

FLAGSTAR BANCORP INC  
Form 10-K  
March 05, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K  
(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

OR

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

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)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, par value \$0.01 per share

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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 ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 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 ☐ Smaller Reporting Company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The estimated aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing sale price (\$8.40 per share) as reported on the New York Stock Exchange on June 30,

2012, was approximately \$167.1 million. The registrant does not have any non-voting common equity shares. As of February 28, 2013, 56,003,453 shares of the registrant's Common Stock, \$0.01 par value, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement relating to the 2013 Annual Meeting of Stockholders have been incorporated into Part III of this Report on Form 10-K.

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## FORWARD-LOOKING STATEMENTS

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Forward-looking statements, by their nature, involve estimates, projections, goals, forecasts, assumptions, risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed in a forward-looking statement. Examples of forward-looking statements include statements regarding our expectations, beliefs, plans, goals, objectives and future financial or other performance. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. Except to fulfill our obligations under the U.S. securities laws, we undertake no obligation to update any such statement to reflect events or circumstances after the date on which it is made.

There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include:

(1) Volatile interest rates that impact, amongst other things, (i) the mortgage business, (ii) our ability to originate loans and sell assets at a profit, (iii) prepayment speeds and (iv) our cost of funds, could adversely affect earnings, and our ability to pay dividends to stockholders;

(2) Competitive factors for mortgage loan originations could negatively impact gain on loan sale margins;

(3) Competition from banking and non-banking companies for deposits and loans can affect our earnings, gain on sale margins and market share;

(4) Changes in the regulation of financial services companies and government-sponsored housing enterprises, and in particular, declines in the liquidity of the residential mortgage loan secondary market, could adversely affect our business;

(5) Changes in regulatory capital requirements or an inability to achieve or maintain desired capital ratios could adversely affect our earnings opportunities and our ability to originate certain types of loans, as well as our ability to sell certain types of assets for fair market value;

(6) General business and economic conditions, including unemployment rates, movements in interest rates, the slope of the yield curve, any increase in mortgage fraud and other related criminal activity and the further decline of asset values in certain geographic markets, may significantly affect our business activities, loan losses, reserves, earnings and business prospects;

(7) Repurchases and indemnity demands by mortgage loan purchasers, guarantors and insurers, uncertainty related to foreclosure procedures, and the outcome of current and future legal or regulatory proceedings could result in unforeseen consequences and adversely affect our business activities and earnings;

(8) The Dodd-Frank Wall Street Reform and Consumer Protection Act has resulted in the elimination of the Office of Thrift Supervision (the "OTS"), tightening of capital standards, and the creation of a new Consumer Financial Protection Bureau and has resulted, or will result, in new laws and regulations, such as the emerging mortgage servicing standards, that are expected to increase our costs of operations. In addition, the change to the Board of Governors of the Federal Reserve System (the "Federal Reserve") as our primary federal regulator and to the Office of the Comptroller of the Currency (the "OCC") as Flagstar Bank, FSB's (the "Bank") primary federal regulator may result in interpretations affecting our operations different than those of the OTS;

(9)

Both the volume and the nature of consumer actions and other forms of litigation against financial institutions have increased and to the extent that such actions are brought against us or threatened, the cost of defending such suits as well as potential exposure could increase our costs of operations;

(10) Our compliance with the terms and conditions of the agreement with the U.S. Department of Justice, the impact of performance and enforcement of commitments under, and provisions contained in the agreement, and our accuracy and ability to estimate the financial impact of that agreement, including the fair value of the future payments required, could accelerate our litigation settlement expenses relating thereto;

Our, or the Bank's, failure to comply with the terms and conditions of the Supervisory Agreement with the  
(11) Federal Reserve or the Consent Order with the OCC, respectively, could result in further enforcement actions against us, which could negatively affect our results of operations and financial condition;

The downgrade of the long-term credit rating of the U.S. by one or more ratings agencies could materially affect  
(12) global and domestic financial markets and economic conditions, which may affect our business activities, financial condition, and liquidity; and

The sale of a substantial portion of our commercial loan portfolio is subject to the satisfaction of settlement conditions and certain post-closing indemnification obligations. Because of business, economic or market  
(13) conditions or for any other reasons within or outside of our discretion, the sale may not have the projected impact or be consummated in a timely manner.

All of the above factors are difficult to predict, contain uncertainties that may materially affect actual results, and may be beyond our control. New factors emerge from time to time, and it is not possible for our management to predict all such factors or to assess the effect of each such factor on our business.

Please also refer to Item 1A to Part I of this Annual Report on Form 10-K, which is incorporated by reference herein, for further information on these and other factors affecting us.

Although we believe that these forward-looking statements are based on reasonable, estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies and other factors. Accordingly, we cannot give you any assurance that our expectations will in fact occur or that actual results will not differ materially from those expressed or implied by such forward-looking statements. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved.

PART I

ITEM 1. BUSINESS

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, and Flagstar Capital Markets Corporation ("FCMC"), its wholly-owned subsidiary, which we collectively refer to as the "Bank."

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 December 31, 2012, our total assets were \$14.1 billion, making us the largest bank headquartered in Michigan and one of the top 10 largest savings banks in the United States. 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 63.7 percent of our common stock as of December 31, 2012.

As a savings and loan holding company, we are subject to regulation, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency ("OCC") of the United States Department of the Treasury ("U.S. Treasury"). The Bank is also subject to regulation, examination and supervision by the Federal Deposit Insurance Corporation ("FDIC") and the Bank's deposits are insured by the FDIC through the Deposit Insurance Fund ("DIF"). The Bank is also subject to the rule-making, supervision and examination authority of the Consumer Financial Protection Bureau (the "CFPB"), which is responsible for the principal federal consumer protection laws. The Bank is a member of the Federal Home Loan Bank ("FHLB") of Indianapolis.

Our primary business is the Mortgage Banking segment, in which we originate or purchase residential first mortgage loans throughout the country and sell them into securitization pools, primarily to Fannie Mae, Freddie Mac and Ginnie Mae (collectively, government sponsored entities or the "GSEs") or as whole loans. Approximately 98.6 percent of our total loan originations during the year ended December 31, 2012 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale. Our revenue primarily consists of net gain on loan sales, loan fees and charges, net loan administration income, and interest income from residential first mortgage loans held-for-investment and held-for-sale, second mortgage loans and warehouse loans held-for-investment. We originate residential first mortgage loans through our wholesale relationships with over 1,700 mortgage brokers and approximately 1,300 correspondents, which are located in all 50 states and serviced by 134 account executives. We also operate 31 home lending centers located in 14 states, which primarily originate one-to-four family residential first mortgage loans as part of our Mortgage Banking segment. These loan origination centers employ approximately 200 loan officers. We also originate mortgage loans through referrals from our 111 banking centers, consumer direct call center and our website, [www.flagstar.com](http://www.flagstar.com). The combination of our home lending, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our residential first mortgage loan products. Our servicing activities primarily include collecting cash for principal, interest and escrow payments from borrowers, assisting homeowners through loss mitigation activities, and accounting for and remitting principal and interest payments to investors and escrow payments to third parties.

Our business also includes the Community Banking segment, in which our revenues include net interest income and fee-based income from community banking services. At December 31, 2012, we operated 111 banking centers (of which 15 are located in retail stores), all of which are located in Michigan. Of the 111 banking centers, 66 facilities are owned and 45 facilities are leased. Through our banking centers, we gather deposits and offer a line of consumer and commercial financial products and services to individuals and businesses. We provide deposit and cash management

services to governmental units on a relationship basis. We leverage our banking centers to cross-sell loan and deposit products to existing customers and to increase our customer base by attracting new customers. At December 31, 2012, we had a total of \$8.3 billion in deposits, including \$6.4 billion in retail deposits, \$1.0 billion in company controlled deposits, \$0.8 billion in government deposits, and \$0.1 billion in wholesale deposits.

At December 31, 2012, we had 3,662 full-time equivalent salaried employees of which 334 were account executives and loan officers.

## Commercial Loan Sales

In late 2012, we made a strategic decision to exit our New England based commercial loan production offices. These offices are in the process of being closed, and we expect that operations will cease by June 30, 2013. In connection with this decision, we also entered into two agreements to sell our New England commercial loan portfolios.

Effective December 31, 2012, the Bank entered into a definitive Transaction Purchase and Sale Agreement (the "CIT Agreement") with CIT Bank, the wholly-owned U.S. commercial bank subsidiary of CIT Group Inc. ("CIT"). Under the terms of the CIT Agreement, CIT will acquire \$1.3 billion in commercial loan commitments, \$784.3 million of which were outstanding at December 31, 2012. The loans sold consist primarily of asset-based loans, equipment leases and commercial real estate loans. The sale resulted in a reversal of \$12.6 million in loan loss reserves associated with such loans which was recognized at December 31, 2012. We expect that the total purchase price for the portfolio will be approximately \$779.2 million and that a majority of the assets will be sold during the first quarter of 2013. Through March 1, 2013, we sold \$573.2 million of these loans to CIT.

Effective February 5, 2013, the Bank entered into a definitive Asset and Portfolio Purchase and Sale Agreement (the "Customers Agreement") with Customers Bank ("Customers") located in Wyomissing, Pennsylvania. Under the terms of the Customers Agreement, Customers will acquire \$187.6 million in commercial loan commitments, \$150.9 million of which were outstanding at December 31, 2012. The loans sold consist primarily of commercial and industrial loans. We expect that the total purchase price for the portfolio will be approximately \$148.5 million and that a majority of the assets will be transferred during the first quarter 2013.

The loans sold pursuant to CIT Agreement and Customers Agreement were transferred from the loans held-for-investment portfolio to the loans held-for-sale portfolio at December 31, 2012.

## Assured Litigation

On February 5, 2013, the United States District Court for the Southern District of New York (the "Court") issued a decision in the civil lawsuit against the Bank filed by Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("Assured"). The Court granted judgment in favor of Assured on its claims for breach of contract against the Bank in the amount of \$89.2 million plus contractual interest and attorneys' fees and costs.

Following the Court's decision in the Assured case, we increased our accrual for pending and threatened litigation and recognized such increase in 2012, which resulted in a decrease in net income of \$161.0 million, or \$2.87 per share (diluted), for the year ended December 31, 2012. This accrual increased the total expense for pending and threatened litigation, including amounts paid in anticipation of future settlements, to approximately \$244.6 million at December 31, 2012. Included in this accrual are amounts for the Court's decision regarding Assured and for the lawsuit that MBIA Insurance Corporation ("MBIA") filed against the Bank on January 11, 2013, along with other pending litigation. See Note 29 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein.

## Reverse Stock Split

Our board of directors authorized a one-for-ten reverse stock split on September 24, 2012 following the annual meeting of stockholders on that date at which the reverse stock split was approved by our stockholders. Our common stock began trading on a post-split basis on October 11, 2012. Unless noted otherwise, all share-related amounts herein reflect the one-for-ten reverse stock split.

In connection with the reverse stock split, stockholders received one new share of common stock for every ten shares held at the effective time. The reverse stock split reduced the number of outstanding shares of common stock from approximately 558.3 million to 55.8 million. The number of authorized shares of common stock was reduced from 700 million to 70 million. Proportional adjustments were made to our outstanding options, warrants and other securities entitling holders to purchase or receive shares of common stock. In lieu of fractional shares, stockholders received cash payments based on the common stock's closing price on October 9, 2012, adjusted for the reverse stock split. The reverse stock split did not negatively affect any of the rights that accrue to holders of our outstanding options, warrants and other securities entitling holders to purchase or receive shares of common stock, except to adjust the number of shares relating thereto accordingly. For further information on the reverse stock split, see Note 22 and Note 23 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein.

## Management Change

On October 1, 2012, we announced that our and the Bank's respective boards of directors appointed Michael J. Tierney to serve as our President, effective immediately, and as our and the Bank's Chief Executive Officer, effective November 1, 2012, in each case subject to receipt of non-objection from the Federal Reserve, our primary regulator, and the OCC, the Bank's primary regulator. Mr. Tierney also was appointed to our board of directors and to the board of directors of the Bank, subject to receipt of Federal Reserve and OCC non-objections. We have received non-objection from the Federal Reserve for Mr. Tierney to serve as our President and Chief Executive Officer and a member of our board of directors, and we have received OCC approval for Mr. Tierney to serve as the Bank's President and Chief Executive Officer on an interim basis and as a member of its board of directors. We also announced that John D. Lewis, Managing Director of Donnelly Penman & Partners and former Vice Chairman of Comerica Bank, was appointed to serve as the Non-Executive Chairman of the boards of directors of us and the Bank, in each case subject to receipt of regulatory non-objection. We received non-objection from the Federal Reserve and the OCC for Mr. Lewis to serve as Non-Executive Chairman.

Effective December 18, 2012, our and the Bank's boards of directors appointed Alessandro DiNello as the President of the Bank and as our and the Bank's Chief Administrative Officer, subject to receipt of OCC and, if necessary, Federal Reserve non-objection, requests for which are pending. In addition, the Bank's boards of directors appointed Matthew A. Kerin as the President of the Bank's Mortgage Banking Division, subject to regulatory OCC non-objection. The Bank has received OCC non-objection for Mr. Kerin to serve as President of the Bank's Mortgage Banking Division.

## Consent Order

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 replaces the supervisory agreement entered into between the Bank and the OTS on January 27, 2010. The OCC terminated the supervisory agreement simultaneous with issuance of the Consent Order. We are still subject to a supervisory agreement, dated January 27, 2010, with the Federal Reserve.

Under the terms of the Consent Order, the Bank's board of directors has agreed to, among other things, take the following actions:

- forward to the OCC a written capital plan covering at least a three-year period and establishing projections for our overall risk profile, earnings performance, growth expectations, balance sheet mix, off-balance sheet activities, liability and funding structure, capital and liquidity adequacy, as well as a contingency capital funding process and a plan that identifies alternative capital sources should the primary sources not be available, and at least annually thereafter, review, revise and resubmit the written capital plan;
- review, revise, adopt and forward to the OCC written policies and procedures for maintaining an adequate allowance for loan losses in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP");
- review, revise, adopt and forward to the OCC written policies and procedures for maintaining an adequate representation and warranty reserve in accordance with U.S. GAAP;
- adopt and forward to the OCC a comprehensive written liquidity risk management policy that systematically requires us to reduce liquidity risk;
- adopt, implement, and ensure our adherence to an independent, internal audit program covering all our operations and shall implement appropriate actions to remedy deficiencies cited in such audit reports;
- develop, adopt, and forward to the OCC a written enterprise risk management program that is designed to ensure that we effectively identify, monitor, and control our enterprise-wide risks, including by developing risk limits for each line of business;
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adopt, implement, and ensure adherence to an independent, ongoing loan review system to review our loan and lease portfolios, which system shall provide for the filing with our board of directors of internal loan and lease review reports and shall require our board of directors to review the reports and take immediate remedial action if appropriate;

• establish, adopt, and forward to the OCC written policies and procedures designed to identify, measure, monitor, and control risks associated with our credit concentrations;

review, revise, and ensure adherence to our written Bank Secrecy Act/Anti-Money Laundering ("BSA/AML") Risk Assessment to ensure BSA/AML risks posed to us are accurately identified after consideration of all pertinent information;

review, revise, and ensure adherence to our written program of policies and procedures adopted in accordance with the Bank Secrecy Act ("BSA"), which shall include the production of periodic reports designed to identify, monitor, and evaluate unusual or suspicious activity;

• update the status of our plan and timeline for the implementation of enhanced BSA/AML internal controls and shall forward a copy of the plan and timeline to the OCC;

review, revise, and ensure adherence to our risk-based processes to obtain and analyze appropriate information from our customer due diligence program, both at the time of account opening and on an ongoing basis, in order to effectively monitor for, and investigate, suspicious or unusual activity;

- review, revise, and ensure adherence to our BSA independent testing program;
- adopt and forward to the OCC a written program to improve our compliance management process, which our board of directors shall implement and ensure compliance with following the OCC's determination of non-objection;
- adopt, implement, and ensure adherence to (i) written Flood Disaster Protection Act ("FDPA") policies and procedures detailing a coordinated program to ensure compliance with the FDPA, and (ii) a comprehensive FDPA training program for all applicable lending staff to ensure awareness of their FDPA compliance responsibilities; and
- adopt and forward to the OCC a comprehensive written business continuity plan, which the Bank's board of directors shall implement and ensure compliance with following the OCC's determination of non-objection.

Each of the plans, policies and procedures referenced above in the Consent Order, as well as any subsequent amendments or changes thereto, must be submitted to the OCC for a determination that the OCC has no supervisory objection to them. Upon receiving a determination of no supervisory objection from the OCC, we must implement and adhere to the respective plan, policy or procedure.

The Consent Order also requires the Bank to establish a Compliance Committee to oversee its adherence to the provisions of the Consent Order. The Bank's board of directors has re-designated the existing Regulatory Oversight Committee as the Compliance Committee. The current members of the Compliance Committee are Jay J. Hansen, John D. Lewis, David J. Matlin and Peter Schoels. The Compliance Committee is responsible for monitoring and coordinating the Bank's adherence to the provisions of the Consent Order. The Bank's board of directors has appointed John D. Lewis to serve as the Chairman of the Compliance Committee and Peter Schoels to serve as Vice Chairman of the Compliance Committee.

We intend to address the banking issues identified by the OCC in the manner and within the time periods required for compliance by the OCC, as the OCC may extend one or more of those time frames from time to time. There can be no assurance that the OCC will not provide substantive comments on the capital plan or other submissions that we make pursuant to the Consent Order that will have a material impact on us. We believe that our compliance with the Consent Order should, over time, improve our enterprise risk management practices and our risk profile.

The foregoing summary of the Stipulation and the Consent Order does not purport to be a complete description of all of the terms of such documents, and is qualified in its entirety by reference to copies of the Stipulation and the Consent Order filed with the SEC on October 24, 2012 as exhibits to our Current Report on Form 8-K.

#### Supervisory Agreement

We are subject to a supervisory agreement, dated January 27, 2010, with the Federal Reserve, as a successor regulator to the OTS (the "Supervisory Agreement"). The Supervisory Agreement will remain in effect until terminated, modified, or suspended in writing by the Federal Reserve, and 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. 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.

Pursuant to the Supervisory Agreement, we submitted a capital plan to the OTS, predecessor in interest to the Federal Reserve. In addition, we agreed to request prior non-objection of the Federal Reserve to pay dividends or other capital distributions, purchases, repurchases or redemptions of certain securities, incurrence, issuance, renewal, rolling over or increase of any debt and certain affiliate transactions, and comply with restrictions on the payment of severance and indemnification payments, director and management changes and employment contracts and compensation

arrangements. The foregoing summary of the Supervisory Agreement does not purport to be a complete description of all of the terms of the Supervisory Agreement, and is qualified in its entirety by reference 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.

We addressed the banking issues identified by the Federal Reserve in the manner and within the time periods required for compliance with the Supervisory Agreement.

#### Troubled Asset Relief Program

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (initially introduced as the Troubled Asset Relief Program ("TARP")) was enacted, and the U.S. Treasury injected capital into U.S. financial institutions. On January 30, 2009, we

entered into a letter agreement including the securities purchase agreement with the U.S. Treasury pursuant to which, among other things, we sold to the U.S. Treasury preferred stock and warrants. As long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including our common stock, are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. The preferred stock accrues cumulative dividends quarterly at a rate of 5 percent per annum until January 30, 2014, and 9 percent per annum thereafter.

On January 27, 2012, we provided notice to the U.S. Treasury exercising the contractual right to defer regularly scheduled quarterly payments of dividends and interest, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with participation in the TARP Capital Purchase Program. These payments will be periodically evaluated and reinstated when appropriate, subject to the provisions of our supervisory agreement with the Federal Reserve. Concurrently, we also exercised contractual rights to defer interest payments with respect to our trust preferred securities.

