

FLAGSTAR BANCORP INC  
Form 10-Q  
August 09, 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 June 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-16577

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

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

5151 Corporate Drive, Troy, Michigan	48098-2639
(Address of principal executive offices)	(Zip code)
(248) 312-2000	
(Registrant's telephone number, including area code)	

Not applicable

(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No .

As of August 5, 2016, 56,576,203 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)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Cash	\$ 64	\$ 54
Interest-earning deposits	120	154
Total cash and cash equivalents	184	208
Investment securities available-for-sale	1,145	1,294
Investment securities held-to-maturity	1,211	1,268
Loans held-for-sale (\$3,071 and \$2,541 measured at fair value, respectively)	3,091	2,576
Loans held-for-investment (\$88 and \$111 measured at fair value, respectively)	5,822	6,352
Loans with government guarantees	435	485
Less: allowance for loan losses	(150)	(187)
Total loans held-for-investment and loans with government guarantees, net	6,107	6,650
Mortgage servicing rights	301	296
Federal Home Loan Bank stock	172	170
Premises and equipment, net	259	250
Net deferred tax asset	333	364
Other assets	920	639
Total assets	\$ 13,723	\$ 13,715
Liabilities and Stockholders' Equity		
Noninterest bearing deposits	\$ 2,109	\$ 1,574
Interest bearing deposits	6,462	6,361
Total deposits	8,571	7,935
Short-term Federal Home Loan Bank advances	1,069	2,116
Long-term Federal Home Loan Bank advances	1,577	1,425
Other long-term debt	247	247
Representation and warranty reserve	36	40
Other liabilities (\$84 and \$84 measured at fair value, respectively)	624	423
Total liabilities	12,124	12,186
Stockholders' Equity		
Preferred stock \$0.01 par value, liquidation value \$1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding, respectively	267	267
Common stock \$0.01 par value, 70,000,000 shares authorized; 56,575,779 and 56,483,258 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,491	1,486
Accumulated other comprehensive (loss) income	(19)	2
Accumulated deficit	(141)	(227)
Total stockholders' equity	1,599	1,529
Total liabilities and stockholders' equity	\$ 13,723	\$ 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 Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest Income	(Unaudited)			
Loans	\$82	\$ 74	\$166	\$ 139
Investment securities	17	15	34	29
Interest-earning deposits and other	—	1	—	1
Total interest income	99	90	200	169
Interest Expense				
Deposits	11	11	22	20
Short-term debt	1	—	3	—
Long-term debt	8	4	15	7
Other debt	2	2	4	4
Total interest expense	22	17	44	31
Net interest income	77	73	156	138
Provision (benefit) for loan losses	(3	) (13	) (16	) (17
Net interest income after provision (benefit) for loan losses	80	86	172	155
Noninterest Income				
Net gain on loan sales	90	83	165	174
Loan fees and charges	19	19	34	36
Deposit fees and charges	6	6	12	12
Loan administration income	4	7	10	11
Net (loss) return on mortgage servicing rights	(4	) 9	(10	) 7
Net loss on sale of assets	—	(2	) (2	) (2
Representation and warranty benefit	4	5	6	7
Other noninterest income (loss)	9	(1	) 18	—
Total noninterest income	128	126	233	245
Noninterest Expense				
Compensation and benefits	66	59	134	120
Commissions	14	11	24	21
Occupancy and equipment	21	20	43	40
Asset resolution	1	5	4	13
Federal insurance premiums	3	6	6	12
Loan processing expense	15	14	27	26
Legal and professional expense	6	8	15	17
Other noninterest expense	13	15	23	27
Total noninterest expense	139	138	276	276
Income before income taxes	69	74	129	124
Provision for income taxes	22	28	43	46
Net income	\$47	\$ 46	\$86	\$ 78
Income per share				
Basic	\$0.67	\$ 0.69	\$1.23	\$ 1.12
Diluted	\$0.66	\$ 0.68	\$1.21	\$ 1.11
Weighted average shares outstanding				
Basic	56,574,786	56,436,026	56,544,266	56,410,880
Diluted	57,751,230	57,165,072	57,623,081	57,197,133

