, in the normal course of business, include, but are not limited to, credit, regulatory compliance, legal, reputation, liquidity, market, operational and strategic. Our risk management activities are focused on ensuring we properly identify, measure, and manage such risks across the entire enterprise to maintain safety and soundness and maximize profitability. We hold capital to protect from the risk of unexpected loss.

A comprehensive discussion of risk management and capital matters affecting us can be found in the Risk Factors section included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015. Some of the more significant processes used to manage and control credit, liquidity, market, operational and capital risks are described in the following paragraphs.

## Credit Risk

Credit risk is the risk of loss to us arising from an obligor's inability or failure to meet contractual payment or performance terms. Like other financial services institutions, we make loans, extend credit, purchase securities, and enter into financial derivative contracts, all of which have related credit risk. The majority of our credit risk is associated with lending activities, as the acceptance and management of credit risk is central to profitable lending.

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## Mortgage Originations

Our Mortgage Originations segment originates, acquires and sells one-to-four family residential mortgage loans. We sell substantially all of the residential mortgage loans we produce into the secondary market on a whole loan basis or securitizing the loans into mortgage-backed securities with the Agencies. We utilize production channels to originate or acquire mortgage loans and each production channel originates mortgage loan products which are underwritten to the same standards. We expect to continue to leverage technology to streamline the mortgage origination process, thereby bringing service and convenience to brokers and correspondents. We also continue to make available to our customers various web-based tools that facilitate the mortgage loan origination process through each of our production channels. Brokers and correspondents are able to register and lock loans, check the status of inventory, deliver documents in electronic format, generate closing documents, and request funds through the Internet. Funding for our Mortgage Originations segment is provided primarily by deposits held in our Community Banking segment and borrowings.

**Correspondent.** In a correspondent transaction, an unaffiliated bank or mortgage company completes the loan paperwork and also supplies the funding for the loan at closing. After the bank or mortgage company has funded the transaction, we purchase the loan at a market price. We perform a full review of each loan, whether purchased in bulk or not, purchasing only those that were originated in accordance with our underwriting guidelines. We have active correspondent relationships with 729 companies, including banks, credit unions and mortgage companies located in all 50 states.

**Broker.** In a broker transaction, an unaffiliated bank or mortgage brokerage company completes several steps of the loan origination process including the loan paperwork, but the loans are underwritten on a loan-level basis to our underwriting standards and we supply the funding for the loan at closing (also known as "table funding") thereby becoming the lender of record. Currently, we have active broker relationships with 556 mortgage brokers, credit unions and mortgage brokerage companies located in all 50 states.

**Retail.** Our retail channel combines two business lines, home lending and direct-to-consumer. In a home lending transaction, loans are originated through our nationwide network of stand-alone home loan centers. At September 30, 2016, we maintained 31 retail locations in 21 states. In a direct-to-consumer lending transaction, loans are originated through our Community Banking segment banking centers and from a national direct-to-consumer call center. When loans are originated on a retail basis, most aspects of the lending process are completed internally, including the origination documentation (inclusive of customer disclosures), as well as the funding of the transactions. Our centralized loan processing provides efficiencies and allows lending sales staff to focus on originations.

We are a leading national originator of mortgage loans based on our residential first mortgage loan originations. The following tables disclose residential first mortgage loan originations by channel, type and mix for each respective period:

|                        | Three Months Ended    |               |                |                   |                    |
|------------------------|-----------------------|---------------|----------------|-------------------|--------------------|
|                        | September 30, 2016    | June 30, 2016 | March 31, 2016 | December 31, 2015 | September 30, 2015 |
|                        | (Dollars in millions) |               |                |                   |                    |
| Correspondent          | \$6,994               | \$6,200       | \$4,761        | \$4,115           | \$5,584            |
| Broker                 | 1,555                 | 1,625         | 1,270          | 1,406             | 1,930              |
| Retail                 | 643                   | 496           | 312            | 294               | 353                |
| Total                  | \$9,192               | \$8,321       | \$6,343        | \$5,815           | \$7,867            |
| Purchase originations  | \$3,898               | \$3,837       | \$2,688        | \$2,875           | \$4,357            |
| Refinance originations | 5,294                 | 4,484         | 3,655          | 2,940             | 3,510              |

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|              |         |         |         |         |         |
|--------------|---------|---------|---------|---------|---------|
| Total        | \$9,192 | \$8,321 | \$6,343 | \$5,815 | \$7,867 |
| Conventional | \$5,062 | \$4,763 | \$3,799 | \$3,351 | \$4,452 |
| Government   | 2,328   | 2,060   | 1,525   | 1,416   | 1,908   |
| Jumbo        | 1,802   | 1,498   | 1,019   | 1,048   | 1,507   |
| Total        | \$9,192 | \$8,321 | \$6,343 | \$5,815 | \$7,867 |

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## Mortgage Servicing

The Mortgage Servicing segment services and subservices mortgage loans for others on a fee for service basis and may also collect ancillary fees and earn income through the use of noninterest bearing escrows. The Mortgage Servicing segment services residential mortgages for our own held-for-investment loan portfolio in the Community Banking segment for which it earns revenue via an intercompany service fee allocation. The segment also services and subservices loans for others, which primarily includes servicing Agency loans. Revenue for those serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the status of the underlying loans.

The following table presents the unpaid principal balance (net of write downs) of residential loans serviced and the number of accounts associated with those loans. We are a top 25 mortgage servicer in the nation.

|                                      | September 30,<br>2016 |                          | December 31,<br>2015 |                          |
|--------------------------------------|-----------------------|--------------------------|----------------------|--------------------------|
|                                      | Amount                | Number<br>of<br>accounts | Amount               | Number<br>of<br>accounts |
|                                      | (Dollars in millions) |                          |                      |                          |
| Residential loan servicing           |                       |                          |                      |                          |
| Serviced for own loan portfolio (1)  | \$5,645               | 29,052                   | \$6,088              | 30,683                   |
| Serviced for others                  | 31,372                | 138,711                  | 26,145               | 118,662                  |
| Subserviced for others (2)           | 38,801                | 198,400                  | 40,244               | 211,740                  |
| Total residential loans serviced (2) | \$75,818              | 366,163                  | \$72,477             | 361,085                  |

(1) Includes loans held-for-investment (residential first mortgage, second mortgage, and HELOC), loans held-for-sale (residential first mortgage), loans with government guarantees and repossessed assets.

(2) Does not include temporary short-term subservicing performed as a result of sales of servicing-released mortgage servicing rights. Includes repossessed assets.

## Loans held-for-investment

Loans held-for-investment decreased from \$6.4 billion at December 31, 2015, to \$6.3 billion at September 30, 2016. This decrease was primarily due to a decrease in performing residential first mortgage loans from loan sales of \$1.2 billion unpaid principal balance resulting from a change in management's intent, partially offset by an increase in our higher spread, relationship-based commercial loan portfolio.

For further information relating to the concentration of credit of our loans held-for-investment, see Note 4 of the Notes to the Consolidated Financial Statements, herein.

Residential first mortgage loans. We originate or purchase various types of conforming and non-conforming fixed and adjustable rate loans underwritten using Fannie Mae and Freddie Mac guidelines for the purpose of purchasing or refinancing owner occupied and second home properties. The LTV requirements vary depending on occupancy, property type, loan amount, and FICO. Loans with LTVs exceeding 80 percent are required to obtain mortgage insurance.

At September 30, 2016, the largest geographic concentrations of our residential first mortgage loans in our held-for-investment portfolio were in California, Michigan and Florida, which represented 54.3 percent of such loans outstanding.



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The following table identifies our held-for-investment residential mortgages by major category, at September 30, 2016 and December 31, 2015:

|   | Unpaid<br>Principal<br>Balance<br>(1) | Average<br>Note<br>Rate | Average<br>Original<br>FICO<br>Score | Average<br>Current<br>FICO<br>Score<br>(2) | Weighted<br>Average<br>Maturity<br>(months) | Average<br>Original<br>LTV<br>Ratio | Housing Price<br>Index LTV, as<br>recalculated (3) |
|---|---------------------------------------|-------------------------|--------------------------------------|--|---|-------------------------------------|--|
| September 30, 2016<br>(Dollars in millions) |                                       |                         |                                      |  |   |                                     |  |
| Residential first mortgage loans            |                                       |                         |                                      |  |   |                                     |  |
| Amortizing                                  | \$2,040                               | 3.47 %                  | 754                                  | 755  | 319   | 66.2 %                              | 56.8 %   |
| Interest-only (4)                           | 70                                    | 3.67 %                  | 758                                  | 761  | 324   | 59.4 %                              | 50.0 %   |
| Other (5)                                   | 10                                    | 3.55 %                  | 710                                  | 727  | 259   | 68.8 %                              | 58.2 %   |
| Total residential first mortgage loans      | \$2,120                               | 3.47 %                  | 754                                  | 755  | 319   | 66.0 %                              | 56.6 %   |
| December 31, 2015                           |                                       |                         |                                      |  |   |                                     |  |
| Residential first mortgage loans            |                                       |                         |                                      |  |   |                                     |  |
| Amortizing                                  | \$2,999                               | 3.52 %                  | 752                                  | 752  | 304   | 68.3 %                              | 62.5 %   |
| Interest-only (4)                           | 64                                    | 3.48 %                  | 753                                  | 755  | 320   | 62.0 %                              | 55.1 %   |
| Other (5)                                   | 13                                    | 3.29 %                  | 710                                  | 728  | 268   | 69.0 %                              | 62.1 %   |
| Total residential first mortgage loans      | \$3,076                               | 3.52 %                  | 752                                  | 752  | 304   | 68.2 %                              | 62.4 %   |

(1) Unpaid principal balance, net of write downs, does not include premiums or discounts.

(2) Current FICO scores obtained at various times during the nine months ended September 30, 2016.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level, Office of Federal Housing Enterprise Oversight ("OFHEO") data as of June 30, 2016.

(4) Includes only those loans that are currently in the interest-only phase of repayment. Loans originated as interest-only that are now amortizing are included in amortizing loans.

(5) Primarily Option ARMs.