On December 18, 2012, the U.S. Treasury announced its intention to auction our preferred stock issued and outstanding under the TARP Capital Purchase Program during 2013. Through March 5, 2013, our preferred stock had not been auctioned and was still held by the U.S. Treasury.

#### Payment of Dividend and Interest Payments

We are a legal entity separate and distinct from the Bank and our non-banking subsidiaries. In 2008, we discontinued the payment of dividends on common stock. On January 27, 2012, we provided notice to the U.S. Treasury exercising our contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with our participation in the TARP Capital Purchase Program. Under the terms of the preferred stock, we may defer payments of dividends for up to six quarters in total without default or penalty. Following the sixth quarter, the holders of such preferred stock will have the right to elect two directors to our board of directors. Concurrently, we also exercised our contractual rights to defer interest payments with respect to trust preferred securities. We may not recommence payments on either the preferred stock or trust preferred securities without commencing payments on the other as well. Under the terms of the indentures related to the trust preferred securities, we may defer interest payments for up to 20 consecutive quarters without default or penalty. These payments will be periodically evaluated and reinstated when appropriate, subject to provisions of the Supervisory Agreement.

In addition, we are generally prohibited from making any dividend payments on stock except pursuant to the prior non-objection of the Federal Reserve as set forth in the Supervisory Agreement. Our principal sources of funds are cash dividends paid by the Bank and other subsidiaries, investment income and borrowings. Federal laws and regulations limit the amount of dividends or other capital distributions that the Bank may pay us. The Bank has an internal policy to remain "well-capitalized" under OCC capital adequacy regulations. The Bank does not currently expect to pay dividends to us and, even if it determined to do so, would not make payments if the Bank was not well-capitalized at the time or if such payment would result in the Bank not being well-capitalized. In addition, the Bank must seek prior approval from the OCC at least 30 days before it may make a dividend payment or other capital distribution to us.

#### Agreement with U.S. Department of Justice

On February 24, 2012, we announced that the Bank had entered into an agreement (the "DOJ Agreement") with the U.S. Department of Justice ("DOJ") relating to certain underwriting practices associated with loans insured by the Federal Housing Administration ("FHA") of the Department of Housing and Urban Development ("HUD"). The Bank and the DOJ entered into the DOJ Agreement pursuant to which the Bank agreed to comply with all applicable HUD

and FHA rules related to its continued participation in the direct endorsement lender program, make an initial payment of \$15.0 million within 30 business days of the effective date of the DOJ Agreement (paid on April 3, 2012), make payments of approximately \$118.0 million contingent upon the occurrence of certain future events (as further described below) (the "Additional Payments"), and complete a monitoring period by an independent third party chosen by the Bank and approved by HUD. The Additional Payments will occur if and only if each of the following events happen:

we generate positive income for a sustained period, such that part or all of our Deferred Tax Asset ("DTA"), which has been offset by a valuation allowance (the "DTA Valuation Allowance"), is more likely than not to be realized, as evidenced by the reversal of the DTA Valuation Allowance in accordance with U.S. GAAP;

- we are able to include capital derived from the reversal of the DTA Valuation Allowance in our Tier 1 capital; and

our obligation to repay the \$266.7 million in preferred stock held by the U.S. Treasury under the TARP Capital Purchase Program has been either extinguished or excluded from Tier 1 capital for purposes of calculating the Tier 1 capital ratio as described in the paragraph below.

Upon the occurrence of each of the future events described above, and provided doing so would not violate any banking regulatory requirement or the OCC does not otherwise object, we will begin making Additional Payments provided that (i) each annual payment would be equal to the lesser of \$25.0 million or the portion of the Additional Payments that remains outstanding after deducting prior payments, and (ii) no obligation arises until our call report as filed with the OCC, including any amendments thereto, for the period ending at least six months prior to the making of such Additional Payments, reflects a minimum Tier 1 capital ratio, after excluding any un-extinguished portion of the preferred stock issued in connection with our participation in the TARP Capital Purchase Program, of 11 percent (or higher ratio if required by regulators).

We made the \$15.0 million initial payment during the second quarter 2012. At December, 31, 2012, we had accrued \$19.1 million to reflect the fair value of the remaining \$118.0 million liability. Future changes in the fair value of the Additional Payments could affect earnings in future quarters. See Note 4 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for the key assumptions used in valuing the litigation settlement.

### Business and Strategy

We, as well as the rest of the mortgage industry and most other lenders, were negatively affected in recent years by increased credit losses from the prolonged and unprecedented economic recession. Since the latter part of 2008, financial institutions experienced significant declines in the value of collateral for real estate loans and heightened credit losses, resulting in record levels of non-performing assets, charge-offs, foreclosures and losses on disposition of the underlying assets. Moreover, liquidity in the debt markets remained low throughout 2012, further contributing to the decline in asset prices due to the low level of purchasing activity in the marketplace. While there have been moderate improvements during 2012 in a number of macroeconomic factors which impact our business, near term concerns remain over unemployment, the U.S. mortgage market, real estate values, access to credit and liquidity markets, energy costs, and global political issues such as sovereign debt defaults. Financial institutions also continue to face heightened levels of scrutiny from regulators regarding capital and liquidity requirements, credit risk, and other matters.

We believe that despite the increased scrutiny and heightened capital and liquidity requirements, regulated financial institutions should benefit from reduced competition from unregulated entities that lack the access to and breadth of significant funding sources as well as the capital to meet the financing needs of their customers and the ability to satisfy compliance requirements.

We believe that our management team has the necessary experience to appropriately manage through the credit and operational issues that are present in today's challenging markets. Our Mortgage Banking and Community Banking segments complement each other and contribute to the establishment of a diversified mix of revenue streams.

We intend to continue to seek ways to maximize the value of our Mortgage Banking segment while effectively managing and mitigating risk, with a critical focus on expense management, improving asset quality, increasing profitability, and preserving capital. We expect to pursue opportunities to build our core deposit base through our existing branch banking structure and to serve the credit and non-credit needs of the business customers in our markets, as we diversify our businesses and risk through executing our business plan and transitioning to a full-service and diversified community banking model.

In December 2012, we reorganized the way our operations are managed. The segments are based on an internally-aligned segment leadership structure, which is also how the results are monitored and performance assessed. We expect that the combination of our business model and the services that our operating segments provide

will result in a competitive advantage that supports revenue and earnings. Our business model emphasizes the delivery of a complete set of mortgage and banking products and services, including originating, acquiring, selling and servicing one-to-four family residential first mortgage loans, which we believe is distinguished by timely processing and customer service.

#### Operating Segments

Our business is comprised of two primary operating segments - Community Banking and Mortgage Banking. Our Community Banking segment currently offers a line of financial products and services to individuals, small and middle market businesses, and mortgage lenders. Our Mortgage Banking segment originates, acquires, sells and services residential first mortgage loans on one-to-four family residences. In addition to the two primary segments, we also have an Other segment which includes corporate treasury, tax benefits not assigned to specific operating segments, and miscellaneous other expenses of a corporate nature. Each operating segment supports and complements the operations of the other. For example, funding for the Mortgage Banking segment is primarily provided by deposits obtained through the Community Banking segment. Financial information regarding

the three operating segments is set forth in Note 30 of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data, herein. A more detailed discussion of the three operating segments is set forth below.

### Community Banking

Our Community Banking segment is represented primarily by four groups: Branch Banking, Commercial and Business Banking, Government Banking, and Warehouse Lending. Our Community Banking segment's two strategic responsibilities are providing a stable funding source for the Mortgage Banking segment and operating as a standalone, profitable line of business. The groups within the Community Banking segment originate consumer loans, commercial loans and warehouse loans, gather consumer, business and governmental deposits, and offer liquidity management products. The liquidity management products include customized treasury management solutions, equipment and technology leasing, international services, capital markets services such as interest rate risk protection products, foreign exchange hedging, and trading of securities. At December 31, 2012, Branch Banking included 111 banking centers located throughout Michigan. Commercial and Business Banking includes relationship and portfolio managers throughout Michigan's major markets. Government Banking provides deposit and cash management services to all sizes of government units and school districts on a relationship basis throughout Michigan and, to a much lesser degree, Georgia. We intend to exit our Government Banking operations in Georgia during 2013. Warehouse Lending offers lines of credit to other mortgage lenders, allowing those lenders to fund the closing of residential first mortgage loans.

Our Community Banking segment plans to achieve its strategic objective of becoming a standalone, profitable line of business through a number of important initiatives, including a strengthened leadership team, an enhanced sales process, improved operating efficiencies, and the implementation of a streamlined account opening strategy. Branch Banking will continue to optimize its network of offices through strategic growth and relocations. Commercial and Business Banking and Warehouse Lending will continue its focus on acquiring new customer relationships throughout Michigan, and Government Banking will acquire new and expand existing relationships through a focus on checking accounts and treasury services.

Our Community Banking segment's mission is to build strong and lasting relationships with customers, and such relationships are intended to include multiple financial products and services. Regardless of whether customers are first introduced to us through a deposit account, mortgage loan, or other product, the Community Banking segment's focus is to strengthen those relationships by meeting multiple additional financial needs. Our Community Banking segment also cross-sells primary products, such as checking accounts, savings accounts, investment products, and consumer loans, to new and existing customers. These efforts tend to produce incrementally higher relationship profitability and improved customer retention.

Commercial loans held-for-investment. Our Commercial and Business Banking includes relationship and portfolio managers throughout Michigan's major markets. Our commercial loans held-for-investment totaled \$0.7 billion at December 31, 2012 and \$1.7 billion at December 31, 2011, and consists of three loan types: commercial real estate, commercial and industrial and commercial lease financing, each of which is discussed in more detail below. During the year ended December 31, 2012, we originated \$727.1 million in commercial loans. During the year ended December 31, 2012, we transferred \$779.2 million and \$148.5 million of commercial loans held-for-investment to the loans held-for-sale category related to the previously discussed CIT Agreement and Customers Agreement transactions, respectively, both of which are expected to be substantially closed in the first quarter 2013. The following table identifies the commercial loan held-for-investment portfolio by loan type and selected criteria at December 31, 2012.



## Commercial Loans Held-for-Investment

December 31, 2012	Unpaid Principal Balance (1)	Average Note Rate	Loan on Non-accrual Status
	(Dollars in thousands)		
Commercial real estate loans:			
Fixed rate	\$342,296	5.5	38,909
Adjustable rate	299,489	4.1	47,458
Total commercial real estate loans	641,785		\$86,367
Net deferred fees and other	(1,470)	)	
Total commercial real estate loans	\$640,315		
Commercial and industrial loans:			
Fixed rate	\$33,124	3.5	\$—
Adjustable rate	58,544	2.7	41
Total commercial and industrial loans	91,668		\$41
Net deferred fees and other	(1,103)	)	
Total commercial and industrial loans	\$90,565		
Commercial lease financing loans:			
Fixed rate	\$5,634	6.2	\$—
Net deferred fees and other	666		
Total commercial lease financing loans	\$6,300		
Total commercial loans:			
Fixed rate	\$381,054		\$38,909
Adjustable rate	358,033		47,499
Total commercial and industrial loans	739,087		\$86,408
Net deferred fees and other	(1,907)	)	
Total commercial and industrial loans	\$737,180		

Unpaid principal balance does not include premiums or discounts. During the year ended December 31, 2012, we (1) transferred \$779.2 million and \$148.5 million of commercial loans held-for-investment to the loans held-for-sale category related to the CIT Agreement and Customers Agreement, respectively.

At December 31, 2012, our commercial real estate loans held-for-investment totaled \$640.3 million, or 11.8 percent of our held-for-investment loan portfolio, our commercial and industrial held-for-investment loan portfolio was \$90.6 million, or 1.7 percent of our held-for-investment loan portfolio, and our commercial lease financing loans held-for-investment totaled \$6.3 million, or 0.1 percent of our held-for-investment loan portfolio. At December 31, 2011, our commercial real estate held-for-investment loan portfolio totaled \$1.2 billion, or 17.7 percent of our held-for-investment loan portfolio, our commercial and industrial held-for-investment loan portfolio was \$328.9 million, or 4.7 percent of our held-for-investment loan portfolio, and our commercial lease financing held-for-investment loans totaled \$114.5 million, or 1.6 percent of our held-for-investment loan portfolio.

The following table sets forth the unpaid principal balance of our commercial loan held-for-investment portfolio at December 31, 2012 by year of origination.

Year of Origination	2008 and Prior (Dollars in thousands)	2009	2010	2011	2012	Total
Commercial real estate (1) (2)	\$494,074	\$7,519	\$15,488	\$35,057	\$89,647	\$641,785
Commercial and industrial (2)	1,198	169	673	40,818	48,810	91,668
Commercial lease financing (2)	—	—	—	4,924	710	5,634
Total	\$495,272	\$7,688	\$16,161	\$80,799	\$139,167	\$739,087

(1) During the year ended December 31, 2012, we sold \$20.9 million in non-performing commercial real estate loans and charged off \$124.0 million.

(2) During the year ended December 31, 2012, we transferred \$779.2 million and \$148.5 million of commercial loans held-for-investment to the loans held-for-sale category related to the CIT Agreement and Customers Agreement, respectively, for a total of \$927.7 million, which consisted of \$280.4 million of commercial real estate, \$488.4 million of commercial and industrial, and \$158.9 million of commercial lease financing loans.

The average loan balance in our total commercial held-for-investment loan portfolio was approximately \$0.9 million for the period ending December 31, 2012, with the largest loan being \$39.9 million. There are approximately eight loans with more than \$10.2 million of exposure and those loans comprised approximately \$143.0 million, or 19.3 percent, of the total commercial held-for-investment loan portfolio.

Commercial real estate loans. Our commercial real estate ("CRE") 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 and consists of CRE loans originated prior to 2011, including CRE loans refinanced during 2009 and 2010 and CRE loans originated during 2011 and 2012.

The following table discloses our total unpaid principal balance of CRE held-for-investment loans that were geographically concentrated at December 31, 2012.

State	December 31, 2012	
	Percent	Amount (1) (Dollars in thousands)
Michigan	66.5	% \$427,043
Indiana	7.0	% 44,577
Georgia	6.4	% 40,783
Virginia	5.3	% 33,867
Florida	3.5	% 22,519
Other	11.3	% 72,996
Total	100.0	% 641,785

(1) Unpaid principal balance does not include premiums or discounts.

In early 2008, we ceased the origination of commercial real estate loans and allowed the amortization of this remaining portfolio. For the management of such loans, we replaced the previous commercial real estate management and loan officers with experienced workout officers and relationship managers. In addition, we prepared a comprehensive review, including customized workout plans for all classified loans, and risk assessments were prepared on a loan level basis for the entire commercial real estate portfolio. Such loans are managed by our special assets group, whose primary objectives are working out troubled loans, reducing classified assets and taking pro-active steps to prevent deterioration in performance. We expect to retain a portion of these loans in our loans held-for-investment portfolio while continuing to dispose of the remainder through workouts, charge offs and payoffs.

In February 2011, we began originating CRE loans under enhanced underwriting guidelines through our Northeast commercial lending operations under a lending team in our commercial banking group to establish commercial banking relationship and provide cross-sell opportunities. In connection with the two commercial loan sales noted above, the majority of the loans originated by this group have been sold. Management expects to continue to originate such loans going forward, with a focused concentration on our primary geographic market (e.g., Michigan).

The following table set forth the performance of the unpaid principal balance of CRE loans originated during 2011 and 2012 and contained in our loan held-for-investment portfolio at December 31, 2012.

CRE, originated 2011 and later (1)

Property Type	30 Days Past Due (Dollars in thousands)	60 Days Past Due	90+ Days Past Due (2)	Balance	Total Reserves
Land	\$—	\$—	\$—	\$149	\$3
One-to-four family conventional	—	—	—	1,645	31
Multi-family conventional	—	—	—	10,829	201
Commercial non-owner occupied	6,603	—	—	88,482	1,645
Secured by nonfarm, nonresidential	—	—	—	36,626	682
Other	—	—	—	12,154	226
Negative escrow	—	—	—	(3	) —
Net deferred fees and other	—	—	—	(1,844	) —
Total	\$6,603	\$—	\$—	\$148,038	\$2,788

(1)Includes commercial real estate held-for-investment loans originated during 2011 and 2012.

(2)Greater than 90 days past due includes performing non-accrual loans.

The following table sets forth the performance of the unpaid principal balance of CRE loans originated prior to 2011, including CRE loans refinanced during 2009 and 2010.

CRE, originated prior to 2011 (1)

Property Type	30 Days Past Due (Dollars in thousands)	60 Days Past Due	90+ Days Past Due (2)	Balance	Total Reserves
Land	\$—	\$—	\$1,745	\$4,802	\$276
One-to-four family conventional	102	141	62	756	74
Multi-family conventional	—	6,411	3,022	41,484	3,387
Commercial non-owner occupied	—	438	77,114	412,324	32,309
Secured by nonfarm, nonresidential	274	—	4,424	32,535	2,476
Negative escrow	—	—	—	1,613	—
Net deferred fees and other	—	—	—	(1,237	) —
Total	\$376	\$6,990	\$86,367	\$492,277	\$38,522

(1)Includes commercial real estate held-for-investment loans originated prior to 2011.

(2)Greater than 90 days past due includes performing non-accrual loans.

Commercial and industrial loans. Commercial and industrial held-for-investment loan facilities typically include lines of credit to our small or middle market businesses for use in normal business operations to finance working capital needs, equipment purchases and expansion projects. Commercial and industrial held-for-investment loans include those loan facilities previously described, as well as asset based lending and auto dealer floor plan financing. We participate, with other lenders, in syndicated deals to well known larger companies. As of December 31, 2012, we had no auto dealer floor plan financing loans. At December 31, 2012 our commercial and industrial held-for-investment loans totaled \$90.6 million, compared to \$330.1 million at December 31, 2011. During the year ended December 31, 2012, we transferred \$488.4 million of commercial and industrial loans held-for-investment to the loans held-for-sale category as a result of our agreements to sell such loans pursuant to the CIT Agreement and Customers Agreement.

Commercial lease financing loans. Our commercial lease financing held-for-investment loan portfolio is comprised of equipment leased to customers in a direct financing lease. The net investment in financing leases includes the aggregate amount of lease payments to be received and the estimated residual values of the equipment, less unearned income. Income from lease financing is recognized over the lives of the leases on an approximate level rate of return

on the unrecovered investment. The residual value represents the estimated fair value of the leased asset at the end of the lease term. Unguaranteed residual values of leased assets are reviewed at least annually for impairment. If any declines in residual values are determined to be other-than-temporary they will be recognized in earnings in the period such determinations are made. At December 31, 2012 our commercial lease financing held-for-investment loans totaled \$6.3 million, compared to \$114.5 million at December 31, 2011. During the year

ended December 31, 2012, we transferred \$158.9 million of commercial lease financing loans held-for-investment to the loans held-for-sale category related to the CIT Agreement.

**Warehouse lending.** We also continue to 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 drawdown on the line is collateralized by the residential first mortgage loan being funded, and during 2012, we subsequently acquired approximately 76.7 percent of residential first mortgage loans funded through the warehouse lines. Underlying mortgage loans are predominately originated using GSE underwriting standards. These lines of credit are, in most cases, personally guaranteed by one or more qualified principal officers of the borrower. The aggregate amount of adjustable rate warehouse lines of credit granted to other mortgage lenders at December 31, 2012 was \$2.3 billion, of which \$1.3 billion was outstanding and had an average rate of 5.4 percent, compared to \$2.1 billion granted at December 31, 2011, of which \$1.2 billion was outstanding and had an average rate of 5.5 percent. The levels of outstanding balances of such warehouse lines are generally correlated to the level of our overall production levels because our correspondents (from whom we purchase mortgage loans) also comprise a substantial portion of our warehouse lending customers. As of December 31, 2012 and December 31, 2011, our warehouse lines funded over 62 percent of the loans in our correspondent channel. There were 311 warehouse lines of credit to other mortgage lenders with an average size of \$7.5 million at December 31, 2012, compared to 293 warehouse lines of credit with an average size of \$7.0 million at December 31, 2011. At December 31, 2012 we had no warehouse lines on non-accrual status, as compared to \$28,000 at December 31, 2011.