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 Months Ended June 30, 2016		Six Months Ended June 30, 2015	
	2015	2016	2015	2016
Net income	\$47	\$46	\$86	78
Other comprehensive income, net of tax				
Investment securities				
Unrealized gain (loss) (net of tax effect \$1, \$9, \$10 and \$1, respectively)	1	(16)	16	—
Net change in unrealized gain (loss) on investment securities, net of tax	1	(16)	16	—
Derivatives and hedging activities				
Unrealized loss (net of tax effect \$3, \$0, \$19 and \$0, respectively)	(12)	—	(44)	—
Less: Reclassification of net loss on derivative instruments	3	—	7	—
Net change in derivatives and hedging activities, net of tax	(9)	—	(37)	—
Other comprehensive (loss) income, net of tax	(8)	(16)	(21)	—
Comprehensive income	\$39	\$30	\$65	\$78

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			Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Number of Shares Outstanding	Amount of Preferred Stock	Number of Shares Outstanding	Amount of Common Stock					
Balance at December 31, 2014	266,657	\$ 267	56,332,307	\$ 1	\$ 1,482	\$ 8	\$ (385)	) \$ 1,373	
(Unaudited)									
Net income	—	—	—	—	—	—	78	78	
Stock-based compensation	—	—	103,719	—	—	—	—	—	
Balance at June 30, 2015	266,657	\$ 267	56,436,026	\$ 1	\$ 1,482	\$ 8	\$ (307)	) \$ 1,451	
Balance at December 31, 2015	266,657	\$ 267	56,483,258	\$ 1	\$ 1,486	\$ 2	\$ (227)	) \$ 1,529	
(Unaudited)									
Net income	—	—	—	—	—	—	86	86	
Total other comprehensive loss	—	—	—	—	—	(21)	) —	(21)	
Stock-based compensation	—	—	92,521	—	5	—	—	5	
Balance at June 30, 2016	266,657	\$ 267	56,575,779	\$ 1	\$ 1,491	\$ (19)	) \$ (141)	) \$ 1,599	

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)

	Six Months Ended June 30, 2016 2015 (Unaudited)	
Operating Activities		
Net income	\$86	\$78
Adjustments to reconcile net income to net cash used in operating activities:		
(Benefit) provision for loan losses	(16 )	(17 )
Representation and warranty (benefit) provision	(6 )	(7 )
Depreciation and amortization	16	11
Deferred income taxes	31	43
Net gain on loan and asset sales	(163 )	(171 )
Change in fair value and other non-cash changes	(197 )	(334 )
Proceeds from sales of loans held-for-sale ("HFS")	9,761	9,764
Origination, premium paid and purchase of loans, net of principal repayments	(14,639)	(14,458)
Decrease (increase) in accrued interest receivable	1	(4 )
(Increase) decrease in other assets	(58 )	43
Increase in other liabilities	31	6
Net cash used in operating activities	(5,153 )	(5,046 )
Investing Activities		
Proceeds from sale of available for sale securities including loans that have been securitized	5,943	4,558
Collection of principal on investment securities available-for-sale	68	124
Purchase of investment securities available-for-sale and other	(68 )	(724 )
Collection of principal on investment securities held-to-maturity ("HTM")	72	—
Purchase of investment securities HTM	(15 )	—
Proceeds received from the sale of held-for-investment loans ("HFI")	228	710
Origination and purchase of loans HFI, net of principal repayments	(812 )	(1,717 )
Purchase of bank owned life insurance	(85 )	(150 )
Proceeds from the disposition of repossessed assets	9	13
Net (purchase) redemption of Federal Home Loan Bank stock	(2 )	42
Acquisitions of premises and equipment, net of proceeds	(25 )	(19 )
Proceeds from the sale of mortgage servicing rights	21	100
Net cash provided by investing activities	5,334	2,937
Financing Activities		
Net increase in deposit accounts	636	580
Net change in short-term borrowings	(1,047 )	—
Proceeds from long-term Federal Home Loan Bank advances	150	14,480
Repayment of long-term Federal Home Loan Bank advances	—	(12,796)
Repayment of long-term debt	—	(50 )
Net receipt (disbursement) of payments of loans serviced for others	52	(3 )
Net receipt of escrow payments	4	8
Net cash (used in) provided by financing activities	(205 )	2,219
Net (decrease) increase in cash and cash equivalents	(24 )	110
Beginning cash and cash equivalents	208	136
Ending cash and cash equivalents	\$184	\$246
Supplemental disclosure of cash flow information		