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The following table identifies our residential first mortgage loans held-for-investment by major category, at September 30, 2016:

| September 30, 2016                     | Unpaid Principal Balance (1) | Average Note Rate | Average Original FICO Score | Average Current FICO Score (2) | Weighted Average Maturity (months) | Average Original LTV Ratio | Housing Price Index LTV, as recalculated (3) |
|--|------------------------------|-------------------|-----------------------------|--------------------------------|------------------------------------|----------------------------|--|
| (Dollars in millions)                  |                              |                   |                             |                                |                                    |                            |  |
| Residential first mortgage loans       |                              |                   |                             |                                |                                    |                            |  |
| Amortizing                             |                              |                   |                             |                                |                                    |                            |  |
| 3/1 ARM                                | \$55                         | 3.95 %            | 706                         | 710                            | 215                                | 75.7 %                     | 53.9 %                                       |
| 5/1 ARM                                | 733                          | 3.18 %            | 758                         | 758                            | 314                                | 62.9 %                     | 52.8 %                                       |
| 7/1 ARM                                | 872                          | 3.28 %            | 766                         | 766                            | 348                                | 65.2 %                     | 58.6 %                                       |
| Other ARM                              | 130                          | 3.46 %            | 744                         | 751                            | 330                                | 73.7 %                     | 53.7 %                                       |
| Fixed mortgage loans                   | 250                          | 4.85 %            | 717                         | 713                            | 254                                | 73.4 %                     | 63.8 %                                       |
| Total amortizing                       | 2,040                        | 3.47 %            | 754                         | 755                            | 319                                | 66.2 %                     | 56.8 %                                       |
| Interest-only                          |                              |                   |                             |                                |                                    |                            |  |
| 3/1 ARM                                | 1                            | 3.28 %            | 616                         | 687                            | 254                                | 69.0 %                     | 62.5 %                                       |
| 5/1 ARM                                | 9                            | 3.28 %            | 733                         | 724                            | 266                                | 69.6 %                     | 76.0 %                                       |
| 7/1 ARM                                | 1                            | 3.21 %            | 694                         | 723                            | 244                                | 53.4 %                     | 51.3 %                                       |
| Other ARM                              | 53                           | 3.43 %            | 771                         | 776                            | 343                                | 55.6 %                     | 41.8 %                                       |
| Other interest-only                    | 6                            | 6.50 %            | 711                         | 705                            | 266                                | 77.2 %                     | 81.2 %                                       |
| Interest-only (4)                      | 70                           | 3.67 %            | 758                         | 761                            | 324                                | 59.4 %                     | 50.0 %                                       |
| Other (5)                              | 10                           | 3.55 %            | 710                         | 727                            | 259                                | 68.8 %                     | 58.2 %                                       |
| Total residential first mortgage loans | \$2,120                      | 3.47 %            | 754                         | 755                            | 319                                | 66.0 %                     | 56.6 %                                       |

(1) Unpaid principal balance, net of write downs, does not include premiums or discounts.

(2) Current FICO scores obtained at various times during the nine months ended September 30, 2016.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of June 30, 2016.

(4) Includes only those loans that are currently in the interest-only phase of repayment. Loans originated as interest-only that are now amortizing are included in amortizing loans.

(5) Primarily Option ARMs.

Adjustable-rate mortgage loans. Adjustable rate mortgage ("ARM") loans held-for-investment were originated using Fannie Mae and Freddie Mac guidelines as a base framework, and the debt-to-income ratio guidelines and documentation typically followed the automated underwriting system guidelines. Our underwriting guidelines were designed with the intent to minimize layered risk. The maximum ratios allowable for purposes of both the LTV ratio and the combined loan-to-value ("CLTV") ratio, which includes second mortgages on the same collateral, was 95 percent, but subordinate (or second mortgage) financing was not allowed over a 95 percent LTV ratio. At a 95 percent LTV ratio with private mortgage insurance, the minimum acceptable FICO score, or the "floor," was 620, and at lower LTV ratio levels, the FICO floor was also 620.

Set forth below as of September 30, 2016, are the amounts of the ARM loans in our held-for-investment loan portfolio with interest rate reset dates in the periods noted. As noted in the above table, loans may reset more than once over a three-year period and nonperforming loans do not reset while in the nonperforming status. Accordingly, the table below may include the same loans in more than one period. In addition, the table below excludes purchased loan portfolios.

1<sup>st</sup> Quarter 2<sup>nd</sup> Quarter 3<sup>rd</sup> Quarter 4<sup>th</sup> Quarter  
(Dollars in millions)

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|                 |       |        |        |        |
|-----------------|-------|--------|--------|--------|
| 2016 (1)        | N/A   | N/A    | N/A    | \$ 105 |
| 2017            | \$113 | \$ 118 | \$ 121 | 114    |
| 2018            | 115   | 122    | 124    | 116    |
| Later years (2) | 347   | 575    | 863    | 850    |

N/A - Not applicable

(1) Reflects loans that have reset through September 30, 2016.

(2) Later years reflect one reset period per loan.

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Second mortgage loans. The majority of second mortgages we currently originate are closed in conjunction with the closing of the residential first mortgages originated by us. We generally require the same levels of documentation and ratios as with our residential first mortgages. Our current allowable debt-to-income ratio for approval of second mortgages is capped at 43 percent. We currently limit the maximum CLTV to 80 percent and FICO scores to a minimum of 680. Current fixed rate loans are available with terms up to 15 years. The second mortgage loans require full documentation and are underwritten and priced to ensure high credit quality and loan profitability.

Home Equity Line of Credit loans. Underwriting guidelines for our HELOC originations have been established to attract higher credit quality loans with long-term profitability. The minimum FICO is 680, maximum CLTV up to 89 percent, and the maximum debt-to-income ratio is 43 percent. HELOCs are adjustable-rate loans that generally contain a 10-year interest-only draw period followed by a 20-year amortizing period. We also offer HELOC loans for a term period of five to 15 years to repay. The minimum FICO is 680, maximum CLTV up to 89 percent, and the maximum debt-to-income ratio is 43 percent. Included in HELOC loans are interest-only loans. At September 30, 2016, the unpaid principal balance of our interest-only mortgage loans was \$70 million.

Commercial loans held-for-investment. During the nine months ended September 30, 2016, we have continued to grow our longer term commercial real estate and commercial and industrial loans. Our Business and Commercial Banking group includes relationships with relationship managers primarily throughout Michigan's major markets. Our commercial loans held-for-investment totaled \$3.7 billion at September 30, 2016 and \$2.7 billion at December 31, 2015. The portfolio consists of three loan types: commercial real estate, commercial and industrial, and warehouse loans, each of which is discussed in more detail below.

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The following table identifies the commercial loans held-for-investment portfolio by loan type and selected criteria at September 30, 2016 and December 31, 2015:

## Commercial Loans Held-for-Investment

|  | September 30,<br>2016 |                      |  | December 31,<br>2015 |                      |  |
|--|-----------------------|----------------------|--|----------------------|----------------------|--|
|  | Balance               | Average<br>Note Rate |  | Balance              | Average<br>Note Rate |  |
| (Dollars in millions)                      |                       |                      |  |                      |                      |  |
| Commercial real estate loans:              |                       |                      |  |                      |                      |  |
| Fixed rate                                 | \$55                  | 4.8 %                |  | \$52                 | 4.9 %                |  |
| Adjustable rate                            | 1,118                 | 3.2 %                |  | 769                  | 2.8 %                |  |
| Total commercial real estate loans (1)     | 1,173                 |                      |  | 821                  |                      |  |
| Net deferred fees and other                | (5 )                  |                      |  | (7 )                 |                      |  |
| Total commercial real estate loans, net    | \$1,168               |                      |  | \$814                |                      |  |
| Commercial and industrial loans:           |                       |                      |  |                      |                      |  |
| Fixed rate                                 | \$86                  | 4.2 %                |  | \$44                 | 4.7 %                |  |
| Adjustable rate                            | 629                   | 3.8 %                |  | 512                  | 3.0 %                |  |
| Total commercial and industrial loans      | 715                   |                      |  | 556                  |                      |  |
| Net deferred fees and other                | (7 )                  |                      |  | (4 )                 |                      |  |
| Total commercial and industrial loans, net | \$708                 |                      |  | \$552                |                      |  |
| Warehouse loans:                           |                       |                      |  |                      |                      |  |
| Adjustable rate                            | \$1,835               | 3.4 %                |  | \$1,367              | 3.4 %                |  |
| Net deferred fees and other                | (41 )                 |                      |  | (31 )                |                      |  |
| Total warehouse loans, net                 | \$1,794               |                      |  | \$1,336              |                      |  |
| Total commercial loans:                    |                       |                      |  |                      |                      |  |
| Fixed rate                                 | \$141                 | 4.4 %                |  | \$96                 | 4.8 %                |  |
| Adjustable rate                            | 3,582                 | 3.4 %                |  | 2,648                | 3.1 %                |  |
| Total commercial loans                     | 3,723                 |                      |  | 2,744                |                      |  |
| Net deferred fees and other                | (53 )                 |                      |  | (42 )                |                      |  |
| Total commercial loans, net                | \$3,670               |                      |  | \$2,702              |                      |  |

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

Commercial real estate loans. Our commercial real estate held-for-investment loan portfolio is comprised of loans that are collateralized by real estate properties intended to be income-producing in the normal course of business. This portfolio also includes owner occupied real estate loans, in addition to secured home builder loans.

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The following table discloses our total unpaid principal balance (net of write downs) of commercial real estate held-for-investment loans by borrower geographic concentration and collateral type at September 30, 2016:

| Collateral Type                              | State                 |         |            |        | Total (1) |
|--|-----------------------|---------|------------|--------|-----------|
|  | Michigan              | Florida | California | Other  |           |
|  | (Dollars in millions) |         |            |        |           |
| Office                                       | \$188                 | \$—     | \$ 7       | \$—    | \$195     |
| Retail                                       | 126                   | 33      | 9          | 20     | 188       |
| Apartments                                   | 130                   | —       | —          | 42     | 172       |
| Industrial                                   | 131                   | —       | 25         | 4      | 160       |
| Single family residence, which includes land | 44                    | 21      | —          | 53     | 118       |
| Hotel/motel                                  | 62                    | —       | —          | —      | 62        |
| Parking Garage/Lot                           | 58                    | —       | —          | —      | 58        |
| Special Purpose                              | 49                    | 1       | 1          | —      | 51        |
| Senior living facility                       | 42                    | —       | —          | —      | 42        |
| Shopping Center                              | 36                    | —       | —          | 4      | 40        |
| Non Profit                                   | 32                    | —       | —          | —      | 32        |
| Other  | 15                    | 8       | 12         | 20     | 55        |
| Total  | \$913                 | \$ 63   | \$ 54      | \$143  | \$1,173   |
| Percent                                      | 77.8 %                | 5.4 %   | 4.6 %      | 12.2 % | 100.0 %   |

(1) Unpaid principal balance, net of write downs, does not include premiums or discounts.

Includes \$252 million of commercial owner occupied real estate loans at September 30, 2016.