#### Mortgage Banking

Our Mortgage Banking segment originates, acquires, sells and services one-to-four family residential first mortgage loans. The origination or acquisition of residential first mortgage loans held-for-sale constitutes our most significant lending activity.

Throughout 2012, we remained one of the country's leading mortgage loan originators. We utilize three production channels to originate or acquire mortgage loans: Home Lending Centers (also referred to as "retail"), as well as, Broker and Correspondent (also collectively referred to as "wholesale"). Each production channel produces similar mortgage loan products and applies the same underwriting standards. We expect to continue to leverage technology to streamline the mortgage origination process and bring service and convenience to brokers and correspondents. Sales support offices are maintained that assist brokers and correspondents nationwide. We also continue to make increasing use of the Internet as a tool to 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. Most mortgage loans that closed in 2012 utilized the Internet in the completion of the mortgage origination or acquisition process.

**Home Lending Centers.** In a home lending center transaction, loans are originated through a nationwide network of our stand-alone loan origination centers, as well as referrals from our Banking segment and the national call center. When loans are originated on a retail basis, the origination documentation is completed internally inclusive of customer disclosures and other aspects of the lending process and the funding of the transactions. At December 31, 2012, we maintained 31 loan origination centers. At the same time, our centralized loan processing gained efficiencies and allowed lending sales staff to focus on originations. For the year ended December 31, 2012, we closed \$3.4 billion of loans utilizing this origination channel, which equaled 6.4 percent of total originations, compared to \$1.8 billion or 6.7 percent of total originations during the year ended December 31, 2011.

**Broker.** In a broker transaction, an unaffiliated bank or mortgage brokerage company completes 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 over 1,700 banks, credit unions, and mortgage brokerage companies located in all 50 states. For the year ended December 31, 2012, we closed loans totaling \$14.7 billion utilizing this origination channel, which equaled 27.5 percent of total originations, compared to \$7.9 billion or 29.6 percent during the year ended December 31, 2011.

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 do not acquire loans on a bulk basis without prior review from correspondents, but instead we acquire each loan after review on a loan-level basis and each loan is required to be originated to our underwriting guidelines. We have active correspondent relationships with over 1,300 companies, including banks, credit unions, and mortgage companies located in all 50 states. For the year ended December 31, 2012, we closed loans totaling \$35.4 billion utilizing the correspondent origination channel, which equaled 66.1 percent of total originations, compared to \$16.9 billion or 63.7 percent originated during the year ended December 31, 2011.

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The following tables disclose residential first mortgage loan originations by channel, type and mix for each respective period.

	2012				
	First	Second	Third	Fourth	Year to
	Quarter	Quarter	Quarter	Quarter	Date
	(Dollars in thousands)				
Home Lending Centers	\$729,369	\$751,075	\$961,591	\$998,804	\$3,440,839
Broker	2,909,446	3,156,949	4,117,742	4,524,775	14,708,912
Correspondent	7,530,594	8,638,977	9,434,287	9,833,218	35,437,076
Total	\$11,169,409	\$12,547,001	\$14,513,620	\$15,356,797	\$53,586,827
Purchase originations	\$2,188,508	\$3,324,501	\$3,267,788	2,915,724	\$11,696,521
Refinance originations	8,980,901	9,222,500	11,245,832	12,441,073	41,890,306
Total	\$11,169,409	\$12,547,001	\$14,513,620	\$15,356,797	\$53,586,827
Conventional	\$7,859,960	\$8,762,268	\$10,020,863	\$10,427,131	\$37,070,222
Government	2,611,691	3,085,247	3,178,563	\$3,363,134	12,238,635
Jumbo	697,758	699,486	1,314,194	1,566,532	4,277,970
Total	\$11,169,409	\$12,547,001	\$14,513,620	\$15,356,797	\$53,586,827
	2011				
	First	Second	Third	Fourth	Year to
	Quarter	Quarter	Quarter	Quarter	Date
	(Dollars in thousands)				
Home Lending Centers	\$329,973	\$354,359	\$481,057	\$616,765	\$1,782,154
Broker	1,341,973	1,436,632	2,178,801	2,931,106	7,888,512
Correspondent	3,184,364	2,851,716	4,266,593	6,639,229	16,941,902
Total	\$4,856,310	\$4,642,707	\$6,926,451	\$10,187,100	\$26,612,568
Purchase originations	\$1,702,041	\$2,347,212	\$2,538,925	\$2,148,300	\$8,736,478
Refinance originations	3,154,269	2,295,495	4,387,526	8,038,800	17,876,090
Total	\$4,856,310	\$4,642,707	\$6,926,451	\$10,187,100	\$26,612,568
Conventional	\$2,965,986	\$2,726,979	\$4,431,229	\$7,180,349	\$17,304,543
Government	1,645,232	1,680,766	1,759,984	2,135,840	7,221,822
Jumbo	245,092	234,962	735,238	870,911	2,086,203
Total	\$4,856,310	\$4,642,707	\$6,926,451	\$10,187,100	\$26,612,568
	2010				
	First	Second	Third	Fourth	Year to
	Quarter	Quarter	Quarter	Quarter	Date
	(Dollars in thousands)				
Home Lending Centers	\$413,663	\$441,693	\$581,334	\$549,908	\$1,986,598
Broker	1,661,460	1,811,108	2,545,969	3,051,509	9,070,046
Correspondent	2,249,998	3,198,866	4,486,089	5,562,820	15,497,773
Total	\$4,325,121	\$5,451,667	\$7,613,392	\$9,164,237	\$26,554,417
Purchase originations	\$1,624,556	\$2,536,104	\$2,053,092	\$1,679,921	\$7,893,673
Refinance originations	2,700,565	2,915,563	5,560,300	7,484,316	18,660,744
Total	\$4,325,121	\$5,451,667	\$7,613,392	\$9,164,237	\$26,554,417

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Conventional	\$2,671,186	\$3,316,366	\$5,007,734	\$6,249,138	\$17,244,424
Government	1,424,570	1,843,956	2,141,729	2,516,125	7,926,380
Jumbo	229,365	291,345	463,929	398,974	1,383,613
Total	\$4,325,121	\$5,451,667	\$7,613,392	\$9,164,237	\$26,554,417

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## Underwriting

During the year ended December 31, 2012, we primarily originated residential first mortgage loans for sale that conformed to the respective underwriting guidelines established by GSEs.

## Residential first mortgage loans

At December 31, 2012, most of our held-for-investment residential first mortgage loans had been originated in 2008 or prior years with underwriting criteria that varied by product and with the standards in place at the time of origination. Loans originated after 2008 are loans that generally satisfy specific criteria for sale into securitization pools insured by the GSEs or were repurchased from the GSEs subsequent to such sales.

Set forth below is a table describing the characteristics of the residential first mortgage loans in our held-for-investment portfolio at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total / Weighted Average	
	(Dollars in thousands)						
Unpaid principal balance (1)	\$2,778,879	\$62,432	\$37,214	\$47,458	\$48,031	\$2,974,014	
Average note rate	4.11	% 4.87	% 4.11	% 4.21	% 3.90	% 4.13	%
Average original FICO score	713	690	693	722	738	712	
Average current FICO score (2)	686	650	685	719	734	686	
Average original LTV ratio	75.8	% 85.9	% 79.9	% 78.3	% 74.6	% 76.1	%
Housing Price Index LTV, as recalculated (3)	93.8	% 91.7	% 84.8	% 82.1	% 73.0	% 93.2	%
Underwritten with low or stated income documentation	38.0	% 3.0	% 6.0	% 1.0	% —	% 35.0	%

(1) Unpaid principal balance does not include premiums or discounts.

(2) Current FICO scores obtained at various times during the year ended December 31, 2012.

(3) The housing price index ("HPI") LTV is updated from the original LTV based on Metropolitan Statistical Area-level Office of Federal Housing Enterprise Oversight ("OFHEO") data as of September 30, 2012.

Average original loan-to-value ("LTV") represents the loan balance at origination, as a percentage of the original appraised value of the property. LTVs are refreshed quarterly based on estimates of home prices using the most current OFHEO data, and reflect the modest recovery in home prices over the past 18 months.

Residential first mortgage loans are underwritten on a loan-by-loan basis rather than on a pool basis. Generally, residential first mortgage loans produced through our production channels in the held-for-investment loan portfolio are reviewed by one of our in-house loan underwriters or by a contract underwriter. In all cases, loans must be underwritten to our underwriting standards.

Our criteria for underwriting generally includes, but are not limited to, full documentation of borrower income and other relevant financial information, fully indexed rate consideration for variable rate loans, and for GSE loans, the specific GSEs eligible LTV ratios with full appraisals when required. Variances from any of these standards are permitted only to the extent allowable under the specific program requirements. These specific program requirements

include the ability to originate loans with less than full documentation and variable rate loans with an initial interest rate less than the fully indexed rate. Mortgage loans are collateralized by a first or second mortgage on a one-to-four family residential property.

In general, for loans in the portfolio originated in years 2008 and prior, loan balances under \$1,000,000 required a valid GSE automated underwriting system ("AUS") response for approval consideration. Documentation and ratio guidelines are driven by the AUS response. A FICO credit score for the borrower was required and a full appraisal of the underlying property that would serve as collateral is obtained.

For loan balances over \$1,000,000, traditional manual underwriting documentation and ratio requirements are required as are two years plus year to date of income documentation and two months of bank statements. Income documentation based solely on a borrower's statement was an available underwriting option for each loan category. Even so, in these cases employment of the borrower was verified under the vast majority of loan programs, and income levels were typically checked against third party sources to confirm validity.

We believe that our underwriting process, which relies on the electronic submission of data and images and is based on an award-winning imaging workflow process, allows for underwriting at a higher level of accuracy and with more timeliness than exists with processes which rely on paper submissions. We also provide our underwriters with integrated quality control tools, such as automated valuation models, multiple fraud detection engines and the ability to electronically submit IRS Form 4506 to ensure underwriters have the information that they need to make informed decisions. The process begins with the submission of an electronic application and an initial determination of eligibility. The application and required documents are then uploaded to our corporate underwriting department and all documents are identified by optical character recognition or our underwriting staff. The underwriter is responsible for checking the data integrity and reviewing credit. The file is then reviewed in accordance with the applicable guidelines established by us for the particular product. Quality control checks are performed by the underwriting department using the tools outlined above, as necessary, and a decision is then made and communicated to the prospective borrower.

The following table identifies our held-for-investment mortgages by major category, at December 31, 2012. Loans categorized as subprime were initially originated for sale and comprised only 0.1 percent of the portfolio of first lien mortgage loans.

December 31, 2012	Unpaid Principal Balance (1)	Average Note Rate	Average Original FICO Score	Average Current FICO Score (2)	Weighted Average Maturity	Average Original LTV Ratio	Housing Price Index LTV, as recalculated (3)	
(Dollars in thousands)								
Residential first mortgage loans								
Amortizing								
3/1 ARM	\$118,026	3.26	% 682	672	261	82.2	% 83.6	%
5/1 ARM	408,593	3.80	% 717	703	282	75.0	% 82.3	%
7/1 ARM	20,532	4.31	% 722	714	279	75.2	% 78.6	%
Other ARM	68,620	3.27	% 702	657	264	83.1	% 85.3	%
Fixed mortgage loans (4)	1,046,982	4.45	% 676	655	332	77.7	% 98.6	%
Total amortizing	1,662,753	4.15	% 704	669	311	77.5	% 92.7	%
Interest only								
3/1 ARM	170,198	3.65	% 722	703	269	74.7	% 89.5	%
5/1 ARM	797,347	3.64	% 723	713	272	74.3	% 90.3	%
7/1 ARM	54,417	6.00	% 731	706	298	74.6	% 104.9	%
Other ARM	40,495	3.64	% 725	702	277	75.9	% 97.5	%
Other interest only	189,201	6.06	% 727	700	296	74.1	% 104.1	%
Total interest only	1,251,658	4.11	% 74	709	276	74.4	% 93.2	%
Option ARMs	55,848	3.54	% 717	684	309	70.4	% 108.9	%
Subprime (5)								
3/1 ARM	205	9.84	% 645	628	294	91.2	% 102.0	%
Other ARM	507	9.50	% 618	631	291	72.8	% 87.3	%
Other subprime	3,043	8.08	% 594	654	295	72.3	% 102.4	%
Total subprime	\$3,755	8.37	% 616	650	295	73.4	% 100.4	%
Total residential first mortgage loans	\$2,974,014	4.13	% 712	686	296	76.1	% 93.2	%
Second mortgage loans (6)	\$114,867	7.68	% 733	733	133	20.4	% 23.5	%
HELOC loans (6)	\$172,081	5.13	% 735	735	44	26.5	% 28.7	%

(1) Unpaid principal balance does not include premiums or discounts.

- (2) Current FICO scores obtained at various times during the year ended December 31, 2012.
- (3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.
- (4) Includes substantially fixed rate mortgage loans.
- (5) Subprime loans are defined in accordance with the FDIC's assessment regulations definitions for subprime loans, which includes loans with FICO scores below 620 or similar characteristics.
- (6) Reflects lower LTV only as to second liens because information regarding the first liens is not available.

The following table sets forth characteristics of those loans in our held-for-investment mortgage portfolio as of December 31, 2012 that were originated with less documentation than is now required by the GSEs. Loans as to which underwriting information was accepted from a borrower without validating that particular item of information are referred to as "low doc" or "stated." Substantially all of those loans were underwritten with verification of employment but with the related job income or personal assets, or both, stated by the borrower without verification of actual amount. Those loans may have additional elements of risk because information provided by the borrower in connection with the loan was limited. Loans as to which underwriting information was supported by third party documentation or procedures are referred to as "full doc," and the information therein is referred to as "verified." Also set forth are different types of loans that may have a higher risk of non-collection than other loans.

December 31, 2012	Low Doc % of Held-for-Investment loans (Dollars in thousands)	% of Residential First Mortgage loans	Unpaid Principal Balance (1)
Characteristics			
SISA (stated income, stated asset)	1.80	% 3.37	% \$99,859
SIVA (stated income, verified assets)	11.11	% 20.83	% 617,472
High LTV (i.e., at or above 95% at origination)	0.15	% 0.28	% 8,405
Second lien products (HELOCs, second mortgages)	1.46	% 2.74	% 81,252
Loan types			
Option ARM loans	0.65	% 1.22	% 36,250
Interest-only loans	8.53	% 15.98	% 473,708
Subprime (2)	0.04	% 0.07	% 2,181

(1) Unpaid principal balance does not include premiums or discounts.

(2) Subprime loans are defined in accordance with the FDIC's assessment regulations definitions for subprime loans, which includes loans with FICO scores below 620 or similar characteristics.

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 AUS 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 100 percent, but subordinate (i.e., second mortgage) financing was not allowed over a 90 percent LTV ratio. At a 100 percent LTV ratio with private mortgage insurance, the minimum acceptable FICO score, or the "floor," was 700, and at lower LTV ratio levels, the FICO floor was 620. All occupancy and specific-purpose loan types were allowed at lower LTVs. At times ARMs were underwritten at an initial rate, also known as the "start rate," that was lower than the fully indexed rate but only for loans with lower LTV ratios and higher FICO scores. Other ARMs were either underwritten at the note rate if the initial fixed term was two years or greater, or at the note rate plus two percentage points if the initial fixed rate term was six months to one year.

Set forth below is a table describing the characteristics of our ARM loans in our residential first mortgage held-for-investment loan portfolio at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total / Weighted Average	
(Dollars in thousands)							
Unpaid principal balance (1)	\$1,686,118	\$8,058	\$6,256	\$20,289	\$14,067	\$1,734,788	
Average note rate	3.71	% 5.05	% 4.45	% 4.13	% 3.69	% 3.72	%
Average original FICO score	717	696	727	744	773	717	
Average current FICO score (2)	702	688	720	738	776	703	
Average original LTV ratio	75.4	% 81.2	% 72.5	% 72.2	% 61.8	% 75.3	%
Housing Price Index LTV, as recalculated (3)	89.3	% 88.8	% 77.2	% 70.6	% 61.0	% 88.8	%
Underwritten with low or stated income documentation	35.0	% 13.0	% —	% 1.0	% —	% 34.0	%

(1) Unpaid principal balance does not include premiums or discounts.

(2) Current FICO scores obtained at various times during the current quarter.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.

At December 31, 2012, we had \$55.8 million of ARM loans referred to as option ARM loans in our held-for-investment loan portfolio. Option ARM loans permit a borrower to vary the monthly payment, including paying an amount that excludes interest otherwise due which is then added to the unpaid principal balance of the loan (a process referred to as "negative amortization"). The amount of negative amortization reflected in such loan balances for the year ended December 31, 2012 was \$3.5 million. The maximum balance that all option ARMs could reach cumulatively is \$86.9 million at December 31, 2012.

Set forth below is a table describing specific characteristics of option ARMs in our held-for-investment mortgage portfolio at December 31, 2012, which were originated in 2008 or prior.

Year of Origination	2008 and Prior	
(Dollars in thousands)		
Unpaid principal balance (1)	\$55,848	
Average note rate	3.54	%
Average original FICO score	717	
Average current FICO score (2)	684	
Average original LTV ratio	70.4	%
Average original CLTV ratio	78.7	%
Housing Price Index LTV, as recalculated (3)	108.9	%
Underwritten with low or stated income documentation	\$36,250	
Total principal balance with any accumulated negative amortization	\$37,747	
Percentage of total ARMS with any accumulated negative amortization	2.2	%
Amount of net negative amortization (i.e., deferred interest) accumulated as interest income during the year ended December 31, 2012	\$3,513	

(1) Unpaid principal balance does not include premiums or discounts.

(2) Current FICO scores obtained at various times during the year ended December 31, 2012.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.

Set forth below are the accumulated amounts of interest income arising from the net negative amortization portion of loans during the years ended December 31, 2012.

	Unpaid Principal Balance of Loans in Negative Amortization At Year-End (1) (Dollars in thousands)	Amount of Net Negative Amortization Accumulated as Interest Income During Period
2012	\$37,747	\$ 3,513
2011	\$82,536	\$ 7,847
2010	\$93,550	\$ 16,219

(1) Unpaid principal balance does not include premiums or discounts.

Set forth below are the frequencies at which the interest rate on ARM loans outstanding at December 31, 2012, will reset.

Reset frequency	# of Loans (Dollars in thousands)	Balance	% of the Total	
Monthly	78	\$13,381	0.8	%
Semi-annually	3,347	1,032,862	59.5	%
Annually	2,960	445,406	25.7	%
No reset — non-performing loans	909	243,139	14.0	%
Total	7,294	\$1,734,788	100.0	%

Set forth below as of December 31, 2012, 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 non-performing loans do not reset while in the non-performing status. Accordingly, the table below may include the same loans in more than one period.

	1 <sup>st</sup> Quarter (Dollars in thousands)	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
2013	\$585,652	\$639,601	\$642,697	\$628,907
2014	644,090	666,707	685,221	646,153
2015	661,524	693,451	711,666	671,669
Later years (1)	679,764	707,759	732,925	690,921

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

Interest only mortgages. We offered adjustable and fixed term loans with 10-year interest only options. These loans were originated using Fannie Mae and Freddie Mac guidelines as a base framework. We generally applied the debt-to-income ratio guidelines and documentation using the automated underwriting Approve/Reject response requirements of Fannie Mae and Freddie Mac.