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Interest paid on deposits and other borrowings	\$37	\$26
Income tax payments	\$2	\$3
Non-cash reclassification of loans originated HFI to loans HFS	\$1,331	\$775
Non-cash reclassification of mortgage loans originated HFS to HFI	\$—	\$27
Non-cash reclassification of mortgage loans HFS to AFS securities	\$5,768	\$4,566
Mortgage servicing rights resulting from sale or securitization of loans	\$122	\$146
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. 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 June 30, 2016 and December 31, 2015, investment securities were comprised of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
June 30, 2016				
Available-for-sale securities				
Agency - Commercial	\$626	\$ 14	\$ —	\$640
Agency - Residential	461	12	—	473
Municipal obligations	31	1	—	32
Total available-for-sale securities (1)	\$1,118	\$ 27	\$ —	\$1,145
Held-to-maturity securities				
Agency - Commercial	\$635	\$ 12	\$ —	\$647
Agency - Residential	576	14	—	590
Total held-to-maturity securities (1)	\$1,211	\$ 26	\$ —	\$1,237
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 June 30, 2016 or December 31, 2015.

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Credit related declines in the available-for-sale and held-to-maturity securities are classified as other than temporary impairments and are reported as a separate component of noninterest income within the Consolidated Statement of Operations. An impaired investment security is considered to be other than temporary if (1) 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 six months ended June 30, 2016 and June 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 reported as a component of other comprehensive income and unrealized losses reported as a component of other comprehensive income to the extent they are temporary in nature.

We purchased \$40 million and \$68 million, respectively, of available-for-sale securities, which included U.S. government sponsored agency mortgage-backed securities and municipal obligations, during the three and six months ended June 30, 2016. We purchased \$72 million and \$724 million, respectively, of available-for-sale securities, which included U.S. government sponsored agencies comprised of mortgage-backed securities and collateralized mortgage obligations during the three and six months ended June 30, 2015.

Gains (losses) on sales of available-for-sale securities are reported in other noninterest income in the Consolidated Statements of Operations. During both the three and six months ended June 30, 2016, there were \$175 million 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 \$1 million during both the three and six months ended June 30, 2016. During the three and six months ended June 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 six months ended June 30, 2016, respectively. During the three and

six months ended June 30, 2015, we had no purchases of held-to-maturity securities.



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

Type of Security	Unrealized Loss Position with Duration 12 Months and Over		Unrealized Loss Position with Duration Under 12 Months	
	Fair Value of Securities (Dollars in millions)	Number of Unrealized Loss	Fair Value of Securities (Dollars in millions)	Number of Unrealized Loss
June 30, 2016				
Available-for-sale securities				
Agency - Commercial	\$7	1	\$—	2
Held-to-maturity securities				
Agency - Commercial	\$—		\$—	4
December 31, 2015				
Available-for-sale securities				
Agency - Commercial	\$—		\$—	27
Agency - Residential	\$8	2	\$—	15
Held-to-maturity securities				
Agency - Commercial	\$—		\$—	27
Agency - Residential	\$—		\$—	50

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

	Investment Securities Available-for-Sale			Investment Securities Held-to-maturity			
	Amortized Cost	Fair Value	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield	
June 30, 2016	(Dollars in millions)			(Dollars in millions)			
Due after one year through five years	\$18	\$18	3.97 %	\$—	\$—	—	%
Due after five years through 10 years	7	7	2.66 %	61	64	2.50	%
Due after 10 years	1,093	1,120	2.59 %	1,150	1,173	2.40	%
Total	\$1,118	\$1,145		\$1,211	\$1,237		

We pledge investment securities, primarily municipal taxable and agency collateralized mortgage obligations, to collateralize lines of credit and/or borrowings. At June 30, 2016, we pledged \$234 million of investment securities, 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 June 30, 2016 and December 31, 2015, loans held-for-sale totaled \$3.1 billion and \$2.6 billion, respectively. For the three and six months ended June 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 \$85 million and \$151 million, respectively, as compared to \$83 million and \$174 million during the three and six months ended June 30, 2015, respectively.

At June 30, 2016 and December 31, 2015, \$20 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 with Government Guarantees

The majority of 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 this risk as a component of our allowance for loan losses on residential first mortgages.