Commercial and industrial loans. Commercial and industrial held-for-investment loan facilities typically include lines of credit and term loans to small and middle market businesses for use in normal business operations to finance working capital needs, equipment purchases, and expansion projects. Most of our commercial and industrial loans earn interest at a variable rate and we offer our customers the ability to enter into interest rate swaps for which we offset our risk by entering into offsetting market trades.

Warehouse lending. We also offer warehouse lines of credit to other mortgage lenders. These allow the lender to fund the closing of residential first mortgage loans. Each extension or draw-down on the line is collateralized by mortgage loans being funded and is paid off once the underlying loan is sold to an outside investor which may be ourselves. Underlying mortgage loans are predominately originated using the agencies' underwriting standards. We believe we are increasing market share in the warehouse lending market through our strategic initiative to increase lending to customers who originate loans they then sell to outside third party investors. The aggregate committed amount of adjustable rate warehouse lines of credit granted to other mortgage lenders at September 30, 2016 was \$2.7 billion, of which \$1.8 billion was outstanding, compared to \$2.2 billion at December 31, 2015, of which \$1.3 billion was outstanding.

### Credit Quality

Management considers a number of qualitative and quantitative factors in assessing the level of our allowance for loan losses. See the section captioned "Allowance for Loan Losses" in this discussion. As illustrated in the following tables, trends in certain credit quality characteristics such as nonperforming loans and past due statistics continue to show improvement. This is predominantly a result of the nonperforming and TDR loan sales, as well as run off of the legacy portfolios and the addition of new loans with strong credit characteristics to the held-for-investment portfolio.



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The following table sets forth certain information about our nonperforming assets as of the end of each of the last five quarters:

## NONPERFORMING LOANS AND ASSETS

|   | September 30, 2016    | June 30, 2016 | March 31, 2016 | December 31, 2015 | September 30, 2015 |
|---|-----------------------|---------------|----------------|-------------------|--------------------|
|   | (Dollars in millions) |               |                |                   |                    |
| Nonperforming loans held-for-investment   | \$23                  | \$23          | \$27           | \$31              | \$37               |
| Nonperforming TDRs  | 8                     | 6             | 6              | 7                 | 6                  |
| Nonperforming TDRs at inception but performing for less than six months             | 9                     | 15            | 20             | 28                | 20                 |
| Total nonperforming loans held-for-investment (1)                                   | 40                    | 44            | 53             | 66                | 63                 |
| Real estate and other nonperforming assets  | 15                    | 19            | 14             | 17                | 17                 |
| Nonperforming assets held-for-investment, net                                       | \$55                  | \$63          | \$67           | \$83              | \$80               |
| Ratio of nonperforming assets to total assets                                       | 0.39%                 | 0.46 %        | 0.49 %         | 0.61 %            | 0.64 %             |
| Ratio of nonperforming loans held-for-investment to loans held-for-investment       | 0.63%                 | 0.76 %        | 0.95 %         | 1.05 %            | 1.15 %             |
| Ratio of allowance for loan losses to loans held-for-investment (2)                 | 2.30%                 | 2.62 %        | 2.93 %         | 3.00 %            | 3.66 %             |
| Ratio of allowance for loan losses to LHFI and loans with government guarantees (2) | 2.16%                 | 2.43 %        | 2.70 %         | 2.78 %            | 3.34 %             |
| Ratio of net charge-offs to average loans held-for-investment (annualized) (2)      | 0.51%                 | 0.62 %        | 0.86 %         | 0.62 %            | 1.84 %             |
| Ratio of nonperforming assets to loans held-for-investment and repossessed assets   | 0.87%                 | 1.09 %        | 1.20 %         | 1.32 %            | 1.45 %             |
| Ratio of nonperforming assets to Tier 1 capital + allowance for loan losses         | 4.03%                 | 3.79 %        | 4.15 %         | 5.12 %            | 5.03 %             |

Does not include nonperforming loans held-for-sale of \$5 million, \$5 million, \$6 million, \$12 million and \$14 (1) million at September 30, 2016, June 30, 2016, March 31, 2016, December 31, 2015 and September 30, 2015, respectively.

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

## Past due loans held-for-investment

For all portfolios 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 nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank. 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. At September 30, 2016, we had \$48 million of past due loans held-for-investment. Of those past due loans, \$40 million were nonperforming. At December 31, 2015, we had \$80 million of past due loans held-for-investment. Of those past due loans, \$66 million were nonperforming. The decrease from December 31, 2015 to September 30, 2016 was primarily due to improved asset quality and the sale of nonperforming residential first mortgage loans.

Consumer loans. As of September 30, 2016, nonperforming consumer loans decreased from December 31, 2015, primarily due to the sale of nonperforming residential first mortgage loans. Net charge-offs in consumer loans totaled

\$7 million and \$28 million for the three and nine months ended September 30, 2016, respectively, compared to \$21 million and \$81 million during the three and nine months ended September 30, 2015, respectively, primarily due to the charge-offs of \$8 million and \$67 million related to the sale or transfer of loans during the nine months ended September 30, 2016 and September 30, 2015, respectively.

Commercial loans. As of September 30, 2016, there were no nonperforming commercial loans, compared to \$2 million at December 31, 2015. There were no net charge-offs in commercial loans for the nine months ended September 30, 2016, compared to recoveries of \$2 million for the nine months ended September 30, 2015.



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The following table sets forth information regarding past due loans held-for-investment at the dates listed:

| Days Past Due                         | September 30, 2016    |  | December 31, 2015 |  |
|---------------------------------------|-----------------------|--|-------------------|--|
|                                       | (Dollars in millions) |  |                   |  |
| 30 – 59 days                          |                       |  |                   |  |
| Consumer loans                        |                       |  |                   |  |
| Residential first mortgage            | \$ 4                  |  | \$ 7              |  |
| HELOC                                 | 1                     |  | 2                 |  |
| Other                                 | 1                     |  | 1                 |  |
| Total 30-59 days past due             | 6                     |  | 10                |  |
| 60 – 89 days                          |                       |  |                   |  |
| Consumer loans                        |                       |  |                   |  |
| Residential first mortgage            | 1                     |  | 3                 |  |
| HELOC                                 | —                     |  | 1                 |  |
| Other                                 | 1                     |  | —                 |  |
| Total 60-89 days past due             | 2                     |  | 4                 |  |
| 90 days or greater                    |                       |  |                   |  |
| Consumer loans                        |                       |  |                   |  |
| Residential first mortgage            | 29                    |  | 53                |  |
| Second mortgage                       | 4                     |  | 2                 |  |
| HELOC                                 | 7                     |  | 9                 |  |
| Commercial loans                      |                       |  |                   |  |
| Commercial and industrial             | —                     |  | 2                 |  |
| Total 90 days or greater past due (1) | 40                    |  | 66                |  |
| Total past due loans                  | \$ 48                 |  | \$ 80             |  |

(1) Includes performing nonaccrual loans that are less than 90 days delinquent and for which interest cannot be accrued.

The \$32 million decrease in total past due loans at September 30, 2016, compared to December 31, 2015 was primarily due to improved asset quality coupled with the sale of \$20 million of nonperforming residential first mortgage loans during the nine months ended September 30, 2016. The 30 to 59 days past due loans decreased to \$6 million at September 30, 2016, compared to \$10 million at December 31, 2015, primarily driven by improved asset quality.

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The following table sets forth information regarding loans held-for-investment and nonperforming loans (i.e., 90 days or greater past due loans) as to which we have ceased accruing interest:

|                                      | September 30, 2016        |                  | As a % of      |                     | As a % of        |  |
|--------------------------------------|---------------------------|------------------|----------------|---------------------|------------------|--|
|                                      | Loans Held-for-Investment | Nonaccrual Loans | Loan Portfolio | Specified Portfolio | Nonaccrual Loans |  |
|                                      | (Dollars in millions)     |                  |                |                     |                  |  |
| Consumer loans                       |                           |                  |                |                     |                  |  |
| Residential first mortgage           | \$2,136                   | \$ 29            | 1.4 %          | 72.5 %              |                  |  |
| Second mortgage                      | 127                       | 4                | 3.1 %          | 10.0 %              |                  |  |
| HELOC                                | 326                       | 7                | 2.1 %          | 17.5 %              |                  |  |
| Other consumer                       | 30                        | —                | — %            | — %                 |                  |  |
| Total consumer loans                 | 2,619                     | 40               | 1.5 %          | 100.0 %             |                  |  |
| Commercial loans                     |                           |                  |                |                     |                  |  |
| Commercial real estate               | 1,168                     | —                | — %            | — %                 |                  |  |
| Commercial and industrial            | 708                       | —                | — %            | — %                 |                  |  |
| Warehouse lending                    | 1,795                     | —                | — %            | — %                 |                  |  |
| Total commercial loans               | 3,671                     | —                | — %            | — %                 |                  |  |
| Total loans (1)                      | \$6,290                   | \$ 40            | 0.6 %          | 100.0 %             |                  |  |
| Less allowance for loan losses       | (143 )                    |                  |                |                     |                  |  |
| Total loans held-for-investment, net | \$6,147                   |                  |                |                     |                  |  |

(1) Includes \$12 million of nonaccrual loans carried under the fair value option at September 30, 2016.

#### Troubled debt restructurings (held-for-investment)

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

|                      | TDRs Held-for-Investment |               |        |
|----------------------|--------------------------|---------------|--------|
|                      | Performing               | Nonperforming | Total  |
|                      | (Dollars in millions)    |               |        |
| September 30, 2016   |                          |               |        |
| Consumer loans (1)   | \$ 70                    | \$ 17         | \$ 87  |
| Commercial loans (2) | 1                        | —             | 1      |
| Total TDRs           | \$ 71                    | \$ 17         | \$ 88  |
| December 31, 2015    |                          |               |        |
| Consumer loans (1)   | \$ 101                   | \$ 35         | \$ 136 |
| Total TDRs           | \$ 101                   | \$ 35         | \$ 136 |

Consumer loans include: residential first mortgage, second mortgage, HELOC and other consumer loans. The (1) allowance for loan losses on consumer TDR loans totaled \$11 million and \$15 million at September 30, 2016 and December 31, 2015, respectively.

(2) Commercial loans include: commercial real estate, commercial and industrial and warehouse loans.

Troubled debt restructurings ("TDRs") are modified loans in which a borrower demonstrates financial difficulties and for which a concession has been granted. The decrease of \$48 million in our total TDR loans at September 30, 2016, compared to December 31, 2015 was primarily due to the sale of TDR loans during the nine months ended September 30, 2016. Nonperforming TDRs were 42.5 percent and 53.4 percent of total nonperforming loans at September 30, 2016 and December 31, 2015, respectively.