Set forth below is a table describing the characteristics of the interest only mortgage loans at the dates indicated in our held-for-investment mortgage portfolio at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total / Weighted Average	
	(Dollars in thousands)						
Unpaid principal balance (1) (2)	\$1,249,699	\$350	\$1,609	N/A	N/A	\$1,251,658	
Average note rate	4.11	% 3.00	% 5.25	% N/A	N/A	4.11	%
Average original FICO score	724	613	727	N/A	N/A	724	
Average current FICO score (3)	709	585	679	N/A	N/A	709	
Average original LTV ratio	74.4	% 100.0	% 63.8	% N/A	N/A	74.4	%
Housing Price Index LTV, as recalculated (4)	93.2	% 80.6	% 66.3	% N/A	N/A	93.2	%
Underwritten with low or stated income documentation	38.0	% —	% —	% N/A	N/A	38.0	%

(1) Unpaid principal balance does not include premiums or discounts.

(2) Interest only loans placed in portfolio in 2010 comprise loans that were initially originated for sale. There are two loans in this population.

(3) Current FICO scores obtained at various times during the year ended December 31, 2012.

(4) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.

Set forth below is a table describing the amortization date and payment shock of current interest only mortgage loans at the dates indicated in our held-for-investment mortgage portfolio at December 31, 2012.

	2013	2014	2015	2016	2017	Thereafter	Total / Weighted Average	
	(Dollars in thousands)							
Unpaid principal balance (1)	\$23,189	\$330,691	\$402,644	\$72,167	\$384,507	\$14,621	\$1,227,819	
Weighted average rate	3.67	% 3.67	% 3.67	% 3.85	% 4.83	% 5.79	% 3.96	%
Average original monthly payment per \$1,321 loan (dollars)		\$1,362	\$1,408	\$1,765	\$2,665	\$1,911	\$1,695	
Average current monthly payment per \$949 loan (dollars)		\$959	\$870	\$1,114	\$2,137	\$1,802	\$1,200	
Average amortizing payment per loan (dollars)	\$1,762	\$2,159	\$1,643	\$1,884	\$3,146	\$2,135	\$2,144	
Loan count	77	1,068	1,441	232	795	47	3,660	
Payment shock (dollars)	\$813	\$1,200	\$773	\$770	\$1,009	\$334	\$943	
Payment shock (percent)	85.7	% 125.1	% 88.9	% 69.2	% 47.2	% 18.5	% 78.6	%

(1) Unpaid principal balance does not include premiums or discounts.

Second mortgage loans. The majority of second mortgages we originated were closed in conjunction with the closing of the residential first mortgages originated by us. We generally required the same levels of documentation and ratios as with our residential first mortgages. For second mortgages closed in conjunction with a residential first mortgage loan that was not being originated by us, our allowable debt-to-income ratios for approval of the second mortgages were capped at 40 percent to 45 percent. In the case of a loan closing in which full documentation was required and the loan was being used to acquire the borrower's primary residence, we allowed a CLTV ratio of up to 100 percent; for similar loans that also contained higher risk elements, we limited the maximum CLTV to 90 percent. FICO floors ranged from 620 to 720, and fixed and adjustable rate loans were available with terms ranging from five to 20 years.

Set forth below is a table describing the characteristics of the second mortgage loans in our held-for-investment portfolio at December 31, 2012, by year of origination.

Year of Origination	Prior to 2008	2009	2010	2011	2012	Total / Weighted Average	
	(Dollars in thousands)						
Unpaid principal balance (1)	\$112,850	\$1,276	\$383	\$54	\$304	\$114,867	
Average note rate	7.70	% 6.93	% 6.86	% 7.14	% 4.26	% 7.68	%
Average original FICO score	733	712	693	681	763	733	
Average original LTV ratio (2)	20.4	% 17.4	% 14.6	% 16.5	% 21.0	% 20.4	%
Average original CLTV ratio	73.1	% 87.6	% 31.8	% 92.8	% 77.9	% 73.1	%
Housing Price Index LTV, as recalculated (3)	23.6	% 18.2	% 14.1	% 14.1	% 17.0	% 23.5	%

(1) Unpaid principal balance does not include premiums or discounts.

(2) Reflects lower LTV only as to second liens because information regarding the first liens is not available.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.

Home Equity Line of Credit ("HELOC") loans. We originated HELOC loans from 2002 to mid-2009. The majority of these HELOC loans were closed in conjunction with the closing of related first mortgage loans originated and serviced by us. Documentation requirements for HELOC applications were generally the same as those required of borrowers for the first mortgage loans originated by us, and debt-to-income ratios were capped at 50 percent. For HELOCs closed in conjunction with the closing of a first mortgage loan that was not being originated by us, our debt-to-income ratio requirements were capped at 40 percent to 45 percent and the LTV was capped at 80 percent. The qualifying payment varied over time and included terms such as either 0.75 percent of the line amount or the interest only payment due on the full line based on the current rate plus 0.5 percent. HELOCs were available in conjunction with primary residence transactions that required full documentation, and the borrower was allowed a CLTV ratio of up to 100 percent. For similar loans that also contained higher risk elements, we limited the maximum CLTV to 90 percent. FICO floors ranged from 620 to 720. The HELOC terms called for monthly interest only payments with a balloon principal payment due at the end of 10 years. At times, initial teaser rates were offered for the first three months.

HELOC loan originations were re-launched in June 2011 as a banking center originated portfolio product. Current HELOC guidelines and pricing parameters have been established to attract high credit quality loans with long term profitability. The minimum FICO is 680, maximum CLTV is 80 percent, and the maximum debt-to-income ratio is 45 percent.

Set forth below is a table describing the characteristics of the HELOCs in our held-for-investment portfolio at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total / Weighted Average	
	(Dollars in thousands)						
Unpaid principal balance (1)	\$158,749	\$689	N/A	\$2,089	\$10,554	\$172,081	
Average note rate (2)	5.23	% 5.48	% N/A	3.91	% 3.75	% 5.13	%
Average original FICO score	733	—	N/A	754	763	735	
Average original LTV ratio	25.0	% 31.1	% N/A	41.2	% 45.8	% 26.5	%
Housing Price Index LTV, as recalculated (3)	28.1	% 27.5	% N/A	32.8	% 36.2	% 28.7	%

(1) Unpaid principal balance does not include premiums or discounts.

(2)

Average note rate reflects the rate that is currently in effect. As these loans adjust on a monthly basis, the average note rate could increase, but would not decrease, as currently the minimum rate on virtually all of the loans is in effect.

The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of (3) September 30, 2012. Reflects lower LTV because these are second liens and information regarding the first lien is not available.

## Loan Sales and Securitizations

We sell substantially all of the residential mortgage loans we produce into the secondary market on a whole loan basis or by first securitizing the loans into mortgage-backed securities. Our securitizations are with Fannie Mae, Ginnie Mae and to a lesser extent Freddie Mac.

The following table indicates the breakdown of our loan sales/securitizations for the period as indicated.

	For the Years Ended December 31,					
	2012 Principal	2011 Principal	2010 Principal			
	Sold %	Sold %	Sold %			
Agency securitizations	99.0	% 96.1	% 90.8			%
Whole loan sales	1.0	% 3.9	% 9.2			%
Total	100.0	% 100.0	% 100.0			%

Upon our sale of mortgage loans, we may retain the servicing of the mortgage loans, or even sell the servicing rights ("MSRs") to other secondary market investors. In general, we do not sell the servicing rights to mortgage loans that we originate for our own portfolio or that we privately securitize. When we retain MSRs, we are entitled to receive a servicing fee equal to a specified percentage of the outstanding principal balance of the loans. We may also be entitled to receive additional servicing compensation, such as late payment fees and earn additional income through the use of non-interest bearing escrows.

Prior to 2008, we engaged in a total of four private-label securitizations, which consisted of two second mortgage loan securitizations and two HELOC loan securitizations. In a private-label securitization, we sold mortgage loans to our wholly-owned bankruptcy remote special purpose entity, which then sold the mortgage loans to separate, transaction-specific trusts formed for this purpose in exchange for cash and certain interests in the trust and those mortgage loans. Each trust then issued and sold mortgage-backed securities to third party investors that are secured by payments on the mortgage loans. These securities were rated by two of the nationally recognized statistical rating organizations (i.e. rating agencies) and insured by two insurance companies. We are in litigation with Assured and MBIA regarding the alleged breach of various loan level representations and warranties made by the Bank in connection with the four private-label securitizations. See Notes 11 and 29 of the Notes to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data, herein.

In addition to the cash we receive from the securitization of mortgage loans, we retain certain interests in the securitized mortgage loans and the trusts. Such retained interests include residual interests, which arise as a result of private-label securitizations, and MSRs, which can arise as a result of our securitizations, whole loan sales or private-label securitizations.

The residual interests created upon the issuance of private-label securitizations represent the first loss position and are not typically rated by any nationally recognized statistical rating organization. Residual interests are designated by us as trading securities and are marked to market in current period operations. We use an internally maintained model to value the residual interest. The model takes into consideration the cash flow structure specific to each transaction, such as over-collateralization requirements and trigger events, and key valuation assumptions, including credit losses, prepayment rates and discount rates. See Note 11 of the Notes to Consolidated Financial Statements, in Item 8, Financial Statements and Supplementary Data, herein.

**Loan servicing.** The Mortgage Banking segment also services mortgage loans for others. Servicing residential mortgage loans for third parties generates fee income and represents a significant business activity. During 2012, we serviced portfolios of mortgage loans of \$76.8 billion. The servicing generated gross revenue of \$209.6 million. The fair value estimate uses a valuation model that calculates the present value of estimated future net servicing cash flows

by taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.

As part of our business model, we periodically sell MSRs into the secondary market, in transactions separate from the sale of the underlying loans, principally for capital management, balance sheet management or interest rate risk purposes. MSRs created in a lower interest rate environment generally will have a higher market value because the underlying loan is less likely to be prepaid. Conversely, an MSR created in a higher interest rate environment will generally sell at a market price below the original fair value recorded because of the increased likelihood of prepayment of the underlying loans, resulting in a loss. MSRs can be sold on a bulk basis or a flow basis. MSRs sold on a bulk basis are reflected in our financial statements following loan sales and later sold to a third party as the opportunity arises. MSRs sold on a flow basis is completed when we sell the servicing rights shortly after it is acquired pursuant to an existing arrangement, generally with little or no gain realized on the sale. All MSR sales were completed on a bulk basis.

Over the past three years, we sold MSRs related to \$40.0 billion of loans serviced for others, including \$17.4 billion in 2012. We did not record significant gains or losses on such loans because the changes in values of the MSRs were recorded on an ongoing basis as a mark to market adjustment.

Set forth below is a table describing the characteristics of the mortgage loans serviced for others at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total / Weighted Average	
(Dollars in thousands)							
Unpaid principal balance (1)	\$8,119,833	\$6,925,907	\$8,097,666	\$11,812,250	\$41,865,549	\$76,821,205	
Average unpaid principal balance per loan	\$152,122	\$155,349	\$184,866	\$199,084	\$237,727	\$203,660	
Weighted average service fee (basis points)	0.30	% 0.35	% 0.29	% 0.27	% 0.27	% 0.28	%
Weighted average rate	5.53	% 5.24	% 4.76	% 4.30	% 3.65	% 4.21	%
Weighted average original maturity (months)	356	339	338	308	322	327	
Weighted average age (months)	68	42	29	16	6	20	
Average current FICO score (2)	679	707	735	748	756	741	
Average original LTV ratio	81.0	% 87.3	% 82.6	% 74.7	% 74.6	% 77.3	%
Housing Price Index LTV, as recalculated (3)	91.6	% 90.2	% 82.2	% 71.6	% 73.1	% 77.3	%
Loan count	53,377	44,583	43,803	59,333	176,108	377,204	

(1) Unpaid principal balance does not include premiums or discounts.

Average note rate reflects the rate that is currently in effect. As these loans adjust on a monthly basis, the average (2) note rate could increase, but would not decrease, as in the current market, the floor rate on virtually all of the loans is in effect.

(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of September 30, 2012.

Set forth below is a table of the past due trends in mortgage loans serviced for others at December 31, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total
(Dollars in thousands)						
30-59 days past due	\$560,072	\$355,497	\$152,219	\$127,473	\$133,912	\$1,329,173
60-89 days past due	335,454	176,588	69,989	39,789	18,998	\$640,818
	1,540,313	158,352	93,304	35,561	10,210	\$1,837,740

90 days or greater past  
due

Total past due	2,435,839	690,437	315,512	202,823	163,120	\$3,807,731
Current	5,683,994	6,235,471	7,782,155	11,609,427	41,702,427	\$73,013,474
Unpaid principal balance (1)	8,119,833	6,925,908	8,097,667	11,812,250	41,865,547	\$76,821,205

(1) Unpaid principal balance does not include premiums or discounts.

Representation and warranty reserve. Our representation and warranty reserve represents our estimate of the lifetime losses associated with loans we have previously sold into the secondary market and as to which we may later be required to repurchase or to indemnify the holder thereof. We sell most of the residential first mortgage loans that we originate into the secondary mortgage market. When we sell mortgage loans, we make customary representations and warranties to the purchasers, including sponsored securitization trusts and their insurers, about various characteristics of each loan, such as the manner of origination, the nature and extent of underwriting standards applied and the types of documentation being provided. Typically, these representations and warranties are in place for the life of the loan. If a defect in the origination process is identified, we may be required to either repurchase the loan or indemnify the purchaser for losses it sustains on the loan. If there are no such defects, generally we have no liability to the purchaser for losses it may incur on such loan.

We maintain a representation and warranty reserve to account for the expected losses related to loans we might be required to repurchase (or the indemnity payments we may have to make to purchasers). The representation and warranty reserve takes into account both our estimate of expected losses on loans sold during the current accounting period, as well as adjustments to previous estimates of expected losses on loans sold. Our previous estimates reflect our estimates of probable losses on loans in repurchase demand (i.e. loans submitted for repurchase but not yet resolved between the holder and us) and loans as to which no demand for repurchase or indemnification has yet been made. In each case, these estimates are based on the most recent data available to us, including data from third parties, regarding demands for loan repurchases, actual loan repurchases, and actual credit losses on repurchased loans, among other factors. Provisions added to the representation and warranty reserve for current loan sales reduce our net gain on loan sales. Adjustments to our previous estimates are recorded under non-interest income in the Statement of Operations as an increase or decrease to representation and warranty reserve - change in estimate. The amount of our representation and warranty reserve equaled \$193.0 million and \$120.0 million at December 31, 2012 and 2011, respectively.

#### Non-bank Subsidiaries

At December 31, 2012, our corporate legal structure consisted of the Bank, including its wholly-owned subsidiaries, and several non-bank subsidiaries which we conduct other business through. The material active non-bank subsidiaries are discussed below.

##### Paperless Office Solutions, Inc.

Paperless Office Solutions, Inc. ("POS"), our wholly-owned subsidiary, provides on-line paperless office solutions for mortgage originators. DocVelocity is the flagship product developed by POS to bring web-based paperless mortgage processing to mortgage originators. POS's activities are not material to our business. On February 13, 2013, we announced an agreement to sell the assets and operations of POS to Capsilon Corporation, a provider of cloud-based document sharing, imaging and collaboration solutions for mortgage lenders.

#### Other Non-bank Subsidiaries

In addition to the subsidiaries listed above, we have a number of wholly-owned non-bank subsidiaries that are either not material or inactive. We also own nine statutory trusts that are not consolidated with our operations. For additional information, see Notes 3 and 31 of the Notes to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data, herein.

#### Regulation and Supervision

We are registered as a savings and loan holding company under the Home Owners Loan Act ("HOLA") and are currently subject to the Federal Reserve regulation, examination and supervision. The Bank is a federally chartered savings bank and subject to OCC regulation, examination and supervision. In addition, the Bank is subject to regulation by the FDIC and the CFPB, and the Bank's deposits are insured by the FDIC through the DIF. Accordingly, we and the Bank are subject to an extensive regulatory framework which imposes activity restrictions, minimum capital requirements, lending and deposit restrictions and numerous other requirements primarily intended for the protection of depositors, the federal deposit insurance fund and the banking system as a whole, rather than for the protection of stockholders and creditors. Many of these laws and regulations have undergone significant changes and, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), will significantly change in the future. Our non-bank financial subsidiaries are also subject to various federal and state laws and regulations.

Pursuant to the Dodd-Frank Act, the OTS ceased to exist on July 21, 2011 and its functions were transferred to the OCC and the Federal Reserve. After the transfer, the Federal Reserve became our primary regulator and supervisor, and the OCC became the primary regulator and supervisor of the Bank. In addition, the CFPB assumed responsibility for regulation of the principal federal consumer protection laws. However, the laws and regulations applicable to us did not materially change by virtue of the elimination of the OTS, other than as otherwise modified by the Dodd-Frank Act. HOLA and the regulations issued thereunder generally still apply but are subject to interpretation by the Federal Reserve and the OCC. Many provisions of the Dodd-Frank Act became effective on the transfer date and throughout the remaining months. In addition, the scope and impact of many of the Dodd-Frank Act's provisions will continue to be determined through the rulemaking process. Because there are many provisions of the Dodd-Frank Act that have not yet been implemented, we cannot fully predict the ultimate impact of the Dodd-Frank Act on us or the Bank.

In addition to the terms and conditions of the Supervisory Agreement and the Consent Order discussed above, we are generally subject to certain laws and regulations that are summarized below.

### Holding Company Status, Acquisitions and Activities

We are a savings and loan holding company, as defined by federal banking law, as is our controlling stockholder, MP Thrift. Neither we nor MP Thrift may acquire control of another savings bank unless the Federal Reserve approves such transaction and we may not be acquired by a company other than a bank holding company unless the Federal Reserve approves such transaction, or by an individual unless the Federal Reserve does not object after receiving notice. We may not be acquired by a bank holding company unless the Federal Reserve approves such transaction. In any case, the public must have an opportunity to comment on any such proposed acquisition and the OCC or Federal Reserve must complete an application review. Without prior approval from the Federal Reserve, we may not acquire more than 5 percent of the voting stock of any savings bank. In addition, the Gramm-Leach-Bliley Act (the "GLBA") generally restricts any non-financial entity from acquiring us unless such non-financial entity was, or had submitted an application to become, a savings and loan holding company on or before May 4, 1999. Also, because we were a savings and loan holding company prior to May 4, 1999 and control a single savings bank that meets the qualified thrift lender ("QTL") test under HOLA, we may engage in non-financial or commercial activities.

### Source of Strength

We are required to act as a source of strength to the Bank and to commit managerial assistance and capital to support the Bank. Capital loans by a savings and loan holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of the Bank. In the event of a savings and loan holding company's bankruptcy, any commitment by the savings and loan holding company to a federal bank regulator to maintain the capital of a subsidiary bank should be assumed by the bankruptcy trustee and may be entitled to a priority of payment.