At June 30, 2016 and December 31, 2015, loans with government guarantees totaled \$435 million and \$485 million, respectively. At June 30, 2016, repossessed assets and the associated claims recorded in other assets totaled \$178 million and \$210 million at December 31, 2015.

## Note 5 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows:

	June 30,	December 31,
	2016	2015
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	\$2,075	\$ 3,100
Second mortgage	127	135
HELOC	346	384
Other	32	31
Total consumer loans	2,580	3,650
Commercial loans		
Commercial real estate (1)	976	814
Commercial and industrial	615	552
Warehouse lending	1,651	1,336
Total commercial loans	3,242	2,702
Total loans held-for-investment	\$5,822	\$ 6,352

(1) Includes \$221 million and \$188 million, respectively, of commercial owner occupied real estate loans at June 30, 2016 and December 31, 2015.

During the six months ended June 30, 2016 and June 30, 2015, we transferred zero and \$27 million, respectively, of loans held-for-sale to loans held-for-investment, based upon a change in our intent.

During the six months ended June 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 six months ended June 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 six months ended June 30, 2016.

Also, during the six months ended June 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 six months ended June 30, 2015, we sold interest-only residential first mortgage loans with unpaid principal balances totaling \$386 million, along with \$401 million of nonperforming, 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 loss on sale of \$1 million during the six months ended June 30, 2015. The loans sold also resulted in a charge-off of \$51 million during the six months ended June 30, 2015.

During the six months ended June 30, 2016, we purchased jumbo residential first mortgage loans with an unpaid principal balance of \$150 million with a premium of \$1 million. During the six months ended June 30, 2015, we purchased \$197 million of HELOC loans with a premium of \$7 million.

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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 June 30, 2016 and December 31, 2015, we pledged \$4.9 billion and \$5.8 billion, respectively.

## Allowance for Loan Losses

We determine the appropriate level of the allowance 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 allowance for loan losses, other than for loans that have been identified for individual evaluation for impairment, is determined on a loan pool basis by grouping loan types with common risk characteristics to determine our best estimate of incurred losses.

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

	Residential First Mortgage (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)								
Three Months Ended June 30, 2016								
Beginning balance allowance for loan losses	\$95	\$ 10	\$ 20	\$ 2	\$ 19	\$ 10	\$ 6	\$162
Charge-offs (2)	(8 )	(1 )	—	(1 )	—	—	—	(10 )
Recoveries	1	1	(1 )	—	—	—	—	1
(Benefit) provision	(7 )	—	1	—	—	1	2	(3 )
Ending balance allowance for loan losses	\$81	\$ 10	\$ 20	\$ 1	\$ 19	\$ 11	\$ 8	\$150
Three Months Ended June 30, 2015								
Beginning balance allowance for loan losses	\$188	\$ 12	\$ 21	\$ —	\$ 16	\$ 12	\$ 4	\$253
Charge-offs (2)	(19 )	(1 )	—	(1 )	—	—	—	(21 )
Recoveries	1	1	—	1	—	—	—	3
(Benefit) provision	(19 )	2	4	1	(1 )	—	—	(13 )
Ending balance allowance for loan losses	\$151	\$ 14	\$ 25	\$ 1	\$ 15	\$ 12	\$ 4	\$222
Six Months Ended June 30, 2016								
Beginning balance allowance for loan losses	\$116	\$ 11	\$ 21	\$ 2	\$ 18	\$ 13	\$ 6	\$187
Charge-offs (2)	(19 )	(2 )	(1 )	(2 )	—	—	—	(24 )
Recoveries	1	1	—	1	—	—	—	3
Provision (benefit)	(17 )	—	—	—	1	(2 )	2	(16 )
Ending balance allowance for loan losses	\$81	\$ 10	\$ 20	\$ 1	\$ 19	\$ 11	\$ 8	\$150
Six Months Ended June 30, 2015								
Beginning balance allowance for loan losses	\$234	\$ 12	\$ 19	\$ 1	\$ 17	\$ 11	\$ 3	\$297
Charge-offs (2)	(60 )	(2 )	(1 )	(1 )	—	—	—	(64 )

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Recoveries	2	1	—	1	2	—	—	6
Provision (benefit)	(25 )	3	7	—	(4 )	1	1	(17 )
Ending balance allowance for loan losses	\$151	\$ 14	\$ 25	\$ 1	\$ 15	\$ 12	\$ 4	\$222

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

Includes charge-offs of \$2 million and \$15 million related to the sale or transfer of loans during the three months ended June 30, 2016 and June 30, 2015, respectively, and \$8 million and \$51 million related to the sale of loans

(2) during the six months ended June 30, 2016 and June 30, 2015, respectively. Also includes charge-offs related to loans with government guarantees of \$4 million and \$7 million during the three and six months ended June 30, 2016, respectively.