Nonperforming TDRs are included in nonaccrual loans. TDRs remain in nonperforming status until a borrower has made at least six consecutive months of payments under the modified terms. Performing TDRs are excluded from nonaccrual loans because it is reasonably assured that all contractual principal and interest due under the restructured terms will be collected. Within consumer nonperforming loans, residential first mortgage TDRs were 35 percent of residential first mortgage nonperforming loans at September 30, 2016, compared to 51 percent at December 31, 2015.

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The following table sets forth the activity during each of the periods presented with respect to performing TDRs and nonperforming TDRs:

|                                 | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine Months<br>Ended<br>September<br>30,<br>2015 |        |
|---------------------------------|--|-------|--|--------|
|                                 | 2016   | 2015  | 2016   | 2015   |
| (Dollars in millions)           |  |       |  |        |
| Performing                      |  |       |  |        |
| Beginning balance               | \$73   | \$108 | \$101  | \$362  |
| Additions                       | —  | 16    | 7  | 67     |
| Transfer to nonperforming TDR   | (1 )   | (7 )  | (7 )   | (12 )  |
| Transfer from nonperforming TDR | 6  | —     | 11   | 1      |
| Principal repayments            | (1 )   | (1 )  | (3 )   | (3 )   |
| Reductions (1)                  | (6 )   | (19 ) | (38 )  | (318 ) |
| Ending balance                  | \$71   | \$97  | \$71   | \$97   |
| Nonperforming                   |  |       |  |        |
| Beginning balance               | \$21   | \$24  | \$35   | \$46   |
| Additions                       | —  | 3     | 5  | 13     |
| Transfer from performing TDR    | 1  | 7     | 7  | 12     |
| Transfer to performing TDR      | (6 )   | —     | (11 )  | (1 )   |
| Principal repayments            | (1 )   | —     | (1 )   | —      |
| Reductions (1)                  | 2  | (8 )  | (18 )  | (44 )  |
| Ending balance                  | \$17   | \$26  | \$17   | \$26   |

(1) Includes loans paid in full or otherwise settled, sold or charged-off.

## Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses that are inherent in our loans held-for-investment portfolio but which have not yet been realized. The consumer loan portfolio includes residential first mortgages, second mortgages, HELOC, and other consumer loans. The commercial loan portfolio includes commercial real estate, commercial and industrial and warehouse lending. See Note 4 to the Consolidated Financial Statements for further information.

The allowance for loan losses decreased \$44 million to \$143 million at September 30, 2016, compared to \$187 million at December 31, 2015. The decrease from December 31, 2015 was primarily driven by a decrease in the amount of residential first mortgage loans as a result of sales along with the sale of \$110 million unpaid principal balance of nonperforming, TDR and non-agency loans during the nine months ended September 30, 2016.

The allowance for loan losses as a percentage of loans held-for-investment decreased to 2.3 percent as of September 30, 2016 from 3.0 percent as of December 31, 2015. At September 30, 2016, we had a 3.8 percent allowance coverage of our consumer loan portfolio. The commercial loan allowance for loan losses coverage ratio was 1.3 percent at September 30, 2016, reflecting the percentage of warehouse loans in the portfolio and improved level of overall quality.

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The following tables set forth certain information regarding the allocation of our allowance for loan losses to each loan category:

|   | September 30, 2016    |            |           | Allowance  |  |
|---|-----------------------|------------|-----------|------------|--|
|   | Loans                 | Percent    | Allowance | as a       |  |
|   | Held-for-             | of         | Amount    | Percent of |  |
|   | Investment            | Investment |           | Loan       |  |
|   | Portfolio             | Portfolio  |           | Portfolio  |  |
|   | (Dollars in millions) |            |           |            |  |
| Consumer loans                          |                       |            |           |            |  |
| Residential first mortgage (1)          | \$2,136               | 33.9 %     | \$ 70     | 3.3 %      |  |
| Second mortgage                         | 127                   | 2.0 %      | 9         | 7.1 %      |  |
| HELOC                                   | 326                   | 5.2 %      | 16        | 4.9 %      |  |
| Other                                   | 30                    | 0.5 %      | 1         | 3.3 %      |  |
| Total consumer loans                    | 2,619                 | 41.6 %     | 96        | 3.7 %      |  |
| Commercial loans                        |                       |            |           |            |  |
| Commercial real estate                  | 1,168                 | 18.6 %     | 25        | 2.1 %      |  |
| Commercial and industrial               | 708                   | 11.3 %     | 14        | 2.0 %      |  |
| Warehouse lending                       | 1,795                 | 28.5 %     | 8         | 0.4 %      |  |
| Total commercial loans                  | 3,671                 | 58.4 %     | 47        | 1.3 %      |  |
| Total consumer and commercial loans (2) | \$6,290               | 100.0 %    | \$ 143    | 2.3 %      |  |

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

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

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## ACTIVITY IN THE ALLOWANCE FOR LOAN LOSSES

|   | Three Months<br>Ended<br>September 30,<br>2016 |        | Nine Months<br>Ended<br>September 30,<br>2015 |        |
|---|--|--------|---|--------|
|   | 2016   | 2015   | 2016  | 2015   |
|   | (Dollars in millions)                          |        |   |        |
| Beginning balance                       | \$150  | \$222  | \$187   | \$297  |
| Provision (benefit) for loan losses (3) | —  | (1 )   | (16 )   | (18 )  |
| Charge-offs                             |  |        |   |        |
| Consumer loans                          |  |        |   |        |
| Residential first mortgage              | (7 )   | (21 )  | (26 )   | (80 )  |
| Second mortgage                         | —  | (1 )   | (2 )  | (2 )   |
| HELOC                                   | (1 )   | (1 )   | (2 )  | (2 )   |
| Other consumer                          | (1 )   | (1 )   | (3 )  | (3 )   |
| Total consumer loans                    | (9 )   | (24 )  | (33 )   | (87 )  |
| Commercial loans                        |  |        |   |        |
| Commercial real estate                  | —  | —      | —   | —      |
| Commercial and industrial               | —  | (3 )   | —   | (3 )   |
| Warehouse lending                       | —  | —      | —   | —      |
| Total commercial loans                  | —  | (3 )   | —   | (3 )   |
| Total charge offs                       | (9 )   | (27 )  | (33 )   | (90 )  |
| Recoveries                              |  |        |   |        |
| Consumer loans                          |  |        |   |        |
| Residential first mortgage              | —  | 1      | 1   | 3      |
| Second mortgage                         | —  | 1      | 1   | 1      |
| HELOC                                   | 1  | —      | 1   | —      |
| Other consumer                          | 1  | 1      | 2   | 2      |
| Total consumer loans                    | 2  | 3      | 5   | 6      |
| Commercial loans                        |  |        |   |        |
| Commercial real estate                  | —  | —      | —   | 2      |
| Total recoveries                        | 2  | 3      | 5   | 8      |
| Charge-offs, net of recoveries          | (7 )   | (24 )  | (28 )   | (82 )  |
| Ending balance                          | \$143  | \$197  | \$143   | \$197  |
| Net charge-off to LHF ratio (1)         | 0.51 %   | 1.84 % | 0.66 %  | 2.34 % |
| Net charge-off ratio, adjusted (1) (2)  | 0.15 %   | 0.61 % | 0.15 %  | 0.43 % |

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

Excludes charge-offs of zero and \$16 million related to the sale or transfer of loans during the three months ended September 30, 2016 and September 30, 2015, respectively, and \$8 million and \$67 million related to the transfer (2) and subsequent sale of loans during the nine months ended September 30, 2016 and September 30, 2015, respectively. Also excludes charge-offs related to loans with government guarantees of \$6 million and \$13 million during the three and nine months ended September 30, 2016.

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.



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### Liquidity Risk

Liquidity risk is the risk that we will not have sufficient funds to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects our ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate and market opportunities. The ability of a financial institution to meet current financial obligations is a function of the balance sheet structure, the ability to liquidate assets, and access to various sources of funds.

We primarily originate Agency-eligible loans held-for-sale and therefore the majority of new residential first mortgage loan originations are readily convertible to cash, either by selling them as part of our monthly Agency sales, private party whole loan sales, or by pledging them to the Federal Home Loan Bank of Indianapolis and borrowing against them. We use the Federal Home Loan Bank of Indianapolis as a significant source for funding our residential mortgage banking business due to our flexibility in terms of being able to borrow or repay borrowings as daily cash needs require.

Our principal uses of funds include loan originations and operating expenses. At September 30, 2016, we had outstanding rate-lock commitments of \$6.5 billion, compared to \$3.8 billion at December 31, 2015. The increase in rate-lock commitments was driven by the lower interest rate environment at September 30, 2016. Total commitments were \$9.0 billion at September 30, 2016 and \$5.5 billion at December 31, 2015. See Note 16 to the Consolidated Financial Statements for further information on commitments.

The amount we can borrow, or the value we receive for the assets pledged to our liquidity providers, varies based on the amount and type of pledged collateral as well as the perceived market value of the assets and the "haircut" of the market value of the assets. That value is sensitive to the pricing and policies of our liquidity providers and can change with little or no notice.

In addition to operating expenses at a particular level of mortgage originations, our cash flows are fairly predictable and relate primarily to the funding of cash outflows to originate or purchase residential first mortgages and cash inflows from sales of those residential first mortgages. Our mortgage warehouse funding line of business also generates cash flows as funds are extended to correspondent relationships to close new loans. Those loans are repaid when the correspondent sells the loan. Other material cash flows relate to growing our commercial lines of business and the loans we service for others and consist primarily of monthly principal, interest, taxes and insurance escrow payments.

Our Consolidated Statements of Cash Flows shows cash used in operating activities of \$10.1 billion and \$7.1 billion for the nine months ended September 30, 2016 and 2015, respectively. This primarily reflects our mortgage operations and is a reflection of the manner in which we execute certain loan sales for which the cash outflow is included in operating activities and the corresponding cash inflow is included in the investing section.

As governed and defined by our internal liquidity policy, we maintain adequate excess liquidity levels appropriate to cover unanticipated liquidity needs. In addition to this liquidity, we also maintain targeted minimum levels of unused collateralized borrowing capacity as another cushion against unexpected liquidity needs. Each business day, we forecast 90 days of daily cash needs. This allows us to determine our projected near term daily cash fluctuations and also to plan and adjust, if necessary, future activities. As a result, in an adverse environment, we would be able to make adjustments to operations as required to meet the liquidity needs of our business, including adjusting deposit rates to increase deposits, planning for additional Federal Home Loan Bank borrowings, accelerating sales of loans held-for-sale (agencies and/or private), selling loans held-for-investment or securities, borrowing through the use of repurchase agreements, reducing originations, making changes to warehouse funding facilities, or borrowing from the discount window.



Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity, capital resources or operations.

#### Parent Company Liquidity

The Company obtains its liquidity from multiple sources, including dividends from the Bank and the issuance of debt and equity securities. The primary uses of the Company's liquidity are debt service, dividends to common and preferred stockholders, capital contributions to the Bank and operating expenses. The Company's most liquid assets are cash it holds at the Bank and interest-bearing demand accounts at correspondent banks, all of which totaled \$73 million at September 30, 2016.

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The Office of the Comptroller of the Currency ("OCC") regulates all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. A subsidiary of a savings and loan holding company, such as the Bank, must file a notice or application with the OCC at least 30 days prior to each proposed capital distribution. Whether an application is required is based on a number of factors including whether the institution qualifies for expedited treatment under the OCC rules and regulations or if the total amount of all capital distributions (including each proposed capital distribution) for the applicable calendar year exceeds net income for that year to date plus the retained net income for the preceding two years. Under the Consent Order, the Bank may not pay a dividend or make a capital distribution if it is not in compliance with its approved capital plan or would not remain in compliance after making the dividend or capital distribution, and the Bank must receive OCC approval under the generally applicable application or notice requirements. In addition, as a subsidiary of a savings and loan holding company, the Bank must receive approval from the Federal Reserve Bank ("FRB") before declaring any dividends. Additional restrictions on dividends apply if the Bank fails the Qualified Thrift Lending ("QTL") test. We anticipate that as long as we remain under the consent order, we will be required to obtain approval from the OCC prior to any capital distribution.

For additional details and restrictions related to the Bank's payment of dividends, refer to the Capital section of Management's discussion and analysis within this form 10-Q.

## Deposits

Our deposits consist of three primary categories: retail deposits, government deposits, and company controlled deposits. Total deposits increased \$1.4 billion, or 18 percent at September 30, 2016, compared to December 31, 2015, primarily due to increases in company controlled deposits.

We have continued to focus on increasing our core deposit accounts such as branch and commercial demand deposits, savings and money market accounts. These core deposits provide a lower cost funding source to the Bank. During the nine months ended September 30, 2016, our core deposits increased \$196 million primarily driven by growth in commercial demand deposits, partially offset by a decline in retail money market demand accounts.

We utilize local governmental agencies, and other public units, as an additional source for deposit funding. These deposit accounts include \$372 million of certificates of deposit with maturities typically less than one year and \$804 million in checking and savings accounts at September 30, 2016.

Company controlled deposits arise due to our servicing of loans for others and represent the portion of the investor custodial accounts on deposit with the Bank. Certain deposits require us to reimburse the owner for the spread on these funds. This cost is a component of net loan administration income. During the nine months ended September 30, 2016, these deposits increased \$869 million, primarily due to taxes not yet paid out.

We participate in the Certificates of Deposit Account Registry Service ("CDARS") program, through which certain customer certificates of deposit ("CD") are exchanged for CDs of similar amounts from other participating banks. This gives customers the potential to receive FDIC insurance up to \$50 million. At September 30, 2016, we had \$249 million of total CDs enrolled in the CDARS program.

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The composition of our deposits was as follows:

|   | September 30, 2016<br>(Dollars in millions) |               |                | December 31, 2015 |               |                |
|---|---|---------------|----------------|-------------------|---------------|----------------|
|   | Balance                                     | Yield/Rate    | % of Deposits  | Balance           | Yield/Rate    | % of Deposits  |
| <b>Retail deposits</b>                  |   |               |                |                   |               |                |
| <b>Branch retail deposits</b>           |   |               |                |                   |               |                |
| Demand deposit accounts                 | \$830                                       | 0.05 %        | 8.9 %          | \$797             | 0.07 %        | 10.0 %         |
| Savings accounts                        | 3,745                                       | 0.77 %        | 40.0 %         | 3,717             | 0.79 %        | 46.8 %         |
| Money market demand accounts            | 142   | 0.14 %        | 1.5 %          | 163               | 0.15 %        | 2.1 %          |
| Certificates of deposit/CDARS (1)       | 1,075                                       | 1.03 %        | 11.5 %         | 811               | 0.86 %        | 10.2 %         |
| <b>Total branch retail deposits</b>     | <b>5,792</b>                                | <b>0.70 %</b> | <b>61.8 %</b>  | <b>5,488</b>      | <b>0.68 %</b> | <b>69.2 %</b>  |
| <b>Commercial retail deposits</b>       |   |               |                |                   |               |                |
| Demand deposit accounts                 | 287   | 0.16 %        | 3.1 %          | 194               | 0.41 %        | 2.4 %          |
| Savings accounts                        | 49  | 0.52 %        | 0.5 %          | 34                | 0.56 %        | 0.4 %          |
| Money market demand accounts            | 151   | 0.78 %        | 1.6 %          | 104               | 0.76 %        | 1.3 %          |
| Certificates of deposit/CDARS (1)       | 8   | 1.25 %        | 0.1 %          | 14                | 1.03 %        | 0.2 %          |
| <b>Total commercial retail deposits</b> | <b>495</b>                                  | <b>0.41 %</b> | <b>5.3 %</b>   | <b>346</b>        | <b>0.55 %</b> | <b>4.3 %</b>   |
| <b>Total retail deposits subtotal</b>   | <b>\$6,287</b>                              | <b>0.68 %</b> | <b>67.1 %</b>  | <b>\$5,834</b>    | <b>0.67 %</b> | <b>73.5 %</b>  |
| <b>Government deposits</b>              |   |               |                |                   |               |                |
| Demand deposit accounts                 | \$273                                       | 0.39 %        | 2.9 %          | \$302             | 0.39 %        | 3.8 %          |
| Savings accounts                        | 531   | 0.53 %        | 5.7 %          | 363               | 0.51 %        | 4.6 %          |
| Certificates of deposit/CDARS (1)       | 372   | 0.70 %        | 4.0 %          | 397               | 0.55 %        | 5.0 %          |
| <b>Total government deposits (2)</b>    | <b>1,176</b>                                | <b>0.55 %</b> | <b>12.5 %</b>  | <b>1,062</b>      | <b>0.49 %</b> | <b>13.4 %</b>  |
| Company controlled deposits (3)         | 1,908                                       | — %           | 20.4 %         | 1,039             | — %           | 13.1 %         |
| <b>Total deposits (4)</b>               | <b>\$9,371</b>                              | <b>0.52 %</b> | <b>100.0 %</b> | <b>\$7,935</b>    | <b>0.56 %</b> | <b>100.0 %</b> |

- (1) The aggregate amount of certificates of deposit with a minimum denomination of \$100,000 was approximately \$1.1 billion and \$0.9 billion at September 30, 2016 and December 31, 2015, respectively.
- (2) Government deposits include funds from municipalities and schools.
- (3) These accounts represent a portion of the investor custodial accounts and escrows controlled by us in connection with loans serviced, or subserviced for others and that have been placed on deposit with the Bank.
- (4) The aggregate amount of deposits with a balance over \$250,000 was approximately \$3.7 billion and \$3.4 billion at September 30, 2016 and December 31, 2015, respectively.

**Borrowings**

The Federal Home Loan Bank provides loans, also referred to as advances, on a fully collateralized basis, to savings banks and other member financial institutions. We are currently authorized through a resolution of our board of directors to apply for advances from the Federal Home Loan Bank using approved loan types as collateral. At September 30, 2016, we had the authority and approval from the Federal Home Loan Bank to utilize a line of credit of up to \$7.0 billion and we may access that line to the extent that collateral is provided. At September 30, 2016, we had \$2.5 billion of advances outstanding and an additional \$2.0 billion of collateralized borrowing capacity available at the Federal Home Loan Bank.

We have arrangements with the Federal Reserve Bank of Chicago to borrow, as appropriate, from its discount window. The discount window is a borrowing facility that is intended to be used only for short-term liquidity needs arising from special or unusual circumstances. The amount we are allowed to borrow is based on the lendable value of the collateral that we provide. To collateralize the line, we pledge commercial and industrial loans that are eligible based on Federal Reserve Bank of Chicago guidelines. At September 30, 2016, we had pledged commercial and

industrial loans amounting to \$517 million with a lendable value of \$508 million. At December 31, 2015, we had pledged commercial and industrial loans amounting to \$75 million with a lendable value of \$45 million. At September 30, 2016 and December 31, 2015, we had no borrowings outstanding against this line of credit. We also have access to overnight borrowings from various counterparty banks that settle through the Federal Reserve Bank. At September 30, 2016 and December 31, 2015, we had \$20 million and no borrowings outstanding on these short-term borrowings, respectively.

Federal Home Loan Bank advances. Federal Home Loan Bank advances decreased \$1,079 million to \$2,462 million at September 30, 2016 from \$3,541 million at December 31, 2015. We rely upon advances from the Federal Home Loan Bank

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as a source of funding for the origination or purchase of loans for sale in the secondary market and for providing duration specific short-term and long-term financing. The outstanding balance of Federal Home Loan Bank advances fluctuates from time to time depending on our current inventory of mortgage loans held-for-sale and the availability of lower cost funding sources. Our portfolio includes short-term fixed and variable rate advances, long-term LIBOR adjustable advances, and long-term fixed rate advances. Interest rates on the LIBOR index advances reset every three-months and the advances may be prepaid without penalty, with notification, at scheduled three-month intervals after an initial 12-month lockout period.

Debt. As part of our overall capital strategy, we previously raised capital through the issuance of junior subordinated notes to our special purpose trusts formed for the offerings, which issued preferred stock (trust preferred securities). The junior subordinated notes are callable by us at any time. Interest is payable on a quarterly basis; however, we may defer interest payments for up to 20 quarters without default or penalty. In January, 2012, we exercised our contractual right to defer regularly scheduled quarterly payments of interest. On July 14, 2016, we ended the deferral and made a \$34 million payment to bring current our previously deferred interest as of that date.

We issued \$250 million of 2021 senior notes on July 11, 2016 ("2021 Senior Notes"). The proceeds from these notes were used to bring current and redeem our outstanding Series C Preferred Stock. The notes will be effectively subordinated to Flagstar Bancorp, Inc.'s secured indebtedness.

Prior to June 15, 2021, we may redeem some or all of the 2021 Senior Notes at a redemption price equal to the greater of 100 percent of the aggregate principal amount of the 2021 Senior Notes to be redeemed or the sum of the present values of the remaining scheduled payments plus, in each case, accrued and unpaid interest.

See Note 9 of the Notes to the Consolidated Financial Statements, for further information about Federal Home Loan Bank advances and other long-term debt.