### Standards for Safety and Soundness

Federal law requires each U.S. bank regulatory agency to prescribe certain safety and soundness standards for all insured financial institutions. The U.S. bank regulatory agencies adopted Interagency Guidelines Establishing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the U.S. bank regulatory agencies use to identify and address problems at insured financial institutions before capital becomes impaired. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, compensation, and other operational and managerial standards as the agency deems appropriate. If the appropriate U.S. banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

### Regulatory Capital Requirements

Savings and loan holding companies, like us, are not currently subject to consolidated capital requirements. Pursuant to the Dodd-Frank Act, the U.S. bank regulatory agencies are required to establish minimum leverage and risk-based capital requirements for savings and loan holding companies. Typically, bank holding companies are required to maintain Tier 1 capital of at least 4 percent of risk-weighted assets and off-balance sheet items, total capital (the sum of Tier 1 capital and Tier 2 capital) of at least 8 percent of risk-weighted assets and off-balance sheet items, and Tier 1 capital of at least 3 percent of adjusted quarterly average assets (subject to an additional cushion of 1 percent to 2 percent if the Bank has less than the highest regulatory rating), and we expect that savings and loan holding companies will be subject to similar consolidated capital requirements. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the consolidated capital requirements should apply to

savings and loan holding companies. However, the rule proposed by the U.S. bank regulatory agencies that would establish such capital requirements for savings and loan holding companies failed to acknowledge either the grandfather for trust preferred securities or the five-year transition period. As a result, it is unclear whether and, if so, when the U.S. bank regulatory agencies will implement the statutory grandfather and transitional period. The Dodd-Frank Act also contains a number of provisions that will affect the regulatory capital requirements of the Bank. Numerous regulations implementing provisions of the Dodd-Frank Act have not been issued and finalized. Accordingly, the ultimate impact on us of the Dodd-Frank Act cannot be determined at this time.

The Bank must maintain a minimum amount of capital to satisfy various regulatory capital requirements under OCC regulations and federal law. Federal law and regulations establish five levels of capital compliance: well-capitalized, adequately-capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. At December 31, 2012, the Bank was considered "well-capitalized" for regulatory purposes, with regulatory capital ratios of 9.26 percent for Tier 1 capital and 17.18 percent for total risk-based capital. An institution is considered well-capitalized if its ratio of total risk-based capital to risk-weighted assets is 10.0 percent or more, its ratio of Tier 1 capital to risk-weighted assets is 6.0 percent or more, its leverage ratio (also

referred to as its core capital ratio) is 5.0 percent or more, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the OCC to meet and maintain a specific capital level for any capital measure. An institution is only considered to be "adequately-capitalized" if its capital structure satisfies lesser required levels, such as a total risk-based capital ratio of not less than 8.0 percent, a Tier 1 risk-based capital ratio of not less than 4.0 percent, and (unless it is in the most highly-rated category) a leverage ratio of not less than 4.0 percent. Any institution that is neither well capitalized nor adequately-capitalized is considered undercapitalized. Any institution with a tangible equity ratio of 2.0 percent or less is considered critically undercapitalized.

In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when implemented by the U.S. bank regulatory agencies and fully phased-in, will require U.S. banks to maintain substantially more capital, with a greater emphasis on common equity.

In June 2012, the U.S. bank regulatory agencies requested comment on three sets of proposed rules that implement the Basel III capital framework and also make other changes to U.S. regulatory capital standards for banking institutions. The Basel III proposed rules include heightened capital requirements for banking institutions in terms of both higher quality capital and higher regulatory capital ratios. These proposed rules, among other things, would revise the capital levels at which a banking institution would be subject to the prompt corrective action framework (including the establishment of a new Tier 1 common capital requirement), eliminate or reduce the ability of certain types of capital instruments to count as regulatory capital, eliminate the Tier 1 treatment of trust preferred securities (as required by the Dodd-Frank Act) following a phase-in period beginning in 2013, and require new deductions from capital for investments in unconsolidated financial institutions, mortgage servicing assets and deferred tax assets that exceed specified thresholds. The proposed rules also would establish a new capital conservation buffer and, for large or internationally active banks, a supplemental leverage capital requirement that would take into account certain off-balance sheet exposures and a countercyclical capital buffer that would initially be set at zero. Once fully phased in, the Basel III capital rules will significantly reduce the allowable amount of the fair value of MSRs included in Tier 1 capital. While the proposed Basel III rules would have become effective under a phase-in period that was to have begun January 1, 2013 and to be in full effect on January 1, 2019, the U.S. bank regulatory agencies announced on November 9, 2012 that the implementations of the proposed Basel III rules would be delayed. No date or time period for implementation has subsequently been announced.

In addition, proposed rules issued by the U.S. bank regulatory agencies in June 2012 would revise the manner in which a banking institution determines risk-weighted assets for risk-based capital purposes under the Basel II framework applicable to large or internationally active banks (referred to as the advanced approach) and under the Basel I framework applicable to all banking institutions (referred to as the standardized approach). These rules would replace references to credit ratings with alternative methodologies for assessing creditworthiness. Among other things, the advanced approach proposal would implement the changes to counterparty credit risk weightings included in the Basel III capital framework, and the standardized approach would modify the risk weighting framework for residential mortgage assets. The standardized approach changes to the Basel I risk-weighting rules are proposed to become effective no later than July 1, 2015.

In June 2012, the U.S. bank regulatory agencies also adopted final market risk capital rules to implement the enhancements to the market risk framework adopted by the Basel Committee (commonly referred to as "Basel II.5"). The final rules became effective January 1, 2013 and, among other things, establish new stressed Value at Risk ("VaR") and incremental risk charges for covered trading positions and replace references to credit ratings in the market risk rules with alternative methodologies for assessing credit risk.

The regulations ultimately applicable to us may be substantially different from the Basel III framework as published in December 2010 and the rules proposed by the U.S. bank regulatory agencies in June 2012. Until such regulations, as

well as any other capital regulations under the Dodd-Frank Act, are adopted, we cannot be certain that such regulations will apply to us or of the impact such regulations will have on our capital ratios. Requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely affect our results of operations and financial condition.

#### Qualified Thrift Lender

The Bank is required to meet a Qualified Thrift Lender ("QTL") test to avoid certain restrictions on operations, including the activities restrictions applicable to multiple savings and loan holding companies, restrictions on the ability to branch interstate, and our mandatory registration as a bank holding company under the Bank Holding Company Act of 1956. A savings bank satisfies the QTL test if: (i) on a monthly average basis, for at least nine months out of each twelve month period, at least 65 percent of a specified asset base of the savings bank consists of loans to small businesses, credit card loans, educational loans, or certain assets related to domestic residential real estate, including residential mortgage loans and mortgage securities; or (ii) at least 60 percent of the savings bank's total assets consist of cash, U.S. government or government agency debt or equity securities, fixed assets,

or loans secured by deposits, real property used for residential, educational, church, welfare, or health purposes, or real property in certain urban renewal areas. The Bank is currently, and expects to remain, in compliance with QTL standards.

#### American Recovery and Reinvestment Act of 2009

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 ("ARRA"), more commonly known as the economic stimulus or economic recovery package was enacted into law. ARRA includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health, and education needs. In addition, ARRA imposed certain new executive compensation and corporate expenditure limits on all current and future TARP recipients that are in addition to those previously announced by the U.S. Treasury, until the financial institution has repaid the U.S. Treasury, which is now permitted under ARRA without penalty and without the need to raise new capital, subject to the U.S. Treasury's consultation with the recipient's appropriate banking agency.

#### FDIC Insurance and Assessment

The FDIC insures the deposits of the Bank and such insurance is backed by the full faith and credit of the U.S. government through the DIF. The Dodd-Frank Act raised the standard maximum deposit insurance amount to \$250,000 per depositor, per insured financial institution for each account ownership category. Under the Dodd-Frank Act, non-interest-bearing transaction accounts had unlimited deposit insurance through December 31, 2012.

Pursuant to the Dodd-Frank Act, the minimum reserve ratio designated by the FDIC each year is 1.35 percent of the assessment base, as opposed to 1.15 percent under prior law. The FDIC is required to meet the minimum reserve ratio by September 30, 2020 and is required to offset the effect of the increased reserve ratio for banks with less than \$10 billion. The Dodd-Frank Act also eliminates requirements under prior law that the FDIC pay dividends to member institutions if the reserve ratio exceeds certain thresholds, and the FDIC has proposed that in lieu of dividends, it will adopt lower rate schedules when the reserve ratio exceeds certain thresholds. The FDIC has established a higher reserve ratio of 2% as a long-term goal beyond what is required by statute.

The FDIC maintains the DIF by assessing each financial institution an insurance premium. Prior to April 2011, the amount of the FDIC assessments paid by an insured depository institution was based on its relative risk of default as measured by our FDIC supervisory rating, and other various measures, such as the level of brokered deposits, unsecured debt and debt issuer ratings, and the amount of deposits.

Effective April 2011, the FDIC defined deposit insurance assessment base for an insured depository institution was changed to such institution's average consolidated total assets during the assessment period, minus average tangible equity. The FDIC adopted a final rule implementing this change to the assessment calculation effective April 1, 2011. The assessment rate schedule for larger institutions, such as the Bank (i.e., financial institutions with at least \$10 billion in assets), differentiates between such large financial institutions by use of a scorecard that combines a financial institution's Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity ("CAMELS") ratings with certain forward-looking financial information to measure the risk to the DIF. Pursuant to this scorecard method, two scores (a performance score and a loss severity score) are combined and converted to an initial base assessment rate (also referred to as IBAR). The performance score measures a financial institution's financial performance and ability to withstand stress. The loss severity score measures the relative magnitude of potential losses to the FDIC in the event of the financial institution's failure. Total scores are converted pursuant to a predetermined formula into an initial base assessment rate, which is subject to adjustment based upon significant risk factors not captured in the scoreboard. Total assessment rates range from 2.5 basis points to 45 basis points for such large financial institutions. Premiums for the Bank are calculated based upon the average balance of total assets minus average tangible equity as

of the close of business for each day during the calendar quarter. The new assessment calculation has increased the Bank's insurance premiums. For further information, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Interest Expense.

All FDIC-insured financial institutions must pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, which are referred to as FICO bonds, were issued to capitalize the Federal Savings and Loan Insurance Corporation, and the assessments will continue until the bonds mature in 2019.

#### Affiliate Transaction Restrictions

We are subject to the affiliate and insider transaction rules applicable to member banks of the Federal Reserve as well as additional limitations imposed by the OCC. These provisions prohibit or limit a banking institution from extending credit to, or entering into certain transactions with, affiliates, principal stockholders, directors and executive officers of the banking institution

and its affiliates. The Dodd-Frank Act imposed further restrictions on transactions with affiliates and extension of credit to executive officers, directors and principal stockholders that were effective as of July 21, 2012.

#### Incentive Compensation

In June 2010, the U.S. bank regulatory agencies issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of U.S. banks do not undermine the safety and soundness of such banks by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of a bank, either individually or as part of a group, is based upon the key principles that a bank's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the bank's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the bank's board of directors.

The U.S. bank regulatory agencies will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of U.S. banks that are not "large, complex banking organizations." These reviews will be tailored to each bank based on the scope and complexity of the bank's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the bank's supervisory ratings, which can affect the bank's ability to make acquisitions and take other actions. Enforcement actions may be taken against a bank if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the bank's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

#### Federal Reserve

Numerous regulations promulgated by the Federal Reserve affect the business operations of the Bank and us. These include regulations relating to electronic fund transfers, collection of checks, availability of funds, and cash reserve requirements.

#### Bank Secrecy Act

The BSA requires all financial institutions, including banks, to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. The BSA includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting), as well as due diligence/know-your-customer documentation requirements. The Bank has established a global anti-money laundering program in order to comply with BSA requirements.

#### USA Patriot Act of 2001

The USA Patriot Act of 2001 (the "Patriot Act"), which was enacted following the events of September 11, 2001, includes numerous provisions designed to detect and prevent international money laundering and to block terrorist access to the U.S. financial system. We have established policies and procedures intended to fully comply with the Patriot Act's provisions, as well as other aspects of anti-money laundering legislation and the BSA.

#### Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury's Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different

forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

#### Consumer Protection Laws and Regulations

The Bank is subject to many federal consumer protection statutes and regulations, the examination and enforcement of which has become more pronounced. Pursuant to the Dodd-Frank Act the CFPB has assumed the responsibility for the development

and enforcement of the federal consumer protection statutes and regulations, such as the Truth in Lending Act (the "TILA"), the Equal Credit Opportunity Act (the "ECOA"), the Real Estate Settlement Procedures Act ("RESPA") and the Truth in Saving Act. The Dodd-Frank Act gave the CFPB broad rule-making, supervisory and examination authority in this area over financial institutions, such as the Bank, that have assets of \$10 billion or more and expanded data collecting powers for fair lending purposes for both small business and mortgage loans and authority to prevent unfair, deceptive and abusive practices. The consumer complaint function of the OCC also has been transferred into the CFPB. The Dodd-Frank Act also narrows the scope of federal preemption of state laws related to federally chartered financial institutions, including savings banks such as the Bank.

**Predatory lending.** Federal regulations require additional disclosures and consumer protections to borrowers for certain lending practices, including predatory lending. The term "predatory lending," much like the terms "safety and soundness" and "unfair and deceptive practices," is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. Predatory lending typically involves at least one, and perhaps all three, of the following elements:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
- Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, also known as loan flipping; and/or
- Engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Many states also have predatory lending laws, and although the Bank may be exempt from those laws due to federal preemption, they do apply to the brokers and correspondents from whom we purchase loans and, therefore have an effect on our business and our sales of certain loans into the secondary market.

**GLBA.** The GLBA includes provisions that protect consumers from the unauthorized transfer and use of their non-public personal information by financial institutions. Privacy policies are required by federal banking regulations which limit the ability of banks and other financial institutions to disclose non-public personal information about consumers to non-affiliated third parties. Pursuant to those rules, financial institutions must provide:

- Initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public personal information to non-affiliated third parties and affiliates;
- Annual notices of their privacy policies to current customers; and
- A reasonable method for customers to "opt out" of disclosures to non-affiliated third parties.

These privacy protections affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. In addition, states are permitted under the GLBA to have their own privacy laws, which may offer greater protection to consumers than the GLBA. Numerous states in which the Bank does business have enacted such laws.

**FACT Act.** The Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act (the "FACT Act"), requires financial firms to help deter identity theft, including developing appropriate fraud response programs, and gives consumers more control of their credit data. It also reauthorizes a federal ban on state laws that interfere with corporate credit granting and marketing practices. In connection with the FACT Act, U.S. bank regulatory agencies proposed rules that would prohibit an institution from using certain information about a consumer it received from an affiliate to make a solicitation to the consumer, unless the consumer has been notified and given a chance to opt out of such solicitations. A consumer's election to opt out would be applicable for at least five years.

ECOA. The ECOA generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

TILA. The TILA is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things. In addition, the TILA also provides a variety of substantive protections for consumers.

FH Act. The Fair Housing Act (the "FH Act") regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered illegal, under the FH Act, including some that are not specifically mentioned in the FH Act itself.

HMDA. The Home Mortgage Disclosure Act (the "HMDA") grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes. In 2004, the Federal Reserve amended regulations issued under HMDA to require the reporting of certain pricing data with respect to higher-priced mortgage loans. This expanded reporting is being reviewed by U.S. bank regulatory agencies and others from a fair lending perspective.

RESPA. Lenders are required by RESPA to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Violations of RESPA may result in civil liability or administrative sanctions.

Enforcement actions under the above laws may include fines, reimbursements and other penalties. Due to heightened regulatory concern related to compliance with the FACT Act, ECOA, TILA, FH Act, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

#### Community Reinvestment Act

The Community Reinvestment Act ("CRA") requires the Bank to ascertain and help meet the credit needs of the communities it serves, including low- to moderate-income neighborhoods, while maintaining safe and sound banking practices. The primary banking agency assigns one of four possible ratings to an institution's CRA performance and is required to make public an institution's rating and written evaluation. The four possible ratings of meeting community credit needs are outstanding, satisfactory, needs to improve and substantial non-compliance. In 2009, the Bank received a "satisfactory" CRA rating from the OTS (as predecessor to the OCC) and this remains our current rating.

#### Regulatory Reform

On July 21, 2010, the Dodd-Frank Act was signed into law. This law has changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including us and the Bank. Various federal agencies have begun to adopt a broad range of rules and regulations and are given significant discretion in drafting these rules and regulations. Consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Pursuant to the Dodd-Frank Act, the OTS ceased to exist on July 21, 2011 and its functions were transferred to the OCC and the Federal Reserve. After the transfer, the Federal Reserve became our primary regulator and supervisor, and the OCC became the primary regulator and supervisor of the Bank. Except as described below, however, the laws and regulations applicable to us and the Bank did not generally change by virtue of the elimination of the OTS - the HOLA and the regulations issued under the Dodd-Frank Act do still apply (although these laws and regulations will be interpreted by the Federal Reserve and the OCC, respectively). The Dodd-Frank Act also transferred to the CFPB the responsibility for the development and enforcement of the federal consumer protection statutes and regulations, such as TILA, ECOA, RESPA and the Truth in Saving Act.

The Dodd-Frank Act contains a number of provisions intended to strengthen capital. For example, the bank regulatory agencies are directed to establish minimum leverage and risk-based capital that are at least as stringent as those currently in effect. In addition, we will be subject to consolidated capital requirements for the first time and will be required to serve as a source of strength to the Bank.

The Dodd-Frank Act also expands the affiliate transaction rules in Sections 23A and 23B of the Federal Reserve Act to broaden the definition of affiliate and to apply to securities lending, repurchase agreement and derivatives activities that the Bank may have with an affiliate, as well as to strengthen collateral requirements and limit Federal Reserve exemptive authority. Also, the definition of "extension of credit" for transactions with executive officers, directors and principal shareholders is expanded to include credit exposure arising from a derivative transaction, a repurchase or reverse repurchase agreement and a securities lending or borrowing transaction. These expansions became effective one year after the transfer date. These provisions did not have a material effect on us or the Bank.

The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments. In addition, the Federal Reserve adopted a rule addressing interchange fees applicable to debit card transactions which lowered fee income generated from this source. The reduced debit card fee income did not have a material impact on the Bank.

The Dodd-Frank Act requires the federal financial regulatory agencies to adopt rules that prohibit banks and affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds), with implementation starting in July 2012. The statutory provision is commonly called the "Volcker Rule." The proposed rules are highly complex, and many aspects of their application remain uncertain. Based on the proposed rules, we do not currently anticipate that the Volcker Rule will have a meaningful effect on our operations or those of our subsidiaries, as we do not materially engage in the businesses prohibited by the Volcker Rule. We may incur costs if required to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material. Until a final rule is adopted, the precise financial impact of the rule on us, our customers or the financial industry more generally, cannot be determined.

#### Regulatory Enforcement

Both the OCC and the FDIC may take regulatory enforcement actions against any of their regulated institutions, such as the Bank, that do not operate in accordance with applicable regulations, policies and directives. Proceedings may be instituted against any banking institution, or any "institution-affiliated party," such as a director, officer, employee, agent or controlling person, who engages in unsafe and unsound practices, including violations of applicable laws and regulations. Both the OCC and the FDIC have authority under various circumstances to appoint a receiver or conservator for an insured institution that it regulates, to issue cease and desist orders, to obtain injunctions restraining or prohibiting unsafe or unsound practices, to revalue assets and to require the establishment of reserves. The FDIC has additional authority to terminate insurance of accounts, after notice and hearing, upon a finding that the insured institution is or has engaged in any unsafe or unsound practice that has not been corrected, is operating in an unsafe or unsound condition or has violated any applicable law, regulation, rule, or order of, or condition imposed by, the FDIC. In addition, the Federal Reserve may take regulatory enforcement actions against us, and the CFPB has the authority to take regulatory enforcement actions against us or the Bank.

#### Federal Home Loan Bank System

The primary purpose of the Federal Home Loan Banks ("FHLBs") is to provide loans to their respective members, such as the Bank, in the form of collateralized advances for making housing loans as well as for affordable housing and community development lending. The FHLBs are generally able to make advances to their member institutions at interest rates that are lower than the members could otherwise obtain. The FHLB system consists of 12 regional FHLBs, each being federally chartered but privately owned by their respective member institutions. The Federal Housing Finance Agency, a government agency, is generally responsible for regulating the FHLB system. The Bank is currently a member of the FHLB of Indianapolis.