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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 First Mortgage (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)								
June 30, 2016								
Loans held-for-investment								
Individually evaluated	\$43	\$ 27	\$ 6	\$ —	\$ —	\$ 1	\$ —	\$77
Collectively evaluated (2)	2,027	61	296	32	976	614	1,651	5,657
Total loans	\$2,070	\$ 88	\$ 302	\$ 32	\$ 976	\$ 615	\$ 1,651	\$5,734
Allowance for loan losses								
Individually evaluated	\$7	\$ 6	\$ 3	\$ —	\$ —	\$ —	\$ —	\$16
Collectively evaluated (2)	74	4	17	1	19	11	8	134
Total allowance for loan losses	\$81	\$ 10	\$ 20	\$ 1	\$ 19	\$ 11	\$ 8	\$150
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 June 30, 2016 and December 31, 2015, of past due and current loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due (1)	Total Past Due	Current	Total Investment Loans
(Dollars in millions)						
June 30, 2016						
Consumer loans						
Residential first mortgage	\$ 3	\$ 1	\$ 32	\$ 36	\$ 2,039	\$ 2,075
Second mortgage	—	—	3	3	124	127
HELOC	2	1	9	12	334	346
Other	—	—	—	—	32	32
Total consumer loans	5	2	44	51	2,529	2,580
Commercial loans						
Commercial real estate	—	—	—	—	976	976
Commercial and industrial	—	—	—	—	615	615
Warehouse lending	—	—	—	—	1,651	1,651
Total commercial loans	—	—	—	—	3,242	3,242
Total loans (2)	\$ 5	\$ 2	\$ 44	\$ 51	\$ 5,771	\$ 5,822
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 \$10 million of loans 90 days or greater past due, accounted for under the fair value option at both June 30, 2016 and December 31, 2015.

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 nonperforming), 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 less than \$1 million and \$1 million during the three and six months ended June 30, 2016, respectively, and \$1 million and \$3 million during the three and six months ended June 30, 2015, respectively. At June 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.

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

	TDRs		
	Performing	Nonperforming	Total
June 30, 2016	(Dollars in millions)		
Consumer loans			
Residential first mortgage	\$21	\$ 13	\$34
Second mortgage	30	1	31
HELOC	21	7	28
Total consumer loans	72	21	93
Commercial loans			
Commercial and industrial	1	—	1
Total commercial loans	1	—	1
Total TDRs (1)(2)	\$73	\$ 21	\$94
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 \$12 million and \$15 million at June 30, 2016 and December 31, 2015, respectively.

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

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.

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

	New TDRs			Increase in Allowance at Modification
	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	
(Dollars in millions)				
<b>Three Months Ended June 30, 2016</b>				
Residential first mortgages	3	\$ 1	\$ 1	\$ —
Second mortgages	5	—	—	—
HELOC (2)(3)	20	2	2	—
Total TDR loans	28	\$ 3	\$ 3	\$ —
<b>Three Months Ended June 30, 2015</b>				
Residential first mortgages	77	\$ 23	\$ 22	\$ (2 )
Second mortgages	35	1	1	—
HELOC (2)	122	8	7	—
Other consumer	3	—	—	—
Total TDR loans	237	\$ 32	\$ 30	\$ (2 )
<b>Six Months Ended June 30, 2016</b>				
Residential first mortgages	16	\$ 3	\$ 4	\$ —
Second mortgages	26	1	1	—
HELOC (2)(3)	85	6	5	—
Commercial and industrial	1	2	1	—
Total TDR loans	128	\$ 12	\$ 11	\$ —
<b>Six Months Ended June 30, 2015</b>				
Residential first mortgages	191	\$ 53	\$ 52	\$ (1 )
Second mortgages	68	3	2	—
HELOC (2)(3)	158	8	7	—
Other consumer	3	—	—	—
Total TDR loans	420	\$ 64	\$ 61	\$ (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 six months ended June 30, 2016 and 2015. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when they are greater than 90 days past due.