## Market Risk

Market risk is the risk of reduced earnings and or declines in the net market value of the balance sheet primarily due to changes in interest rates, currency exchange rates, or equity prices. We do not have any material foreign currency exchange risk or equity price risk. The primary market risk is interest rate risk and results from timing differences in the repricing of our assets and liabilities, changes in the relationships between rate indices, and the potential exercise of explicit or embedded options.

Interest rate risk is monitored by the asset liability committee ("ALCO"), which is composed of our executive officers and other members of management, in accordance with policies approved by our board of directors. In determining the appropriate level of interest rate risk, the ALCO considers the impact projected interest rate scenarios have on earnings and capital, liquidity, business strategies, and other factors. The ALCO meets monthly or as deemed necessary to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and fair values of assets and liabilities, unrealized gains and losses, purchase and sale activity, loans held-for-sale and commitments to originate loans, and the maturities of investments, borrowings and time deposits.

Financial instruments used to manage interest rate risk include derivative financial instruments such as interest rate swaps and forward sales commitments. Further discussion of the use of and the accounting for derivative instruments is included in Notes 8 and 17 of the Notes to Consolidated Financial Statements. All of our derivatives are accounted for at fair market value. All mortgage loan production originated for sale is accounted for on a fair value basis.

To effectively measure and manage interest rate risk, sensitivity analysis is used to determine the impact on earnings and the net market value of the balance sheet across various interest rate scenarios, balance sheet trends, and

strategies. From these simulations, interest rate risk is quantified and appropriate strategies are developed and implemented. Additionally, duration and net interest income sensitivity measures are utilized when they provide added value to the overall interest rate risk management process. The overall interest rate risk position and strategies are reviewed by executive management and the board of directors on an ongoing basis. However, management has the latitude to increase interest rate sensitivity within certain limits if, in management's judgment, the increase will enhance profitability.

Net interest income simulation analysis provides estimated net interest income of the current balance sheet across alternative interest rate scenarios. The net interest income analysis measures the sensitivity of interest sensitive earnings over a 12 month time horizon. The analysis holds the current balance sheet values constant and does not take into account management intervention. The net interest income simulation demonstrates the level of interest rate risk inherent in the existing balance sheet.

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The following table is a summary of the changes in our net interest income that are projected to result from hypothetical changes in market interest rates. The interest rate scenarios presented in the table include interest rates as of September 30, 2016 and December 31, 2015 and adjusted by instantaneous parallel rate changes plus or minus 200 basis points. The minus 200 basis point shock scenario is a flattener scenario as rates are floored at zero given the current interest rate levels.

September 30, 2016

| Scenario | Net interest income (Dollars in millions) | \$ Change | % Change |
|----------|---|-----------|----------|
| 200      | \$356                                     | \$ 52     | 17.0 %   |
| Constant | 304                                       | —         | — %      |
| (200)    | 256                                       | (48 )     | (16.0 )% |

December 31, 2015

| Scenario | Net interest income (Dollars in millions) | \$ Change | % Change |
|----------|---|-----------|----------|
| 200      | \$312                                     | \$ 6      | 2.0 %    |
| Constant | 306                                       | —         | — %      |
| (200)    | 258                                       | (48 )     | (16.0 )% |

At September 30, 2016, the \$2 million decline in the net interest margin in the constant scenario as compared to December 31, 2015, was primarily driven by a decreased yield on other investments and consumer loans.

We have also projected the potential impact to net interest income in a hypothetical "bear flattener" interest rate scenario as of September 30, 2016. When increasing short-term interest rates instantaneously by 100 basis points and holding the longer term interest rates unchanged, the decrease to net interest income over a 12-month and 24-month period based on our forecasted balance sheet is a loss of \$21 million and \$27 million, respectively.

In the net interest income simulation, our balance sheet exhibits slight asset sensitivity. When interest rates rise our interest income increases, conversely when interest rates fall our interest income decreases. The net interest income simulation measures the interest rate risk of the balance sheet over a short period of time, typically 12 months. An additional analysis is completed that measures the interest rate risk over an extended period of time. The Economic Value of Equity ("EVE") analysis provides a fair value of the balance sheet in alternative interest rate scenarios. The EVE analysis does not take into account management intervention and assumes the new rate environment is constant and the change is instantaneous.

The following table is a summary of the changes in our EVE that are projected to result from hypothetical changes in market interest rates. EVE is the market value of assets, less the market value of liabilities, adjusted for the market value of off-balance sheet instruments. The interest rate scenarios presented in the table include interest rates at September 30, 2016 and December 31, 2015, and as adjusted by instantaneous parallel rate changes upward to 300 basis points and downward to 100 basis points. The scenarios are not comparable due to differences in the interest rate environments, including the absolute level of rates and the shape of the yield curve. Each rate scenario reflects unique prepayment, repricing, and reinvestment assumptions. Management derives these assumptions by considering published market prepayment expectations, the repricing characteristics of individual instruments or groups of similar

instruments, our historical experience, and our asset and liability management strategy. Further, this analysis assumes that certain instruments would not be affected by the changes in interest rates or would be partially affected due to the characteristics of the instruments.

Further, as this framework evaluates risks to the current statement of financial condition only, changes to the volumes and pricing of new business opportunities that can be expected in the different interest rate outcomes are not incorporated in this analytical framework. For instance, analysis of our history suggests that declining interest rate levels are associated with higher loan production volumes at higher levels of profitability. While this "natural business hedge" historically offsets most, if not all, of the identified risks associated with declining interest rate scenarios, these factors fall outside of the EVE framework. Further, there can be no assurance that this natural business hedge would positively affect the economic value of equity in the same manner and to the same extent as in the past.

There are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates. It is not possible to fully model the market risk in instruments with leverage, option, or prepayment risks. Also, we are affected by basis risk, which is the difference in repricing characteristics of similar term rate indices. As such, this analysis is not intended to be a precise forecast of the effect a change in market interest rates would have on us.



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If EVE increases in any interest rate scenario, that would indicate an increasing direction for the margin in that hypothetical rate scenario. A perfectly matched balance sheet would possess no change in the EVE, no matter what the rate scenario. The following table presents the EVE in the stated interest rate scenarios:

| September 30, 2016 |                       |        |           |          | December 31, 2015 |                       |        |           |          |
|--------------------|-----------------------|--------|-----------|----------|-------------------|-----------------------|--------|-----------|----------|
| Scenario           | EVE                   | EVE%   | \$ Change | % Change | Scenario          | EVE                   | EVE%   | \$ Change | % Change |
|                    | (Dollars in millions) |        |           |          |                   | (Dollars in millions) |        |           |          |
| 300                | \$1,998               | 14.1 % | \$ (4 )   | (0.2 )%  | 300               | \$1,788               | 14.6 % | \$ (247 ) | (12.1 )% |
| 200                | 2,030                 | 14.3 % | 27        | 1.4 %    | 200               | 1,889                 | 14.9 % | (146 )    | (7.2 )%  |
| 100                | 2,043                 | 14.4 % | 41        | 2.0 %    | 100               | 1,978                 | 15.1 % | (57 )     | (2.8 )%  |
| Current            | 2,002                 | 14.1 % | —         | — %      | Current           | 2,035                 | 15.0 % | —         | — %      |
| (100)              | 1,879                 | 13.2 % | (123 )    | (6.2 )%  | (100)             | 2,001                 | 14.7 % | (34 )     | (1.7 )%  |

Our balance sheet exhibits sensitivity in a rising interest rate scenario as the EVE decreases. The decrease in EVE is the result of the amount of liabilities that would be expected to reprice exceeding the amount of assets repriced in the up to 200 scenario. The (100) is a flattener scenario as shorter term rates are unable to decrease 100 basis points due to the absolute level of rates. Therefore, the yields of the longer term variable rate assets decrease by the full 100 basis points, but the liabilities repricing to shorter term rates decrease to less than 100 basis points, leading to a reduction in EVE.

#### Mortgage servicing rights

At September 30, 2016, MSR at fair value increased \$6 million to \$302 million, compared to \$296 million at December 31, 2015, primarily due to additions from loan sales where we retained servicing, partially offset by actual and pending MSR sales and higher prepayments.

Once fully phased in, the Basel III capital rules will significantly reduce the allowable amount of the fair value of MSR included in Tier 1 capital. Our ratio of MSR to Tier 1 capital was 24.6 percent and 20.6 percent at September 30, 2016 and December 31, 2015, respectively. As of September 30, 2016, we have pending MSR sales with a fair value of \$50 million expected to close in the fourth quarter 2016. These sales represent nearly all of the Company's remaining Ginnie Mae MSR and will significantly reduce the mortgage servicing asset as we work to prepare for Basel III final phase-in capital requirements as discussed above.

The principal balance of the loans underlying our total MSR was \$31.4 billion at September 30, 2016, compared to \$26.1 billion at December 31, 2015, primarily attributable to an increase in servicing loan volume, partially offset by loan payoffs and MSR sales of \$12.7 billion in underlying loans.

For further information relating to the mortgage servicing rights, see Note 7 of the Notes to the Consolidated Financial Statements, herein.

#### Operational Risk

Operational risk is the risk of loss due to human error; inadequate or failed internal systems and controls; violations of, or noncompliance with, laws, rules and regulations, prescribed practices, or ethical standards; and external influences such as market conditions, fraudulent activities, disasters, and security risks. We continuously strive to strengthen our system of internal controls to ensure compliance with laws, rules, and regulations, and to improve the oversight of our operational risk. We evaluate internal systems, processes, and controls to mitigate loss from cyber-attacks and, to date, have not experienced any material losses. The goal of this framework is to implement effective operational risk techniques and strategies, minimize operational and fraud losses, and enhance our overall

performance.

Loans with government guarantees

The amount of loans with government guarantees totaled \$404 million at September 30, 2016 and the loans which we have not yet repurchased but had the unilateral right to repurchase totaled \$21 million and were classified as loans with government guarantees. At December 31, 2015, loans with government guarantees totaled \$485 million and those loans which we had not yet repurchased but had the unilateral right to repurchase totaled \$9 million and were classified as loans with government guarantees. The balance of this portfolio decreased at September 30, 2016, primarily due to loans with government guarantees transferred to held-for-sale and loan liquidations, partially offset by an increase in repurchased loans.

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Substantially all of these loans continue to be insured or guaranteed by the Federal Housing Administration ("FHA") or the U.S. Department of Veterans Affairs and management believes that the reimbursement process is proceeding appropriately. These repurchased loans earn interest at a statutory rate, which varies for each loan, but is based on the 10-year U.S. Treasury note rate at the time the loan becomes greater than 60 days delinquent. 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.