#### Environmental Regulation

Our business and properties are subject to federal and state laws and regulations governing environmental matters, including the regulation of hazardous substances and wastes. For example, under the federal Comprehensive Environmental Response, Compensation, and Liability Act, as amended, and similar state laws, owners and operators of contaminated properties may be liable for the costs of cleaning up hazardous substances without regard to whether such persons actually caused the contamination. Such laws may affect us both as an owner or former owner of properties used in or held for our business, and as a secured lender on property that is found to contain hazardous substances or wastes. Our general practice is to obtain an environmental assessment prior to foreclosing on commercial property. We may elect not to foreclose on properties that contain such hazardous substances or wastes, thereby limiting, and in some instances precluding, the liquidation of such properties.

## Competition

We face substantial competition in attracting deposits and making loans. Our most direct competition for deposits has historically come from other savings banks, commercial banks and credit unions in our local market areas. Money market funds and full-service securities brokerage firms also compete with us for deposits and, in recent years, many financial institutions have competed for deposits through the Internet. We compete for deposits by offering high quality and convenient banking services at a large number of convenient locations, including longer banking hours and "sit-down" banking in which a customer is served at a desk rather than in a teller line and offering a broad range of treasury management products. We may also compete by offering competitive interest rates on our deposit products.

From a lending perspective, there are a large number of institutions offering mortgage loans, consumer loans and commercial loans, including many mortgage lenders that operate on a national scale, as well as local savings banks, commercial banks, and other lenders. With respect to those products that we offer, we compete by offering competitive interest rates, fees, and other loan terms banking products and services and by offering efficient and rapid service.

## Additional Information

Our executive offices are located at 5151 Corporate Drive, Troy, Michigan 48098, and our telephone number is (248) 312-2000. Our stock is traded on the NYSE under the symbol "FBC."

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act available free of charge on our website at [www.flagstar.com](http://www.flagstar.com), under "Investor Relations," as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission (the "SEC"). These reports are also available without charge on the SEC website at [www.sec.gov](http://www.sec.gov).

## ITEM 1A. RISK FACTORS

Our financial condition and results of operations may be adversely affected by various factors, many of which are beyond our control. These risk factors include the following.

### Market, Interest Rate, Credit and Liquidity Risk

Our business has been and may continue to be adversely affected by conditions in the global financial markets and economic conditions generally.

The financial services industry has been materially and adversely affected by significant declines in the values of nearly all asset classes and by a significant and prolonged period of negative economic conditions. This was initially triggered by declines in the values of subprime mortgages, but spread to virtually all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes. The U.S. economy has continued to be adversely affected by these events as shown by high unemployment across most industries, and high delinquencies and defaults on loans. There is also evidence of "strategic defaults" on loans, which are characterized by borrowers that appear to have the financial means to satisfy the required loan payments as they come due but choose not to do so because the value of the assets securing their debts (such as the value of a house securing a residential mortgage) may have declined below the amount of the debt itself. Further, there are several states, such as California, in which many residential mortgages are effectively non-recourse in nature or in which statutes or regulations cause collection efforts to be unduly difficult or expensive to pursue. There are also a multitude of commercial real estate loans throughout the United States that are soon to mature, and declines in commercial real estate values nationwide could prevent refinancing of the debt and thereby result in an increase in delinquencies, foreclosures and non-performing loans, as well as further reductions in asset values. The decline in asset values to date has resulted in considerable losses to secured lenders, such as the Bank, that historically have been able to rely on the underlying collateral value of their loans to be minimize or eliminate losses. There can be no assurance that property values will stabilize or improve and if they continue to decline, there can be no assurance that the Bank will not continue to incur significant credit losses.

Prior market conditions have also led to the failure or merger of a number of the largest financial institutions in the United States and global marketplaces and could recur. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under bilateral derivatives and other contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to increase swap spreads, cause rating agencies to lower credit ratings, and otherwise increase the cost and decrease the availability of liquidity, despite very significant declines in central bank borrowing rates and other government actions. Banks and other lenders have suffered significant losses and often have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of

collateral.

While there have been moderate improvements during 2012 in a number of macroeconomic factors which impact our business, near term concerns remain over unemployment, the U.S. mortgage market, depressed real estate values, access to credit and liquidity markets, energy costs, and global political issues such as sovereign debt defaults. There can be no assurance that the current economic downturn will improve, and as a result, our results of operations could continue to be adversely affected.

If we cannot effectively manage the impact of the volatility of interest rates our earnings could be adversely affected.

Our main objective in managing interest rate risk is to maximize the benefit and minimize the adverse effect of changes in interest rates on our earnings over an extended period of time. In managing these risks, we look at, among other things, yield curves and hedging strategies. As such, our interest rate risk management strategies may result in significant earnings volatility in

the short term because the market value of our assets and related hedges may be significantly impacted either positively or negatively by unanticipated variations in interest rates. In particular, our portfolio of MSRs and our mortgage pipeline are highly sensitive to movements in interest rates, and hedging activities related to the portfolio.

Our profitability depends in substantial part on our net interest margin, which is the difference between the rates we receive on loans made to others and investments and the rates we pay for deposits and other sources of funds. Our profitability also depends in substantial part on the volume of loan originations and the related fees received from our Mortgage Banking segment. Our net interest margin and our volume of mortgage originations will depend on many factors that are partly or entirely outside our control, including competition, federal economic, monetary and fiscal policies, and global and domestic economic conditions generally. Historically, net interest margin and the mortgage origination volumes for the Bank and for other financial institutions have widened and narrowed in response to these and other factors. Also, our volume of mortgage originations will also depend on the mortgage qualification standards imposed by the GSEs, such that if their standards are tightened, our origination volume could be reduced. Our goal has been to structure our asset and liability management strategies to maximize the benefit of changes in market interest rates on our net interest margin and revenues related to mortgage origination volume. However, a sudden or significant change in prevailing interest rates may have a material adverse effect on our operating results.

Increasing long-term interest rates may decrease our mortgage loan originations and sales. Generally, the volume of mortgage loan originations is inversely related to the level of long-term interest rates. During periods of low long-term interest rates, a significant number of our customers may elect to refinance their mortgages (i.e., pay off their existing higher rate mortgage loans with new mortgage loans obtained at lower interest rates). Our profitability levels and those of others in the mortgage industry have generally been strongest during periods of low and/or declining interest rates, as we have historically been able to sell the resulting increased volume of loans into the secondary market at a gain. During 2012 and 2011, the interest rate environment was quite favorable for mortgage loan originations, particularly refinancing activity, in large part due to government intervention through the purchase of mortgage-backed securities and other federal monetary policies and heightened global demand for investment in U.S. Treasury obligations, all of which facilitated a low-rate interest rate environment for the residential mortgage market. In addition, there were wide spreads between short and long term interest rates for much of 2012, resulting in higher profit margins on loan sales than in prior periods. There is no guarantee that these conditions will persist, and a change in these conditions could have a material adverse effect on our operating results.

When interest rates fluctuate, repricing risks arise from the timing difference in the maturity and/or repricing of assets, liabilities and off-balance sheet positions. While such repricing mismatches are fundamental to our business, they can expose us to fluctuations in income and economic value as interest rates vary. Our interest rate risk management strategies do not completely eliminate repricing risk.

A significant number of our depositors are believed to be rate sensitive. Because of the interest rate sensitivity of these depositors, there is no guarantee that in a changing interest rate environment we will be able to retain all funds in these accounts.

Current and further deterioration in the housing and commercial real estate markets may lead to increased loss severities and further increases in past due loans and non-performing assets in our loan portfolios. Consequently, our allowance for loan losses may not be adequate to cover actual losses, and we may be required to materially increase reserves.

A good portion of our loans held-for-investment portfolio is comprised of loans collateralized by real estate in which we are in the first lien position. A significant source of risk arises from the possibility that we could sustain losses because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The underwriting and credit monitoring policies and procedures that we have adopted to address this risk may not prevent

unexpected losses that could have an adverse effect on our business, financial condition, results of operations, cash flows and prospects. Unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond our ability to predict, influence or control.

As with most lending institutions, we maintain an allowance for loan losses to provide for probable and inherent losses in our loans held for our investment portfolio. Our allowance for loan losses may not be adequate to cover actual credit losses, and future provisions for credit losses could adversely affect our business, financial condition, results of operations, cash flows and prospects. The allowance for loan losses reflects management's estimate of the probable and inherent losses in our portfolio of held-for-investment loans at the relevant statement of financial condition date. Our allowance for loan losses is based on prior experience as well as an evaluation of the risks in the current portfolio, composition and maintaining our current revenue pace of the portfolio and economic factors. The determination of an appropriate level of loan loss allowance is an inherently subjective process that requires significant management judgment and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond our control and these losses may exceed current estimates.

Moreover, our regulators, as part of their supervisory function, periodically review our allowance for loan losses. Our regulators may require us to increase our allowance for loan losses or to recognize further losses, based on their judgment, which may be different from that of our management. The results of such reviews may have an adverse effect on our earnings and financial condition.

The housing and the residential mortgage markets have continued to experience a variety of difficulties and changed economic conditions. If market conditions remain poor or further deteriorate, they may lead to additional valuation adjustments on loan portfolios and real estate owned as we continue to reassess the fair value of our non-performing assets, the loss severities of loans in default, and the fair value of real estate owned. We may also realize additional losses in connection with our disposition of non-performing assets. Poor economic conditions could result in decreased demand for residential housing, which, in turn, could adversely affect the value of residential properties. A sustained weak economy could also result in higher levels of non-performing loans in other categories, such as commercial loans, which may result in additional losses. Management continually monitors market conditions and economic factors throughout our footprint for indications of change in other markets. If these economic conditions and market factors negatively and/or disproportionately affect our loans, then we could see a sharp increase in our total net-charge offs and also be required to significantly increase allowance for loan losses. Any further increase in our non-performing assets and related increases in our provision expense for losses on loans could negatively affect our business and could have a material adverse effect on our capital, financial condition and results of operations.

Changes in the fair value of our securities may reduce our stockholders' equity, net earnings, or regulatory capital ratios.

At December 31, 2012, we had \$184.4 million of securities classified as available-for-sale. The estimated fair value of available-for-sale securities portfolio may increase or decrease depending on market conditions. Our securities portfolio is comprised primarily of fixed rate securities. We increase or decrease stockholders' equity by the amount of the change in the unrealized gain or loss (difference between the estimated fair value and the amortized cost) of available-for-sale securities portfolio, net of the related tax benefit, under the category of accumulated other comprehensive income (loss). Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders' equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold, the decrease may be recovered over the life of the securities.

We conduct a periodic review and evaluation of the securities portfolio to determine if the decline in the fair value of any security below its cost basis is other-than-temporary. Factors which are considered in the analysis include, but are not limited to, the severity and duration of the decline in fair value of the security, the financial condition and near-term prospects of the issuer, whether the decline appears to be related to issuer conditions or general market or industry conditions, intent and ability to retain the security for a period of time sufficient to allow for any anticipated recovery in fair value and the likelihood of any near-term fair value recovery. Generally these changes in fair value caused by changes in interest rates are viewed as temporary, which is consistent with experience. If we deem such decline to be other-than-temporary related to credit losses, the security is written down to a new cost basis and the resulting loss is charged to earnings as a component of non-interest income.

In the past, we recorded other than temporary impairment ("OTTI") charges. Our securities portfolio is monitored as part of ongoing OTTI evaluation process. No assurance can be given that we will not need to recognize OTTI charges related to securities in the future.

The capital that the Bank is required to hold for regulatory purposes is impacted by, among other things, the securities ratings. Therefore, ratings downgrades on our securities may have a material adverse effect on our risk-based

regulatory capital ratios.

Certain hedging strategies that we use to manage investment in MSRs may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rates and market liquidity.

We invest in MSRs to support mortgage strategies and to deploy capital at acceptable returns. We also deploy derivatives and other fair value assets as economic hedges to offset changes in fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. The primary risk associated with MSRs is that they will lose a substantial portion of their value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. There is also a risk of valuation decline due to higher than expected increases in default rates, but we do not believe such risk can be sufficiently quantified to effectively hedge. Our hedging strategies are highly susceptible to prepayment risk, basis risk, market volatility, and changes in the shape of the yield curve, among other factors.

In addition, hedging strategies rely on assumptions and projections regarding assets and general market factors. If one or more of these assumptions and projections prove to be incorrect or our hedging strategies do not adequately mitigate the impact of changes in interest rates or prepayment speeds, we may incur losses that would adversely impact earnings.

Our ability to borrow funds, maintain or increase deposits or raise capital could be limited, which could adversely affect our liquidity and earnings.

Our access to external sources of financing, including deposits, as well as the cost of that financing, is dependent on various factors including regulatory restrictions. A number of factors could make funding more difficult, more expensive or unavailable on any terms, including, but not limited to, further reductions in debt ratings, financial results and losses, changes within the organization, specific events that adversely impact reputation, disruptions in the capital markets, specific events that adversely impact the financial services industry, counterparty availability, changes affecting assets, the corporate and regulatory structure, interest rate fluctuations, general economic conditions and the legal, regulatory, accounting and tax environments governing funding transactions. Many of these factors depend upon market perceptions of events that are beyond our control, such as the failure of other banks or financial institutions. Other factors are dependent upon results of operations, including but not limited to material changes in operating margins; earnings trends and volatility; funding and liquidity management practices; financial leverage on an absolute basis or relative to peers; the composition of the Consolidated Statements of Financial Condition and/or capital structure; geographic and business diversification; and our market share and competitive position in the operating segments. The material deterioration in any one or a combination of these factors could result in a downgrade of our credit or servicer standing with counterparties or a decline in our financial reputation within the marketplace and could result in our having a limited ability to borrow funds, maintain or increase deposits (including custodial deposits for our agency servicing portfolio) or to raise capital. Also, we compete for funding with other banks and similar companies, many of which are substantially larger, and have more capital and other resources than we do. In addition, as some of these competitors consolidate with other financial institutions, these advantages may increase. Competition from these institutions may increase our cost of funds.

Our ability to make mortgage loans and fund our investments and operations depends largely on our ability to secure funds on terms acceptable to us. Our primary sources of funds to meet our financing needs include loan sales and securitizations; deposits, which include custodial accounts from our servicing portfolio and brokered deposits and public funds; borrowings from the FHLB or other federally backed entities; borrowings from investment and commercial banks through repurchase agreements; and capital-raising activities. If we are unable to maintain any of these financing arrangements, are restricted from accessing certain of these funding sources by our regulators, are unable to arrange for new financing on terms acceptable to us, or if we default on any of the covenants imposed upon us by our borrowing facilities, then we may have to reduce the number of loans we are able to originate for sale in the secondary market or for our own investment or take other actions that could have other negative effects on our operations. A sudden and significant reduction in loan originations that occurs as a result could adversely impact our earnings, financial condition, results of operations and future prospects. There is no guarantee that we will be able to renew or maintain our financing arrangements or deposits or that we will be able to adequately access capital markets when or if a need for additional capital arises.

Defaults by another larger financial institution could adversely affect financial markets generally.

The commercial soundness of many financial institutions may be closely interrelated as a result of credit or other relationships between and among institutions. As a result, concerns about, or a default or threatened default by, one institution could lead to significant market-wide liquidity and credit problems, losses or defaults by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as banks with which we interact on a daily basis, and therefore could adversely affect us.

We may be required to raise capital at terms that are materially adverse to stockholders.

During past years, capital was raised at terms that were significantly dilutive to the stockholders. There can be no assurance that we will not suffer additional losses or that additional capital will not otherwise be required for regulatory or other reasons. In those circumstances, we may be required to obtain additional capital to maintain regulatory capital ratios at or above their current levels. Such capital raising could be at terms that are dilutive to existing stockholders and there can be no assurance that any capital raising undertaken would be successful.

## Regulatory Risk

Our business is highly regulated and the regulations applicable to us are subject to change.

The banking industry is extensively regulated at the federal and state levels. Insured financial institutions and their holding companies are subject to comprehensive regulation and supervision by financial regulatory authorities covering all aspects of their organization, management and operations. Currently, the Bank is subject to supervision and regulation by the OCC, the FDIC and the CFPB. In addition, the Federal Reserve is responsible for supervising and regulating all savings and loan holding companies that were formerly regulated by the OTS, including us. The Federal Reserve is also authorized to impose capital requirements on savings and loan holding companies and subject such companies to new and potentially heightened examination and reporting requirements. Savings and loan holding companies, including us, are also required to serve as a source of financial strength to their financial institution subsidiaries. The OCC is the primary regulator of the Bank and its affiliated entities. In addition to its regulatory powers, the OCC has significant enforcement authority that it can use to address banking practices that it believes to be unsafe and unsound, violations of laws, and capital and operational deficiencies. The FDIC also has significant regulatory authority over the Bank and may impose further regulation at its discretion for the protection of the DIF. Such regulation and supervision are intended primarily for the protection of the DIF and for the Bank's depositors and borrowers, and are not intended to protect the interests of investors in our securities. The CFPB is responsible for enforcement of the principal federal consumer protection laws over institutions that have assets of \$10 billion or more, such as the Bank.

Further, the Bank's business is affected by consumer protection laws and regulation at the state and federal level, including a variety of consumer protection provisions, many of which provide for a private right of action and pose a risk of class action lawsuits. In the current environment, there have been, and will likely be, significant changes to the banking and financial institutions regulatory regime in light of recent government intervention in the financial services industry, and it is not possible to predict the impact of all such changes on our results of operations. Changes to, or in the interpretation or implementation of, statutes, regulations or policies, heightened regulatory scrutiny, requirements or expectations, implementation of new government programs and plans, and changes to judicial interpretations of statutes or regulations could affect us in substantial and unpredictable ways. For example, regulators' views of capital adequacy has been evolving since the economic recession. As a result, while we have historically operated at lower Tier 1 capital levels, we are currently operating at a Tier 1 capital ratio of greater than 9 percent and do not currently intend to operate at lower Tier 1 capital levels in the future. Among other things, such changes, as well as the implementation of such changes, could result in unintended consequences and could subject us to additional costs, constrain our resources, limit the types of financial services and products that we may offer, increase the ability of non-banks to offer competing financial services and products, and/or reduce our ability to effectively hedge against risk.

The Bank has entered into a Consent Order with the OCC, which requires the Bank to adopt or review and revise various plans, policies and procedures related to, among other things, regulatory capital, enterprise risk management and liquidity. While subject to the Consent Order, the Bank's management and board of directors will be required to focus a substantial amount of time on complying with its terms, which could adversely affect our financial performance. Non-compliance with the Consent Order may lead to additional corrective actions by the OCC which could negatively impact our operations and financial performance.

Effective October 23, 2012, the Bank entered into a Consent Order with the OCC. Under the Consent Order, the Bank is required to adopt or review and revise various plans, policies and procedures related to, among other things, regulatory capital, enterprise risk management and liquidity. Specifically, under the terms of the Consent Order, the Bank's board of directors has agreed to, among other things, take the following actions:

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Review, revise, and forward to the OCC a written capital plan for the Bank covering at least a three-year period and establishing projections for the Bank's overall risk profile, earnings performance, growth expectations, balance sheet mix, off-balance sheet activities, liability and funding structure, capital and liquidity adequacy, as well as a contingency capital funding process and plan that identifies alternative capital sources should the primary sources not be available;

Adopt and forward to the OCC a comprehensive written liquidity risk management policy that systematically requires the Bank to reduce liquidity risk; and

Develop, adopt, and forward to the OCC a written enterprise risk management program that is designed to ensure that the Bank effectively identifies, monitors, and controls its enterprise-wide risks, including by developing risk limits for each line of business.