	TDRs that were modified in the previous 12 months, which have subsequently defaulted			
	Number of Accounts	Unpaid Principal	Balance	Increase in Allowance Subsequent Default
	(Dollars in millions)			
Three Months Ended June 30, 2015				
Second mortgages	1	\$	—	\$ —
Total TDR loans	1	\$	—	\$ —
Six Months Ended June 30, 2016				
Residential first mortgages	1	\$	—	\$ —
HELOC (1)	4	—	—	—
Total TDR loans	5	\$	—	\$ —
Six Months Ended June 30, 2015				
Second mortgages	1	\$	—	\$ —
Total TDR loans	1	\$	—	\$ —

(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:

	June 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 loans	\$2	\$ 2	\$ —	\$20	\$ 20	\$ —
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
	\$3	\$ 3	\$ —	\$25	\$ 22	\$ —
With an allowance recorded						
Consumer loans						
Residential first mortgage	\$41	\$ 41	\$ 6	\$65	\$ 67	\$ 12
Second mortgage	26	27	7	28	28	6
HELOC	6	6	3	3	3	1
Other consumer	—	—	—	—	—	1
	\$73	\$ 74	\$ 16	\$96	\$ 98	\$ 20
Total						
Consumer loans						
Residential first mortgage	\$43	\$ 43	\$ 6	\$85	\$ 87	\$ 12
Second mortgage	26	27	7	28	28	6
HELOC	6	6	3	3	3	1
Other consumer	—	—	—	—	—	1
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
Total impaired loans	\$76	\$ 77	\$ 16	\$121	\$ 120	\$ 20

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(Dollars in millions)								
Consumer loans								
Residential first mortgage	\$47	\$ —	\$ 116	\$ 1	\$60	\$ 1	\$ 210	\$ 2
Second mortgage	27	1	31	—	27	1	31	1
HELOC	5	—	2	—	5	—	2	—
Commercial loans								
Commercial and industrial	1	—	—	—	3	—	—	—
Total impaired loans	\$80	\$ 1	\$ 149	\$ 1	\$95	\$ 2	\$ 243	\$ 3



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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 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 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	
June 30, 2016	(Dollars in millions)				
Grade					
Pass	\$934	\$ 562	\$ 1,505	\$ 3,001	
Watch	38	20	146	204	
Special mention	3	32	—	35	
Substandard	1	1	—	2	
Total loans	\$976	\$ 615	\$ 1,651	\$ 3,242	
December 31, 2015					
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	Resident Mortgage	Subprime Mortgage	HELOC	Other Consumer	Total
June 30, 2016	(Dollars in millions)				
Grade					
Pass	\$2,019	\$ 93	\$ 315	\$ 32	\$2,459
Watch	21	31	22	—	74
Substandard	35	3	9	—	47
Total loans	\$2,075	\$ 127	\$ 346	\$ 32	\$2,580
December 31, 2015					
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 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. The transactions resulted in cash payments of \$52 million to the debt bondholders during the year ended December 31, 2015. After payment of the debt, the FSTAR 2005-1 and FSTAR 2006-2 HELOC securitization trusts were dissolved and we no longer have any consolidated VIEs as of 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 June 30, 2016 and December 31, 2015, the FSTAR 2007-1 mortgage securitization trust included 2,762 loans and 3,061 loans, respectively, with an aggregate principal balance of \$103 million and \$117 million, respectively.



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## Note 7 – Mortgage Servicing Rights

We have investments in mortgage servicing rights ("MSRs") resulting from the sale of loans to the secondary market and retaining the servicing. The primary risk associated with MSRs is the potential reduction in 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 also 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. Our portfolio of MSRs is highly sensitive to movements in interest rates. There is also a risk of valuation decline due to higher than expected increases in default rates, which we do not believe can be effectively managed using derivatives. See Note 8 of the Notes to the Consolidated Financial Statements, herein, for further information regarding the derivative instruments utilized to manage our MSR risks.