For further information on loans with government guarantees, see Note 5 of the Notes to the Consolidated Financial Statements, herein.

Representation and warranty reserve

When we sell mortgage loans, we make customary representations and warranties to the purchasers, including sponsored securitization trusts and their insurers (primarily Fannie Mae and Freddie Mac).

During the nine months ended September 30, 2016, we had \$14 million in Fannie Mae new repurchase demands and \$10 million in Freddie Mac new repurchase demands. These amounts are down as compared to the nine months ended September 30, 2015 when we had \$75 million in Fannie Mae new repurchase demands and \$23 million in Freddie Mac new repurchase demands.

The following table summarizes the trends with respect to key model attributes and assumptions for estimating the representation and warranty reserve:

September 30, 2016      December 31, 2015

|           |                       |            |  |
|-----------|-----------------------|------------|--|
|           | 2016                  | 2015       |  |
|           | (Dollars in millions) |            |  |
| UPB       |                       |            |  |
| of        |                       |            |  |
| loans     | \$176,870             | \$ 162,301 |  |
| sold      |                       |            |  |
| (1)       |                       |            |  |
| Losses    |                       |            |  |
| expected  |                       |            |  |
| from      |                       |            |  |
| put-backs |                       |            |  |
| percent   | % 0.03                | %          |  |
| of        |                       |            |  |
| loans     |                       |            |  |
| sold)     |                       |            |  |
| (2)       |                       |            |  |

(1) Includes original unpaid principal balance of 2009 and later vintage loans sold to Fannie Mae and Freddie Mac through September 30, 2016.

(2) Estimated losses from expected repurchases to be made (post appeal loss).

See Note 10 of the Notes to the Consolidated Financial Statements.

Capital

Under the capital distribution regulations, a savings bank that is a subsidiary of a savings and loan holding company must either notify or seek approval from the OCC of a capital distribution at least 30 days prior to the declaration of a dividend or the approval by the board of directors of the proposed capital distribution. The 30-day period allows the OCC to determine whether the distribution would not be advisable. Because we are under the Consent Order, we currently must seek approval from the OCC prior to making a capital distribution from the Bank. Also, under Federal Reserve requirements, the Bank must provide a 30-day notice to the Federal Reserve prior to declaring or paying dividends. In addition, under the Supervisory Agreement, the Company agreed to request prior non-objection of the Federal Reserve to pay dividends or other capital distributions. We seek to manage our capital levels and overall business in a manner which we consider to be prudent and work with our regulators to ensure that our capital levels are appropriate considering our risk profile and evaluation of the capital levels maintained by peer institutions.

#### Consent Orders

Effective October 23, 2012, the Bank's board of directors executed a Stipulation and Consent (the "Stipulation"), accepting the issuance of a Consent Order (the "Consent Order") by the OCC. The Consent Order replaced the supervisory agreement entered into between the Bank and the Office of Thrift Supervision (the "OTS") on January 27, 2010, which the OCC terminated simultaneous with issuance of the Consent Order. For further information and a complete description of all of the terms of the Consent Order, please refer to the copy of the Consent Order filed with the SEC as an exhibit to our Current Report on Form 8-K filed on October 24, 2012.

On September 29, 2014, the Bank entered into a Consent Order with the Consumer Financial Protection Bureau (the "CFPB"). The Consent Order relates to alleged violations of federal consumer financial laws arising from the Bank's residential

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first mortgage loan loss mitigation practices and default servicing operations dating back to 2011. Under the terms of the Consent Order, the Bank paid \$28 million for borrower remediation and \$10 million in civil money penalties. The settlement does not involve any admission of wrongdoing on the part of the Bank or our employees, directors, officers, or agents. For further information and a complete description of all of the terms of the Consent Order, please refer to our Current Report on Form 8-K filed on September 29, 2014.

### Supervisory Agreement

On January 28, 2010, we became subject to the Supervisory Agreement, which will remain in effect until terminated, modified, or suspended in writing by the Federal Reserve. The failure to comply with the Supervisory Agreement could result in the initiation of further enforcement action by the Federal Reserve, including the imposition of further operating restrictions, and could result in additional enforcement actions against us. We have taken actions which we believe are appropriate to comply with, and intend to maintain compliance with, all of the requirements of the Supervisory Agreement. For further information and a complete description of all of the terms of the Supervisory Agreement, please refer to the copy of the Supervisory Agreement filed with the SEC as an exhibit to our Current Report on Form 8-K filed on January 28, 2010.

### Department of Justice Settlement Agreement

On February 24, 2012, the Bank entered into a Settlement Agreement with the Department of Justice ("DOJ") under which we made an initial payment of \$15 million and agreed to make future payments totaling \$118 million in annual increments of up to \$25 million upon meeting all of the following conditions which are evaluated quarterly and include: (a) the reversal of the deferred tax asset valuation allowance, which occurred at the end of 2013; (b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred") (or, in the absence of a redemption, adjusting our Bank Tier 1 Capital Ratio for any unextinguished TARP Preferred); and (c) our Bank's Tier 1 Leverage Capital Ratio is 11 percent or more. Additionally, if the Bank or Bancorp become party to a business combination in which the Bank or Bancorp represent less than 33.3 percent of the resulting company's assets, annual payments would commence twelve months after the date of that business combination. Further, should all conditions for payment be satisfied, an annual payment under the settlement agreement would be made, and any further payments would be made only so long as such conditions are satisfied at the time required for such further payments.

Within six months of satisfying the conditions specified above, the Bank would make an additional payment, to occur no more frequently than annually, provided that doing so would not violate any material banking regulatory requirement or the OCC does not object in writing. Consistent with our business and regulatory requirements, Flagstar shall seek in good faith to fulfill the conditions, and will not undertake any conduct or fail to take any action the purpose of which is to frustrate or delay our ability to fulfill any of the conditions.

In July 2016, we paid a \$200 million dividend from the Bank to the Bancorp and issued \$250 million in Senior Notes to a) bring current the interest payments on our trust preferred securities, b) become current on our deferred interest and dividends related to our TARP Preferred and c) repay our TARP Preferred. To support the on-going debt service and other Bancorp expenses, we also intend to reduce our Bancorp double leverage and debt to equity ratios to be more consistent with such ratios at other mid-sized banks, which would likely require further dividend payments from the Bank to the Bancorp for the foreseeable future.

Future annual payments of \$25 million or the final payment of the remaining balance under the Settlement Agreement could be required if the Tier 1 Leverage Ratio of the Bank meets or exceeds 11 percent after adjusting for any outstanding TARP Preferred. Following the TARP Preferred redemption, which included a \$200 million dividend from the Bank to Bancorp, the Bank's Tier 1 Leverage Ratio is less than 11 percent. The combination of (a) future

dividends from the Bank to Bancorp and (b) continued growth in earning assets at the Bank are expected to continue to limit the growth rate of the Bank's Tier 1 Leverage Ratio, which could have an impact on the timing of expected cash flows under the Settlement Agreement.

The Settlement Agreement meets the definition of a financial instrument for which we elected the fair value option. The fair value of the liability is subject to significant uncertainty and is impacted by forecasted estimates of equity, earnings, timing and amount of dividends and growth of the balance sheet and their related impacts on forecasted Tier 1 Capital. We consider the assumptions a market participant would make to transfer the liability and evaluate multiple possible outcomes and our estimates of the likelihood of these outcomes, which may change over time.

Regulatory Capital Composition - Transition

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific

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capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors. We are currently subject to regulatory capital rules issued by U.S. banking regulators

Effective January 1, 2015, we became subject to the Basel III rules, which include certain transition provisions. Capital deductions related to the Company's MSRs and deferred tax assets are recognized in 20 percent annual increments, and will be fully recognized as of January 1, 2018. When presented on a fully phased-in basis, capital, risk-weighted assets, and the capital ratios assume all regulatory capital adjustments and deductions are fully recognized. As of September 30, 2016, the Company and the Bank were subject to the transitional phase-in limitation on deductions related to MSRs and certain deferred tax assets. The annual incremental change in the deductions due to the increase in the transitional phase-in from 40 percent in 2015 to 60 percent in 2016 reduced our regulatory capital ratios.

Effective January 1, 2016, we became subject to the capital conservation buffer under the Basel III rules, subjecting a banking organization to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization does not maintain a capital conservation buffer above the minimum risk based capital requirements. The capital conservation buffer for 2016 must be greater than 0.625 percent in order to not be subject to limitations. The Company and the Bank had a capital conservation buffer of 7.3 percent and 9.9 percent, respectively as of September 30, 2016. When fully phased-in on January 1, 2019, the capital conservation buffer must be greater than 2.5 percent and will effectively increase the minimum common equity Tier 1 capital ratio to 7.0 percent, the minimum Tier 1 risk-based capital ratio to 8.5 percent and the minimum total risk-based capital ratio to 10.5 percent.

The new regulations grandfather the regulatory capital treatment of hybrid debt and equity securities, such as trust preferred securities issued prior to May 19, 2010, for banks or holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009.

At September 30, 2016, we were considered "well-capitalized" for regulatory purposes. The following tables show the regulatory capital ratios as of the dates indicated:

| Bancorp  | September 30,<br>2016 |         | December 31,<br>2015 |         |
|--|-----------------------|---------|----------------------|---------|
|  | Amount                | Ratio   | Amount               | Ratio   |
|  | (Dollars in millions) |         |                      |         |
| Tier 1 leverage (to adjusted tangible assets)      | \$1,225               | 8.88 %  | \$1,435              | 11.51 % |
| Total adjusted tangible asset base (1)             | 13,798                |         | 12,474               |         |
| Tier 1 capital (to risk-weighted assets)           | \$1,225               | 13.98 % | \$1,435              | 18.98 % |
| Common equity Tier 1 (to RWA)                      | 1,056                 | 12.04 % | 1,065                | 14.09 % |
| Total risk-based capital (to risk-weighted assets) | 1,338                 | 15.26 % | 1,534                | 20.28 % |
| Risk-weighted asset base (1)                       | \$8,767               |         | \$7,561              |         |
| Bank   | September 30,<br>2016 |         | December 31,<br>2015 |         |
|  | Amount                | Ratio   | Amount               | Ratio   |
|  | (Dollars in millions) |         |                      |         |
| Tier 1 leverage (to adjusted tangible assets)      | \$1,459               | 10.55 % | \$1,472              | 11.79 % |
| Total adjusted tangible asset base (1)             | 13,824                |         | 12,491               |         |
| Tier 1 capital (to risk-weighted assets)           | \$1,459               | 16.59 % | \$1,472              | 19.42 % |
| Common equity Tier 1 (to RWA)                      | 1,459                 | 16.59 % | 1,472                | 19.42 % |
| Total risk-based capital (to risk-weighted assets) | 1,571                 | 17.87 % | 1,570                | 20.71 % |
| Risk-weighted asset base (1)                       | \$8,794               |         | \$7,582              |         |

(1) Based on adjusted total assets for purposes of Tier 1 leverage capital and risk-weighted assets for purposes Tier1, common equity Tier 1, and total risk-based capital.