The Bank has submitted or will submit these plans, policies and procedures to the OCC for a written determination that the OCC has no supervisory objection to them. Upon the Bank's receipt of no supervisory objection from the OCC, the Consent Order requires the Bank to implement and ensure adherence to the plans, policies and procedures.

While subject to the Consent Order, the Bank's management and Board of Directors will be required to focus a substantial amount of time on complying with its terms, which could adversely affect our financial performance. There is also no guarantee that the Bank will be able to fully comply with the Consent Order. In the event the Bank is in material non-compliance with the terms of the Consent Order, the OCC has the authority to subject the Bank to additional corrective actions. In particular, if the Bank fails to submit a written capital plan within a time period acceptable to the OCC, or fails to implement a written capital plan for which the OCC has provided a written determination of no supervisory objection, then at the sole discretion of the OCC, the Bank may be deemed undercapitalized for purposes of the Consent Order. If the OCC determines that the Bank is undercapitalized for purposes of the Consent Order, it may at its discretion impose additional certain corrective actions on the Bank's operations that are applicable to undercapitalized institutions. These corrective actions could negatively impact the Bank's operations and financial performance.

We remain subject to the restrictions and conditions of the Supervisory Agreement. Failure to comply with the Supervisory Agreement could result in further enforcement action against us, which could negatively affect our results of operations and financial condition.

We remain subject to the Supervisory Agreement, which requires that we take certain actions to address issues identified by the OTS. The Supervisory Agreement is enforced by the Federal Reserve as a successor regulator to the OTS. While we believe that we have taken numerous steps to comply with, and intend to comply in the future with, the requirements of the Supervisory Agreement, failure to comply with the Supervisory Agreement in the time frames provided, or at all, could result in additional enforcement orders or penalties from our regulators, which could include further restrictions on us, assessment of civil money penalties on us, as well as our directors, officers and other affiliated parties and removal of one or more officers and/or directors. Such actions, if initiated, could have a material adverse effect on our operating results and liquidity.

Financial services reform legislation has resulted in, among other things, numerous restrictions and requirements which could negatively impact our business and increase our costs of operations.

The Dodd-Frank Act was signed into law on July 21, 2010 and has significantly changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. As a result, various federal agencies were required to adopt a broad range of new implementation rules and regulations and are given significant discretion in drafting the implementation rules and regulations. Consequently, it is difficult to predict the ultimate impact of Dodd-Frank Act on us or the Bank, including the extent to which it could increase costs or limit our ability to pursue business opportunities in an efficient manner, or otherwise adversely affect our business, financial condition and results of operations. Nor can we predict the impact or substance of other future legislation or regulation. However, it is expected that at a minimum they will increase our operating and compliance costs and potentially our interest expense. Moreover, the Dodd-Frank Act did not address reform of the GSEs. While options for the reform of the GSEs have been released no specific reform proposal has been enacted. The results of any such reform, and its effect on us, are difficult to predict and may result in unintended consequences.

Increases in deposit insurance premiums and special FDIC assessments will adversely affect our earnings.

Since late 2008, the economic environment has caused higher levels of bank failures, which dramatically increased FDIC resolution costs and led to a significant reduction in the DIF. As a result, we were required to pay higher deposit insurance premiums and special assessments that adversely affect our earnings. In addition, the Dodd-Frank Act required the FDIC to substantially revise its regulations for determining the amount of an institution's deposit insurance premiums. The Dodd-Frank Act also made changes, among other things, to the minimum designated reserve

ratio of the DIF, increasing the minimum from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to financial institutions when the reserve ratio exceeds certain thresholds. The FDIC has established a higher reserve ratio of 2% as a long-term goal beyond what is required by statute. Effective April 1, 2011, the FDIC implemented a new assessment rate schedule, which included changing the deposit insurance assessment base to an amount equal to the insured institution's average consolidated total assets during the assessment period minus average tangible equity and requiring the use of a scorecard that combines CAMELS ratings with certain forward looking information. These changes resulted in increases to our FDIC deposit insurance premiums, and we could be subject to higher deposit insurance premiums and special assessments in the future that could adversely affect our earnings.

We are subject to heightened regulatory scrutiny with respect to bank secrecy and anti-money laundering statutes and regulations.

In recent years, regulators have intensified their focus on bank secrecy and anti-money laundering, statutes, regulations and compliance requirements, as well as compliance with the rules enforced by OFAC, and we have been required to revise policies and procedures and install new systems in order to comply with regulations, guidelines and examination procedures in this area. More recently, the Bank agreed in the Consent Order to review and revise the Bank's bank secrecy and anti-money laundering risk assessment and written program of policies and procedures adopted in accordance with the Bank Secrecy Act and update the status of the Bank's plan and timeline for the implementation of enhanced bank secrecy and anti-money laundering internal controls. We cannot be certain that the policies, procedures and systems we have in place or may in the future put in place are or will be successful. Therefore, there is no assurance that in every instance we are and will be in full compliance with these requirements or the Consent Order.

We may incur fines, penalties and other negative consequences from regulatory violations, possibly even for inadvertent or unintentional violations.

We maintain systems and procedures designed to ensure that we comply with applicable laws and regulations. However, some legal and regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there was in place at the time systems and procedures designed to ensure compliance. For example, we are subject to regulations issued by OFAC that prohibit financial institutions from participating in the transfer of property belonging to the governments of certain foreign countries and designated nationals of those countries. OFAC may impose penalties for inadvertent or unintentional violations even if reasonable processes are in place to prevent the violations. There may be other negative consequences resulting from a finding of noncompliance, including restrictions on certain activities. Such a finding may also damage our reputation as described below and could restrict the ability of institutional investment managers to invest in our securities.

The impact of the new Basel III capital standards is uncertain.

In December 2010, the Basel Committee issued its framework for strengthening capital and liquidity requirements (together, "Basel III"). Basel III imposes, if implemented by U.S. bank regulatory agencies, new minimum capital requirements on banking institutions, as well as a capital conservation buffer and, if applicable, a countercyclical capital buffer that can be used by banks to absorb losses during periods of financial and economic stress. In addition, Basel III limits the inclusion of MSRs and deferred tax assets to 10 percent of Common Equity Tier 1 (as defined in the Basel III final framework, "CET1"), individually, and 15 percent of CET1, in the aggregate. Our MSRs and deferred tax assets currently significantly exceed the limit, and there is no assurance that they will be includable in CET1 in the future. Basel III also proposes minimum liquidity measures.

In June 2012, the U.S. bank regulatory agencies requested comment on three sets of proposed rules that implement the Basel III capital framework and also make other changes to U.S. regulatory capital standards for banking institutions, which rules were to become effective under a phase-in period beginning January 1, 2013. However, the U.S. bank regulatory agencies announced on November 9, 2012 that the implementations of the proposed Basel III rules would be delayed. In addition, the Basel Committee is considering further amendments to Basel III. Accordingly, the regulations ultimately applicable to us may be substantially different from the Basel III final framework as published in December 2010 and the rules proposed by the U.S. bank regulatory agencies in June 2012, but may result in higher capital and liquidity requirements which could have an adverse effect on our results of operations and financial condition.

We may not be able to resume making future payments of dividends on our capital stock and interest on trust preferred securities.

In early 2012, we provided notice to the U.S. Treasury exercising our contractual right to defer our regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with our participation in the TARP Capital Purchase Program. We also exercised our contractual right to defer interest payments with respect to our trust preferred securities. As a result of such deferrals, we are prohibited from making dividend payments on our capital stock, because the terms of the preferred stock and the trust preferred securities prohibit dividend payments and repurchases or redemptions of certain equity securities until all accrued and unpaid dividends and interest are paid, subject to limited exceptions. There can be no assurances that we will be able to resume making these dividend and interest payments in the future, and our inability to do so after a number of quarters may cause us to default on those obligations.

In addition, our ability to make dividend payments is subject to the limitations set forth in the Supervisory Agreement, which provides that we must receive the prior written non-objection of the Federal Reserve in order to pay dividends, and to the

receipt of dividends from the Bank, which are restricted by the Consent Order. Also, under Michigan law, we are prohibited from paying dividends on our capital stock if, after giving effect to the dividend, (i) we would not be able to pay our debts as they become due in the usual course of business or (ii) our total assets would be less than the sum of our total liabilities plus the preferential rights upon dissolution of stockholders with preferential rights on dissolution which are superior to those receiving the dividend.

#### Operational Risk

We have restructured our executive team, and our ability to execute our revised business strategy may not prove successful.

Many of our executive officers are serving in new capacities, and several of our directors have been appointed to the board of directors for a relatively short period of time. Since the restructuring, which began on October 1, 2012 and continued through the fourth quarter 2012, the executive team has devoted substantial efforts to significantly change our business strategy and operational activities. There is no assurance that these efforts will prove successful or that the executive team will be able to successfully execute upon the revised business strategy and operational activities.

We depend on our institutional counterparties to provide services that are critical to our business. If one or more of our institutional counterparties defaults on its obligations to us or becomes insolvent, it could have a material adverse affect on our earnings, liquidity, capital position and financial condition.

We face the risk that one or more of our institutional counterparties may fail to fulfill their contractual obligations to us. We believe that our primary exposures to institutional counterparty risk are with third-party providers of credit enhancement on the mortgage assets that we hold in our investment portfolio, including mortgage insurers and financial guarantors, issuers of securities held on our Consolidated Statements of Financial Condition, and derivatives counterparties. Counterparty risk can also adversely affect our ability to acquire, sell or hold MSRs in the future. For example, because MSRs are a contractual right, we may be required to sell the MSRs to counterparties. The challenging mortgage and credit market conditions have adversely affected, and will likely continue to adversely affect, the liquidity and financial condition of a number of our institutional counterparties, particularly those whose businesses are concentrated in the mortgage industry. One or more of these institutions may default in its obligations to us for a number of reasons, such as changes in financial condition that affect their credit ratings, a reduction in liquidity, operational failures or insolvency. Several of our institutional counterparties have experienced economic hardships and liquidity constraints. These and other key institutional counterparties may become subject to serious liquidity problems that, either temporarily or permanently, negatively affect the viability of their business plans or reduce their access to funding sources. The financial difficulties that a number of our institutional counterparties are currently experiencing may negatively affect the ability of these counterparties to meet their obligations to us and the amount or quality of the products or services they provide to us. A default by a counterparty with significant obligations to us could result in significant financial losses to us and could have a material adverse effect our ability to conduct our operations, which would adversely affect our earnings, liquidity, capital position and financial condition. In addition, a default by a counterparty may require us to obtain a substitute counterparty which may not exist in this economic climate and which may, as a result, cause us to default on our related financial obligations.

Current and further deterioration in the housing market, as well as the number of programs that have been introduced to address the situation by government agencies and government sponsored enterprises, may lead to increased costs to service loans which could affect our margins or impair the value of our MSRs.

The housing and the residential mortgage markets have experienced a variety of difficulties and changed economic conditions. In response, federal and state government, as well as the GSEs, have developed a number of programs and instituted a number of requirements on servicers in an effort to limit foreclosures and, in the case of the GSEs, to

minimize losses on loans that they guarantee or own. These additional programs and requirements may increase operating expenses or otherwise change the costs associated with servicing loans for others, which may result in lower margins or impairment in the expected value of our MSR's.

We may be terminated as a servicer or master servicer, be required to repurchase a mortgage loan or reimburse investors for credit losses on a mortgage loan, or incur costs, liabilities, fines and other sanctions if we fail to satisfy our servicing obligations, including our obligations with respect to mortgage loan foreclosure actions.

We act as servicer for mortgage loans owned by third parties. As a servicer for those loans we have certain contractual obligations, including foreclosing on defaulted mortgage loans or, to the extent applicable, considering alternatives to foreclosure such as loan modifications or short sales. If we commit a material breach of our obligations as servicer, we may be subject to termination if the breach is not cured within a specified period of time following notice, causing us to lose servicing income.

For certain investors and/or certain transactions, we may be contractually obligated to repurchase a mortgage loan or reimburse the investor for credit losses incurred on the loan as a remedy for servicing errors with respect to the loan. If we have increased repurchase obligations because of claims that we did not satisfy our obligations as a servicer, or increased loss severity on such repurchases, we may have a significant reduction to net servicing income within our mortgage banking noninterest income. We may incur costs if we are required to, or if we elect to, re-execute or re-file documents or take other action in our capacity as a servicer in connection with pending or completed foreclosures. We may incur litigation costs if the validity of a foreclosure action is challenged by a borrower. If a court were to overturn a foreclosure because of errors or deficiencies in the foreclosure process, we may have liability to the borrower and/or to any title insurer of the property sold in foreclosure if the required process was not followed. These costs and liabilities may not be legally or otherwise reimbursable to us. In addition, if certain documents required for a foreclosure action are missing or defective, we could be obligated to cure the defect or repurchase the loan. We may incur liability to securitization investors relating to delays or deficiencies in our processing of mortgage assignments or other documents necessary to comply with state law governing foreclosures. The fair value of our MSRs may be negatively affected to the extent our servicing costs increase because of higher foreclosure costs. We may be subject to fines and other sanctions imposed by Federal or state regulators as a result of actual or perceived deficiencies in our foreclosure practices or in the foreclosure practices of other mortgage loan servicers. Any of these actions may harm our reputation or negatively affect our home lending or servicing business.

We use estimates in determining the fair value of certain of our assets and liabilities, which estimates may prove to be incorrect and result in significant declines or increases in valuation.

A portion of our assets and liabilities are carried on our Consolidated Statements of Financial Condition at fair value, including our MSRs, certain mortgage loans held-for-sale, trading assets, available-for-sale securities, derivatives, the future obligations arising from our settlement with the DOJ, and transferors' interests, or the beneficial interests in the HELOC securitization trusts that we receive in exchange for the funds we are obligated to advance to pay for subsequent additional draws on the lines of credit during a rapid amortization period. Generally, for assets that are reported at fair value, we use quoted market prices, when available or internal valuation models that utilize observable market data inputs to estimate their fair value. In certain cases, observable market prices and data may not be readily available or their availability may be diminished due to market conditions. We use financial models to value certain of these assets and liabilities. These models are complex and use asset specific collateral data and market inputs for interest rates. We cannot assure you that the models or the underlying assumptions will prove to be predictive and remain so over time, and therefore, actual results may differ from our models. Any assumptions we use are complex as we must make judgments about the effect of matters that are inherently uncertain and actual experience may differ from our assumptions. Different assumptions could result in significant declines in valuation, which in turn could result in significant declines or increases in the dollar amount of assets or increases in the liabilities we report on our Consolidated Statements of Financial Condition.

We may be required to repurchase mortgage loans or indemnify buyers against losses in some circumstances, which could harm liquidity, results of operations and financial condition.

When mortgage loans are sold, whether as whole loans or pursuant to a securitization, we are required to make customary representations and warranties to purchasers, guarantors and insurers, including the GSEs, about the mortgage loans and the manner in which they were originated. Whole loan sale agreements require repurchase or substitute mortgage loans, or indemnify buyers against losses, in the event we breach these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of early payment default of the borrower on a mortgage loan. With respect to loans that are originated through our broker or correspondent channels, the remedies available against the originating broker or correspondent, if any, may not be as broad as the remedies available to a purchasers, guarantors and insurers of mortgage loans against us. In addition, we also face further risk

that the originating broker or correspondent, if any, may not have financial capacity to perform remedies that otherwise may be available. Therefore, if a purchaser, guarantor or insurer enforces its remedies against us, we may not be able to recover losses from the originating broker or correspondent. If repurchase and indemnity demands increase and such demands are valid claims, the liquidity, results of operations and financial condition may be adversely affected.

Our representation and warranty reserve for losses could be insufficient.

We currently maintain a representation and warranty reserve, formerly known as the secondary market reserve, which is a liability on the Consolidated Statements of Financial Condition, to reflect best estimate of expected losses that have been incurred on loans that we have sold or securitized into the secondary market, including to the securitized trusts in our private-label securitizations and must subsequently repurchase or with respect to which we must indemnify the purchasers and insurers because of violations of customary representations and warranties. Our representation and warranty reserve takes into account both our

estimate of expected losses on loans sold during the current accounting period, as well as adjustments to our previous estimates of expected losses on loans sold, and may, based upon a number of factors, include the recent decision in our litigation with Assured. In addition, the OCC, as part of its supervisory function, periodically reviews our representation and warranty reserve. The OCC may require us to increase our representation and warranty reserve or to recognize further losses, based on its judgment, which may be different from that of our management. The results of such reviews could have an effect on the Bank's reserves. In each case, these estimates are based on our most recent data regarding loan repurchases, and actual credit losses on repurchased loans. We also make increases to the representation and warranty reserve based on current loan sales which reduces our net gain on loan sales. Adjustments to our previous estimates are recorded as an increase or decrease in our representation and warranty reserve – change in estimate. Both the assumptions and estimates used could be inaccurate, resulting in a level of reserve that is less than actual losses. If additional reserves are required, it could have an adverse effect on our financial condition and results of operations.

Our Mortgage Banking profitability could be significantly reduced if we are not able to originate and resell a high volume of mortgage loans.

Mortgage production, especially refinancing activity, declines in rising interest rate environments. While we have been experiencing historically low interest rates, the low interest rate environment likely will not continue indefinitely. When interest rates increase, there can be no assurance that our mortgage production will continue at current levels. Because we sell a substantial portion of the mortgage loans we originate, the profitability of our Mortgage Banking segment depends in large part upon our ability to aggregate a high volume of loans and sell them in the secondary market at a gain. Thus, in addition to our dependence on the interest rate environment, we are dependent upon (i) the existence of an active secondary market and (ii) our ability to profitably sell loans or securities into that market. If our level of mortgage production declines, the profitability will depend upon our ability to reduce our costs commensurate with the reduction of revenue from our mortgage operations.

Our ability to originate and sell mortgage loans readily is dependent upon the availability of an active secondary market for single-family mortgage loans, which in turn depends in part upon the continuation of programs currently offered by the GSEs and other institutional and non-institutional investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are government-sponsored enterprises whose activities are governed by federal law, any future changes in laws that significantly affect the activity of the GSEs could, in turn, adversely affect our operations. In September 2008, the GSEs were placed into conservatorship by the U.S. government. Although to date, the conservatorship has not had a significant or adverse effect on our operations; it is currently unclear whether further changes would significantly and adversely affect our operations. The government and others have provided options to reform the GSEs, but the results of any such reform, and their impact on us, are difficult to predict. To date, no reform proposal has been enacted. In addition, our ability to sell mortgage loans readily is dependent upon our ability to remain eligible for the programs offered by the GSEs and other institutional and non-institutional investors. Our ability to remain eligible to originate and securitize government insured loans may also depend on having an acceptable peer-relative delinquency ratio for FHA loans and maintaining a delinquency rate with respect to Ginnie Mae pools that are below Ginnie Mae guidelines. In the case of Ginnie Mae pools, the Bank has repurchased past due loans to maintain compliance with the minimum required delinquency ratios. Although these loans are typically insured as to principal by FHA, such repurchases increase our liquidity needs, and there can be no assurance that we will have sufficient liquidity to continue to purchase such loans out of the Ginnie Mae pools. In addition, due to our unilateral ability to repurchase such loans out of the Ginnie Mae pools, we are required to account for them on our balance sheet whether or not we choose to repurchase them, which could adversely affect our capital ratios.

Any significant impairment of our eligibility with any of the GSEs could materially and adversely affect our operations. Further, the criteria for loans to be accepted under such programs may be changed from time-to-time by

the sponsoring entity which could result in a lower volume of corresponding loan originations. The profitability of participating in specific programs may vary depending on a number of factors, including our administrative costs of originating and purchasing qualifying loans and our costs of meeting such criteria.