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

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
	2016	2015	2016	2015
	(Dollars in millions)			
Balance at beginning of period	\$281	\$279	\$296	\$258
Additions from loans sold with servicing retained	65	77	122	146
Reductions from sales	—	(49 )	(24 )	(71 )
Changes in fair value due to (1)				
Decrease in MSR due to pay-offs, pay-downs and run-off	(15 )	(11 )	(26 )	(26 )
Changes in estimates of fair value (2)	(30 )	21	(67 )	10
Fair value of MSRs at end of period	\$301	\$317	\$301	\$317

(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 in interest rates.

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

	June 30, 2016		December 31, 2015	
	Fair value due to 10% 20% adverse change		Fair value due to 10% 20% adverse change	
	Actual	adverse change	Actual	adverse change
	(Dollars in millions)			
Option adjusted spread	8.37 %	\$293 \$ 285	8.24 %	\$287 \$ 279
Constant prepayment rate	16.38 %	287 274	12.63 %	285 275
Weighted average cost to service per loan	\$70.99	297 293	\$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 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 18 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

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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 the servicing fees:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Income on mortgage servicing rights				
Servicing fees, ancillary income and late fees (1)	\$ 21	\$ 17	\$ 38	\$ 34
Changes in fair value (2)	(45 )	12	(93 )	(14 )
Gain on MSR derivatives (3)	19	(14 )	45	(5 )
Net transaction costs	1	(6 )	—	(8 )
Total (loss) return, included in net return on mortgage servicing rights	\$ (4 )	\$ 9	\$ (10 )	\$ 7

(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 three and six months ended June 30, 2015.

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

The agency servicing fees, ancillary income and late fees increased during the six month ended June 30, 2016, as compared to the six month ended June 30, 2015, primarily driven by the higher amount of loans serviced and fewer MSR sales during 2016.

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

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
	2016	2015	2016	2015
	(Dollars in millions)			
Income on mortgage loans subserviced				
Subservicing fees, ancillary income and late fees (1)	\$7	\$9	\$14	\$16
Other servicing charges	(3)	(2)	(4)	(5)
Total income, included in loan administration	\$4	\$7	\$10	\$11

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

The subservice fees decreased during the six month ended June 30, 2016, as compared to the six month ended June 30, 2015, primarily due to a decrease in subservice volume near the end of 2015.

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

Derivatives not designated as hedging instruments: The Company maintains a derivative portfolio of interest rate swaps, futures and forward commitments used to manage exposure to changes in interest rates, MSR asset values and to meet the needs of customers. The Company also enters into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Market risk on interest rate lock commitments and mortgage loans held-for-sale is managed using corresponding forward sale commitments.

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

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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 (FHLB) advances. We have also designated certain interest rate swaps as fair value hedges of certain FHLB advances.

Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income 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 June 30, 2016, we had \$40 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 \$8 million of losses (net-of-tax). Changes in the fair value of the derivatives designated as a fair value hedge are recorded in interest expense, in the same line as changes in the fair value of the FHLB debt, the hedged item, in the current period to the extent it is effective.

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 highly effective as of June 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:

		Three Months Ended June 30,		Six Months Ended June 30,	
	Location of Gain/(Loss)	2016	2015	2016	2015
		(Dollars in millions)			
Derivatives not designated as hedging instruments:					
U.S. Treasury, swap and euro dollar futures	Net (loss) return on mortgage servicing rights	\$ 1	\$ (3 )	\$ 4	\$ 3
Interest rate swaps and swaptions	Net (loss) return on mortgage servicing rights	13	(8 )	28	(8 )
Mortgage backed securities forwards	Net (loss) return on mortgage servicing rights	5	(3 )	13	—
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	(6 )	10	(1 )	20
Rate lock commitments	Other noninterest income	—	(1 )	1	—
Interest rate swaps	Other noninterest	(1 )	—	1	—