Our Tier 1 leverage ratio for the Corporation and the Bank decreased at September 30, 2016, compared to December 31, 2015, primarily as a result of transactions related to the payoff of TARP, the payment of TARP dividends in arrears, along with an increase in the deductions related to DTAs and MSRs due to the change in the transitional phase-in limitation from 40 percent at December 31, 2015 to 60 percent at September 30, 2016.



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Banks with assets greater than \$10 billion are required to submit a Dodd-Frank stress test ("DFAST") under the final rules established by their primary regulator. DFAST requires banks to project results over a nine-quarter planning horizon under three scenarios (baseline, adverse, and severely adverse) published by the Federal Reserve and to show that the bank would exceed regulatory minimum capital standards for the Tier 1 leverage ratio, Tier 1 common ratio, Tier 1 risk-based capital ratio, and the Total risk-based capital ratio under all of these scenarios. We are not subject to the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") program.

Certain regulatory capital ratios for the Bank and the Company as of September 30, 2016 are shown in the following table:

| September 30, 2016                     | Regulatory<br>Minimums |   | Regulatory<br>Minimums to be<br>Well-Capitalized |   | Bank   | Bancorp |
|--|------------------------|---|--|---|--------|---------|
| Basel III Ratios (transitional)        |                        |   |  |   |        |         |
| Common equity Tier I capital ratio     | 4.50                   | % | 6.50   | % | 16.59% | 12.04 % |
| Tier I leverage ratio                  | 4.00                   | % | 5.00   | % | 10.55% | 8.88 %  |
| Basel III Ratios (fully phased-in) (1) |                        |   |  |   |        |         |
| Common equity Tier I capital ratio     | 4.50                   | % | 6.50   | % | 15.01% | 9.47 %  |
| Tier I leverage ratio                  | 4.00                   | % | 5.00   | % | 9.84 % | 7.87 %  |

(1) See "Use of Non-GAAP Financial Measures."

The impact to our Tier 1 leverage ratio is mostly driven by the treatment that mortgage servicing rights receive under Basel III. Over the long term, we plan to continue to reduce our mortgage servicing rights to Tier 1 ratio, taking into consideration market conditions to guide our pace of MSR reduction. At September 30, 2016, we had \$302 million of mortgage servicing rights, representing 24.6 percent of Tier 1 capital. We will continue to look for opportunities to reduce our mortgage servicing rights exposure over time.

#### Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes non-GAAP financial measures such as the estimated fully implemented Basel III capital levels and ratios. We believe these non-GAAP financial measures provide additional information that is useful to investors in helping to understand the underlying performance and trends of the Company.

Non-GAAP financial measures have inherent limitations, which are not required to be uniformly applied and are not audited. Readers should be aware of these limitations and should be cautious with respect to the use of such measures. To mitigate these limitations, we have practices in place to ensure that these measures are calculated using the appropriate GAAP or regulatory components in their entirety and to ensure that our performance is properly reflected to facilitate consistent period-to-period comparisons. Our method of calculating these non-GAAP measures may differ from methods used by other companies. Although we believe the non-GAAP financial measures disclosed in this report enhance investors' understanding of our business and performance, these non-GAAP measures should not be considered in isolation, or as a substitute for those financial measures prepared in accordance with GAAP. Where non-GAAP financial measures are used, the most directly comparable GAAP or regulatory financial measure, as well as the reconciliation to the most directly comparable GAAP or regulatory financial measure, can be found in this report.

Basel III (transitional) to Basel III (fully phased-in) reconciliation. On January 1, 2015, the Basel III rules became effective, subject to transition provisions primarily related to regulatory deductions and adjustments impacting

common equity Tier 1 capital and Tier 1 capital. When fully phased-in, Basel III, will increase capital requirements through higher minimum capital levels as well as through increases in risk-weights for certain exposures. Additionally, the final Basel III rules place greater emphasis on common equity. In October 2013, the OCC and Federal Reserve released final rules detailing the U.S. implementation of Basel III and the application of the risk-based and leverage capital rules to top-tier savings and loan holding companies. We have transitioned to the Basel III framework beginning in January 2015 and are subject to a phase-in period extending through 2018. Accordingly, the calculations provided below are estimates. These measures are considered to be non-GAAP financial measures because they are not formally defined by GAAP and the Basel III implementation regulations. The Common Equity Tier 1, Tier 1, Total Capital and Leverage ratios will not be fully phased-in until January 1, 2018 and the Capital Conservation buffer will not be fully phased-in until January 1, 2019. The regulations are subject to change as

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clarifying guidance becomes available and the calculations currently include our interpretations of the requirements including informal feedback received through the regulatory process. Other entities may calculate the Basel III ratios differently from ours based on their interpretation of the guidelines. Since analysts and banking regulators may assess our capital adequacy using the Basel III framework, we believe that it is useful to provide investors information enabling them to assess our capital adequacy on the same basis.

| September 30, 2016   | Common<br>Equity<br>Tier 1 (to<br>Risk<br>Weighted<br>Assets) | Tier 1<br>Leverage<br>(to<br>Adjusted<br>Tangible<br>Assets)<br>(1) | Tier 1<br>Capital<br>(to Risk<br>Weighted<br>Assets) | Total<br>Risk-Based<br>Capital (to<br>Risk-Weighted<br>Assets) |
|--|---|---|--|--|
| (Dollars in millions)<br>(unaudited)   |   |   |  |  |
| Flagstar Bancorp   |   |   |  |  |
| Regulatory capital – Basel III (transitional) to Basel III (fully phased-in)                                 |   |   |  |  |
| Basel III (transitional)   | \$1,056   | \$1,225   | \$1,225  | \$ 1,338   |
| Increased deductions related to deferred tax assets, mortgage servicing rights, and other capital components | (222 )  | (151 )  | (151 )   | (150 )   |
| Basel III (fully phased-in) capital  | \$834   | \$1,074   | \$1,074  | \$ 1,188   |
| Risk-weighted assets – Basel III (transitional) to Basel III (fully phased-in)                               |   |   |  |  |
| Basel III assets (transitional)  | \$8,767   | \$13,798  | \$8,767  | \$ 8,767   |
| Net change in assets   | 36  | (152 )  | 36   | 36   |
| Basel III (fully phased-in) assets   | \$8,803   | \$13,646  | \$8,803  | \$ 8,803   |
| Capital ratios   |   |   |  |  |
| Basel III (transitional)   | 12.04 %   | 8.88 %  | 13.98 %  | 15.26 %  |
| Basel III (fully phased-in)  | 9.47 %  | 7.87 %  | 12.20 %  | 13.49 %  |
| (Dollars in millions)<br>(unaudited)   |   |   |  |  |
| September 30, 2016   |   |   |  |  |
| Flagstar Bank  |   |   |  |  |
| Regulatory capital – Basel III (transitional) to Basel III (fully phased-in)                                 |   |   |  |  |
| Basel III (transitional)   | \$1,459   | \$1,459   | \$1,459  | \$ 1,571   |
| Increased deductions related to deferred tax assets, mortgage servicing rights, and other capital components | (110 )  | (110 )  | (110 )   | (107 )   |
| Basel III (fully phased-in) capital  | \$1,349   | \$1,349   | \$1,349  | \$ 1,464   |
| Risk-weighted assets – Basel III (transitional) to Basel III (fully phased-in)                               |   |   |  |  |
| Basel III assets (transitional)  | \$8,794   | \$13,824  | \$8,794  | \$ 8,794   |
| Net change in assets   | 195   | (110 )  | 195  | 195  |
| Basel III (fully phased-in) assets   | \$8,989   | \$13,714  | \$8,989  | \$ 8,989   |
| Capital ratios   |   |   |  |  |

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|                             |       |   |       |   |       |   |       |   |
|-----------------------------|-------|---|-------|---|-------|---|-------|---|
| Basel III (transitional)    | 16.59 | % | 10.55 | % | 16.59 | % | 17.87 | % |
| Basel III (fully phased-in) | 15.01 | % | 9.84  | % | 15.01 | % | 16.29 | % |

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

A discussion regarding our management of market risk is included in "Market Risk" in this report in "Management's Discussion and Analysis of Financial Condition and Results of Operations" which is incorporated herein by reference.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. As of September 30, 2016, pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), an evaluation was performed by the Company's management, including our principal executive and financial officers, regarding the design and effectiveness of our disclosure controls and procedures. Based upon that evaluation, the principal executive and financial officers have (a) concluded that our current disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms as of September 30, 2016.

Changes in Internal Controls. There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(d) of the Exchange Act) during the three months ended September 30, 2016, (b) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

From time to time, the Company is party to legal proceedings incidental to its business. See "Legal proceedings" under Note 16 of the Notes to Consolidated Financial Statements, in Item 1 Financial Statements, which is incorporated herein by reference.

Item 1A. Risk Factors

The Company believes that there have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sale of Unregistered Securities

The Company made no sales of unregistered securities during the quarter ended September 30, 2016.

Issuer Purchases of Equity Securities

The Company made no purchases of its equity securities during the quarter ended September 30, 2016.

Item 3. Defaults upon Senior Securities

The Company had no defaults on senior securities.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

(a)None.

Item 6. Exhibits

Exhibit No. Description

|      |  |
|------|--|
| 3.1  | Second Amended and Restated Articles of Incorporation of Flagstar Bancorp, Inc. (previously filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K, dated March 16, 2015, and incorporated herein by reference). |
| 3.2  | Sixth Amended and Restated Bylaws of the Company   |
| 11   | Statement regarding computation of per share earnings is incorporated by reference to Note 13 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements.                                      |
| 31.1 | Section 302 Certification of Chief Executive Officer   |
| 31.2 | Section 302 Certification of Chief Financial Officer   |

32.1 Section 906 Certification, as furnished by the Chief Executive Officer

32.2 Section 906 Certification, as furnished by the Chief Financial Officer

101 Financial statements from Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2016, formatted in XBRL: (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FLAGSTAR BANCORP, INC.  
Registrant

Date: November 7, 2016 /s/ Alessandro DiNello  
Alessandro DiNello  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ James K. Ciroli  
James K. Ciroli  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)



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EXHIBIT INDEX

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|      |  |
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| 94   |  |