	income				
Total derivative (loss) gain		\$ 12	\$ (5 )	\$ 46	\$ 15

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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)		
June 30, 2016			
Derivatives designated as hedging instruments:			
Assets			
Interest rate swaps on FHLB advances	\$250	\$ 2	2020
Liabilities (1)			
Interest rate swaps on FHLB advances	\$825	\$ 56	2023-2025
Derivatives not designated as hedging instruments:			
Assets (2)			
U.S. Treasury, swap and euro dollar futures	\$749	\$ 3	2016-2020
Mortgage backed securities forwards	468	4	2016
Rate lock commitments	6,305	83	2016
Interest rate swaps and swaptions	2,337	88	2016-2046
Total derivative assets	\$9,859	\$ 178	
Liabilities (1)			
U.S. Treasury, swap and euro dollar futures	\$7,903	\$ 3	2016-2019
Mortgage backed securities forwards	6,054	58	2016
Rate lock commitments	46	—	2016
Interest rate swaps	510	18	2016-2026
Total derivative liabilities	\$14,513	\$ 79	
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) Derivatives 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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The following tables present the derivatives subject to a master netting arrangement, including the cash pledged as collateral:

	Gross Amounts Netted in Statement of Financial Position	Net Amount Presented in the Statement of Financial Position	Gross Cash Amount Pledged as Collateral	Gross Amounts Not Offset in the Statement of Financial Position
(Dollars in millions)				
June 30, 2016				
Derivatives designated as hedging instruments:				
Assets				
Interest rate swaps on FHLB advances (1)	\$2	\$ 2	\$ —	\$ —
Liabilities				
Interest rate swaps on FHLB advances (1)	\$56	\$ 2	\$ 54	\$ — 35
Derivatives not designated as hedging instruments:				
Assets				
U.S. Treasury, swap and euro dollar futures	\$3	\$ 3	\$ —	\$ —
Mortgage backed securities forwards	4	—	4	—
Interest rate swaps and swaptions (1)	88	—	88	19
Total derivative assets	\$95	\$ 3	\$ 92	\$ — 19
Liabilities				
U.S. Treasury, swap and euro dollar futures	\$3	\$ 3	\$ —	\$ — 5
Mortgage backed securities forwards	58	—	58	— 62
Interest rate swaps and swaptions (1)	18	—	18	— 14
Total derivative liabilities	\$79	\$ 3	\$ 76	\$ — 81
December 31, 2015				
Derivatives designated as hedging instruments:				
Liabilities				
Interest rate swaps on FHLB advances	\$4	\$ —	\$ 4	\$ — 19
Derivatives not designated as hedging instruments:				
Assets				
Mortgage backed securities forwards	\$7	\$ —	\$ 7	\$ — 4
Interest rate swaps and swaptions (1)	25	—	25	— 10
Total derivative assets	\$32	\$ —	\$ 32	\$ — 14
Liabilities				

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U.S. Treasury, swap and euro dollar futures	\$1	\$ —	\$ 1	\$ <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>

Additional funds are pledged to a Central Counterparty Clearing House in the amount of \$32 million as of June 30, (1)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 \$116 million of cash collateral to counterparties and had an obligation to return cash of \$19 million at June 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

The portfolio of Federal Home Loan Bank advances includes short-term adjustable rate, short-term fixed rate advances, long-term LIBOR adjustable advances, and long-term fixed rate advances. The following is a breakdown of the advances outstanding:

	June 30, 2016		December 31, 2015	
	Amount	Rate	Amount	Rate
	(Dollars in millions)			
Short-term adjustable rate	\$1	0.70%	\$—	—%
Short-term fixed rate term advances	1,068	0.40%	2,116	0.32%
Long-term LIBOR adjustable advances	1,025	0.80%	825	0.70%
Long-term fixed rate advances (1)	552	1.44%	600	1.37%
Total	\$2,646	0.77%	\$3,541	0.59%

(1) Includes the current portion of fixed rate advances of \$125 million and \$175 million at June 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 June 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 June 30, 2016, we had \$2.6 billion of advances outstanding and an additional \$0.9 billion of collateralized borrowing capacity available at 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 June 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Maximum outstanding at any month end	\$2,646	\$2,198	\$3,557	\$2,198
Average outstanding balance	2,460	1,828	2,841	1,497
Average remaining borrowing capacity	983	1,503	843	1,697
Weighted average interest rate	1.42%	0.90%	1.25%	0.97%



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The following outlines our Federal Home Loan Bank advance final maturity dates as of June 30, 2016:

June 30, 2016

(Dollars in millions)

2016 \$ 1,194

2017 50

2018 125

2019 —

Thereafter 1,277

Total \$ 2,646

Trust Preferred Securities