We are a holding company and therefore dependent on the Bank for funding of obligations and dividends.

As a holding company without significant assets other than the capital stock of the Bank, our ability to service our debt or preferred stock obligations, including interest payments on debentures underlying the trust preferred securities, and dividend payments on the preferred stock we issued to the U.S. Treasury, is dependent upon available cash on hand and the receipt of dividends from the Bank on such capital stock. The declaration and payment of dividends by the Bank on all classes of its capital stock is subject to the discretion of the Bank's board of directors and to applicable regulatory and legal limitations, including the prior written non-objection of the OCC as a result of the Consent Order. If the Bank does not make dividend payments to us, we may not be able to service our debt or preferred stock obligations, which could have a material adverse effect of our financial

condition and results of operations. Furthermore, the Federal Reserve has the authority, and under certain circumstances the duty, to prohibit or to limit the payment of dividends by the holding companies they supervise, including us.

We may be exposed to other operational, legal and reputational risks.

We are exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees, disputes with employees and contractors, customers or outsiders, litigation, unauthorized transactions by employees or operational errors. Negative public opinion can result from our actual or alleged conduct in activities, such as lending practices, data security, corporate governance and foreclosure practices, or our involvement in government programs, such as the TARP Capital Purchase Program, and may damage our reputation. Additionally, actions taken by government regulators and community organizations may also damage our reputation. This negative public opinion can adversely affect our ability to attract and keep customers and can expose us to litigation and regulatory action which, in turn, could increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and cause us to incur related costs and expenses. For example, current public opinion regarding defects in the foreclosure practices of financial institutions may lead to an increased risk of consumer litigation, uncertainty of title, a depressed market for non-performing assets and indemnification risk from our counterparties, including the GSEs.

Our dependence upon automated systems to record and process our transaction volume poses the risk that technical system flaws, poor implementation of systems or employee errors or tampering or manipulation of those systems could result in losses and may be difficult to detect. We may also be subject to disruptions of our operating systems arising from events that are beyond our control (for example, computer viruses, electrical or telecommunications outages). We are further exposed to the risk that our third party service providers may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors as we are). These disruptions may interfere with service to our customers and result in a financial loss or liability.

A disproportionate impact could be experienced from continued adverse economic conditions because our loans are geographically concentrated in only a few states.

A significant portion of our mortgage loan portfolio is geographically concentrated in certain states, including California, Michigan, Florida, Washington and Arizona, which collectively represent approximately 63.3 percent of mortgage loans held-for-investment balance at December 31, 2012. In addition, 67.5 percent of commercial real estate loans held-for-investment are in Michigan at December 31, 2012. Continued adverse economic conditions in these markets could cause delinquencies and charge-offs of these loans to increase, likely resulting in a corresponding and disproportionately large decline in revenues and demand for our services and an increase in credit risk and the value of collateral for our loans to decline, in turn reducing customers' borrowing power, and reducing the value of assets and collateral associated with our existing loans.

We may incur additional costs and expenses relating to foreclosure procedures.

Officials in 50 states and the District of Columbia have announced a joint investigation of the procedures followed by banks and mortgage companies in connection with completing affidavits relating to home foreclosures, specifically with respect to (i) whether the persons signing such affidavits had the requisite personal knowledge to sign the affidavits and (ii) compliance with notarization requirements. Although we are continuing to review, there are a number of structural differences between our business model and the resulting practices and those of the larger servicers that have been publicized in the media. For example, we do not engage in the practice of bulk purchases of loans from other servicers or investors, nor have engaged in any acquisitions that typically result in multiple servicing locations and integration issues from both a processing and personnel standpoint. As a result, we are not required to

service seasoned loans following a transfer and all of the servicing functions are performed in one location and on one core operating system. In addition, we sell servicing rights with some regularity and the sale of servicing rights has allowed for a more reasonable volume of loans that staff has to manage. Despite these structural differences, we expect to incur additional costs and expenses in connection with foreclosure procedures. In addition, there can be no assurance that we will not incur additional costs and expenses as a result of legislative, administrative or regulatory investigations or actions relating to foreclosure procedures.

We could, as a result of a stock offering or future trading activity in our common or preferred stock, experience an "ownership change" for tax purposes that could cause us to permanently lose a portion of U.S. federal deferred tax assets.

As of December 31, 2012 and 2011, our net deferred tax assets were approximately \$322.1 million and \$221.5 million, respectively, which includes both federal and state operating losses. These net deferred tax assets were fully offset by valuation allowances of the same amounts. As of December 31, 2012, our federal net operating loss carry forwards totaled approximately \$712.6 million. Our ability to use our deferred tax assets to offset future taxable income will be significantly limited if we experience

an "ownership change" as defined for U.S. federal income tax purposes. MP Thrift, our controlling stockholder, held approximately 63.7 percent of common stock as of December 31, 2012. As a result of MP Thrift's ownership, issuances or sales of common stock or other securities in the future or certain other direct or indirect changes in ownership, could result in an "ownership change" under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). Section 382 of the Code imposes restrictions on the use of a corporation's net operating losses, certain recognized built-in losses, and other carryovers after an "ownership change" occurs. An "ownership change" is generally a greater than 50 percentage point increase by certain "five percent shareholders" during the testing period, which is generally the three year-period ending on the transaction date. Upon an "ownership change," a corporation generally is subject to an annual limitation on its prechange losses and certain recognized built-in losses equal to the value of the corporation's market capitalization immediately before the "ownership change" multiplied by the long-term tax-exempt rate (subject to certain adjustments). The annual limitation is increased each year to the extent that there is an unused limitation in a prior year. Since U.S. federal net operating losses generally may be carried forward for up to 20 years, the annual limitation also effectively provides a cap on the cumulative amount of prechange losses and certain recognized built-in losses that may be utilized. Prechange losses and certain recognized built-in losses in excess of the cap are effectively lost.

The relevant calculations under Section 382 of the Code are technical and highly complex. Any stock offering, combined with other ownership changes, could cause us to experience an "ownership change." If an "ownership change" were to occur, we believe it could cause us to permanently lose the ability to realize a portion of our deferred tax asset, resulting in reduction to total shareholders' equity.

Even if there is an "ownership change," and part or all of our deferred tax assets would be limited, our obligations under the terms of the DOJ Agreement would not be relieved. Moreover, if we or the Bank are party to a business transaction so large that it causes the deferred tax asset to be completely eliminated, then 12 months following the transaction we, or our successor, are required to begin making the Additional Payments required under the DOJ Agreement, for more information see Item 1. Business.

We may be subject to additional risks as we enter new lines of business or introduce new products and services.

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

#### General Risk Factors

Our potential loss of key members of senior management or our inability to attract and retain qualified relationship managers in the future could affect our ability to operate effectively.

We depend on the services of existing senior management to carry out our business and investment strategies. As we expand and as we continue to refine and reshape our business model, we will need to continue to attract and retain additional senior management and recruit qualified individuals to succeed existing key personnel that leave our

employ. In addition, as we continue to grow our business and plan to continue to expand our locations, products and services, we will need to continue to attract and retain qualified banking personnel. Competition for such personnel is especially keen in our geographic market areas and competition for the best people in most businesses in which we engage can be intense. In addition, so long as our preferred stock that was issued as part of TARP is held by the U.S. Treasury, ARRA limits the amount of incentive compensation that can be paid to certain executives. The effect could be to limit our ability to attract and retain senior management in the future. If we are unable to attract and retain talented people, our business could suffer. The loss of the services of any senior management personnel, and, in particular, the loss for any reason, including death or disability of our chairman and chief executive officer or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our consolidated results of operations, financial condition and prospects.

Our framework for managing risks may not be effective in mitigating risk and loss to us.

Our risk management framework seeks to mitigate risk and loss to us. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including liquidity risk, credit risk, market risk, interest rate risk, operational risk, legal and compliance risk, and reputational risk, among others. Although we have made, and continue to make, material changes to our risk management framework, in part due to guidance provided by our regulators and consultants, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. If our risk management framework proves ineffective, we could suffer unexpected losses which could have a materially adverse effect on our results of operations or financial condition.

Our network and computer systems on which we depend could fail, experience an interruption, or experience a breach in security.

Our computer systems could be vulnerable to unforeseen problems. Because we conduct part of our business over the Internet and outsource several critical functions to third parties, our operations depend on our ability, as well as that of third-party service providers, to protect computer systems and network infrastructure against damage from fire, power loss, telecommunications failure, physical break-ins or similar catastrophic events. Any damage or failure that causes interruptions in operations could have a material adverse effect on our business, financial condition and results of operations.

In addition, a significant barrier to online financial transactions is the secure transmission of confidential information over public networks. Our Internet banking system relies on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information. Advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms our third-party service providers use to protect customer transaction data. If any such compromise of security were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

Market acceptance of Internet banking depends substantially on widespread adoption of the Internet for general commercial and financial services transactions. If another provider of commercial services through the Internet were to suffer damage from physical break-in, security breach or other disruptive problems caused by the Internet or other users, the growth and public acceptance of the Internet for commercial transactions could suffer. This type of event could deter our potential customers or cause customers to leave us and thereby materially and adversely affect our business, financial condition and results of operations.

To date we have not experienced any material incidents relating to cyber-security or other forms of information security breaches, although there can be no assurance that we will not suffer such losses in the future given the rapidly expanding and evolving cybersecurity threats that exists today. This is especially true because techniques used tend to change frequently or would not be recognized until launched, and attacks can originate from a wide array of sources, including unrelated third parties. These risks may increase in the future given our increased emphasis on Internet based products and services, including mobile banking and mobile payments. As cybersecurity threats continue to evolve, we may be required to expend additional resources to continue to modify or refine our protective measures against these threats.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic

substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. In addition, such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result

in loss of revenue and/or cause us to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

General business, economic and political conditions may significantly affect our earnings.

Our business and earnings are sensitive to general business and economic conditions in the United States. These conditions include short-term and long-term interest rates, inflation, recession, unemployment, real estate values, fluctuations in both debt and equity capital markets, the value of the U.S. dollar as compared to foreign currencies, and the strength of the U.S. economy, as well as the local economies in which we conduct business. If any of these conditions worsen, our business and earnings could be adversely affected. For example, business and economic conditions that negatively impact household incomes could decrease the demand for our home loans and increase the number of customers who become past due or default on their loans; or, a rising interest rate environment could decrease the demand for loans.

In addition, our business and earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies. We are particularly affected by the policies of the Federal Reserve, which regulates the supply of money and credit in the United States, and the perception of those policies by the financial markets. The Federal Reserve's policies influence both the financial markets and the size and liquidity of the mortgage origination market, which significantly impacts the earnings of our mortgage lending operation and the value of our investment in MSRs and other retained interests. The Federal Reserve's policies and perceptions of those policies also influence the yield on our interest-earning assets and the cost of our interest-bearing liabilities. Changes in those policies or perceptions are beyond our control and difficult to predict and could have a material adverse effect on our business, results of operations and financial condition.

We are a controlled company that is exempt from certain NYSE corporate governance requirements.

Our common stock is currently listed on the NYSE. The NYSE generally requires a majority of directors to be independent and requires audit, compensation and nominating committees to be composed solely of independent directors. However, under the rules applicable to the NYSE, if another company owns more than 50 percent of the voting power of a listed company, that company is considered a "controlled company" and exempt from rules relating to independence of the board of directors and the compensation and nominating committees. We are a controlled company because MP Thrift beneficially owns more than 50 percent of our outstanding voting stock. A majority of the directors on the compensation and nominating committees are affiliated with MP Thrift. MP Thrift has the right, if exercised, to designate a majority of the directors on the board of directors. Our stockholders do not have, and may never have, all the protections that these rules are intended to provide. If we become unable to continue to be deemed a controlled company, we would be required to meet these independence requirements and, if we are not able to do so, our common stock could be delisted from the NYSE.

Our controlling stockholder has significant influence over us, including control over decisions that require the approval of stockholders, whether or not such decisions are in the best interests of other stockholders.

MP Thrift beneficially owns a substantial majority of our outstanding common stock and as a result, has control over our decisions to enter into any corporate transaction and also the ability to prevent any transaction that requires the approval of our board of directors or the stockholders regardless of whether or not other members of our board of directors or stockholders believe that any such transactions are in their own best interests. So long as MP Thrift continues to hold a majority of our outstanding common stock, it will have the ability to control the vote in any election of directors and other matters being voted on, and continue to exert significant influence over us.

Changes in accounting standards may impact how we report our financial condition and results of operations.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time the Financial Accounting Standards Board ("FASB") changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be difficult to predict and can materially impact how we record and report our financial condition and results of operations. In addition, we may from time to time experience weaknesses or deficiencies in our internal control over financial reporting that can affect our recording and reporting of financial information. In some cases we could be required to apply a new or revised standard retroactively, resulting in a restatement of prior period financial statements.

For example, on December 20, 2012, the FASB issued for public comment a Proposed Accounting Standards Update, Financial Instruments – Credit Losses (Subtopic 825-15), that would substantially change the accounting for credit losses on loans

and other financial assets held by banks, financial institutions and other organizations. The proposal would remove the existing "probable" threshold in U.S. GAAP for recognizing credit losses and instead require affected reporting companies to reflect their estimate of credit losses on financial assets over the lifetime of each such asset, broadening the range of information that must be considered in measuring the allowance for expected credit losses. This proposal, if adopted as proposed, will likely have a negative impact, potentially material, on our reported earnings and capital and could also have an impact on our lending to the extent that higher reserves are required at the inception of a loan.

We are subject to a number of legal or regulatory proceedings which can be complicated and slow moving, thus making them difficult to predict.

At any given time, we are defending ourselves against a number of legal and regulatory proceedings. Proceedings or actions brought against us may result in judgments, settlements, fines, penalties, injunctions, business improvement orders, or other results adverse to us, which could materially and negatively affect our businesses, financial condition, results of operations, and may require material changes in our business, or cause us reputational harm. Moreover, claims asserted against us can be highly complicated and slow to develop, thus making the outcome of such proceedings difficult to predict or estimate early in the process. For example, Assured filed a lawsuit against the Bank in April 2011, the court issued a decision in February 2013, and the Bank plans to appeal the decision. Notwithstanding the Bank's intention to vigorously contest the decision on appeal and the expected lengthy duration of the appeal process, we decided in light of the court's decision to make an immediate, material increase in our accrual for pending and threatened litigation, which includes amounts for Assured, the litigation with MBIA, which raises legal and factual issues that are similar to Assured, and other pending and threatened litigation. As a participant in the financial services industry, it is likely that we will continue to experience a high level of litigation and regulatory scrutiny and investigations relating to our business and operations. The results of these legal and regulatory proceedings could lead to significant monetary damages or penalties, restrictions on the way in which we conduct our business, or reputational harm.

Although we establish accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable and that the amount of loss can be reasonably estimated, we do not have accruals for all legal proceedings where we face a risk of loss. In addition, due to the inherent subjectivity of the assessments and unpredictability of the outcome of legal proceedings, amounts accrued may not represent the ultimate loss to us from the legal proceedings in question. Thus, our ultimate losses may be higher, and possibly significantly so, than the amounts accrued for legal loss contingencies.

For a further discussion of the unpredictability of legal proceedings and describe some of our pending legal proceedings, see Note 29 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein.

#### Other Risk Factors

The above description of risk factors is not exhaustive. Other risk factors are described elsewhere herein as well as in other reports and documents that we file with or furnish to the SEC. Other factors that could also cause results to differ from our expectations may not be described in any such report or document. Each of these factors could by itself, or together with one or more other factors, adversely affect our business, results of operations and/or financial condition.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

At December 31, 2012, we operated through the headquarters and an annex center in Troy, Michigan, a regional office in Jackson, Michigan, 111 banking centers in Michigan and 31 home lending centers in 14 states. We also maintain ten wholesale lending offices. Our banking centers consist of 66 free-standing office buildings, 15 in-store banking centers and 30 centers in buildings in which there are other tenants, typically strip malls and similar retail centers.

We own the buildings and land for 81 of our offices, own the building, but lease the land for one office, and lease the remaining 70 offices. The offices that we lease have lease expiration dates ranging from 2013 to 2019.

### ITEM 3. LEGAL PROCEEDINGS

From time to time, we are party to legal proceedings incident to our business. See Note 2 and Note 29 of the Notes to Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, which is incorporated herein by reference.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock trades on the NYSE under the trading symbol FBC. At December 31, 2012, there were 55,863,053 shares of our common stock outstanding held by approximately 24,854 stockholders of record. The following table shows the high and low sale prices for our common stock during each calendar quarter during 2012 and 2011.

Quarter Ending	Highest Sale Price (1)	Lowest Sale Price (1)
December 31, 2012	\$19.42	\$10.40
September 30, 2012	12.00	8.00
June 30, 2012	9.70	6.90
March 31, 2012	10.40	5.70
December 31, 2011	8.50	4.60
September 30, 2011	12.50	4.70
June 30, 2011	15.60	11.40
March 31, 2011	18.20	14.50

(1) Where appropriate, the stock prices have been restated for one-for-ten reverse stock split effective on October 10, 2012.

## Dividends

We have not paid dividends on our common stock since the fourth quarter of 2007. The amount and nature of any dividends declared on our common stock in the future will be determined by our board of directors in their sole discretion. Our board of directors has suspended any future dividend on our common stock until the capital markets normalize and residential real estate shows additional signs of improvement. Moreover, we are prohibited from increasing dividends on our common stock above \$0.05 per share without the consent of U.S. Treasury pursuant to the terms of the TARP Capital Purchase Program, and we are generally prohibited from making any dividend payments on stock except pursuant to the prior non-objection of the Federal Reserve as set forth in the Supervisory Agreement. In addition, we are prohibited from paying dividends on our common stock so long as we have deferred and unpaid dividends on our preferred stock issues to the U.S. Treasury under the TARP Capital Purchase Program and deferred and unpaid interest on our trust preferred securities.

In addition, our principal sources of funds are cash dividends paid by the Bank and other subsidiaries, investment income and borrowings. Federal laws and regulations limit the amount of dividends or other capital distributions that the Bank may pay us. The Bank has an internal practice to remain "well-capitalized" under OCC capital adequacy regulations as discussed above. The Bank does not currently expect to pay dividends to us and, even if it determined to do so, would not make payments if the Bank was not well-capitalized at the time or if such payment would result in the Bank not being well-capitalized. In addition, the Bank must seek prior approval from the OCC at least 30 days before it may make a dividend payment or other capital distribution to us.

For information regarding restrictions on our payment of dividends, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Resources and Liquidity.

## Equity Compensation Plan Information

The following table sets forth certain information with respect to securities to be issued under our equity compensation plans as of December 31, 2012.

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders (1) (2)	93,628	\$ 143.41	1,114,965
Equity compensation plans not approved by security holders	—	—	—
Total	93,628	\$ 143.41	1,114,965

Consists of our 2006 Equity Incentive Plan (the “2006 Plan”), which provides for the granting of stock options, incentive stock options, cash-settled stock appreciation rights, restricted stock units, performance shares and performance units and other awards. The 2006 Plan consolidated, merged, amended and restated our 1997 Employees and Directors Stock Option Plan, 2000 Stock Incentive Plan, and 1997 Incentive Compensation Plan.

(1) Awards still outstanding under any of the prior plans will continue to be governed by their respective terms. Under the 2006 Plan, the exercise price of any option granted must be at least equal to the fair value of our common stock on the date of grant. Non-qualified stock options granted to directors expire five years from the date of grant. Grants other than non-qualified stock options have term limits set by the board of directors in the applicable agreement. All securities remaining for future issuance represent option and stock awards available for award under the 2006 Plan.

(2) Restated for one-for-ten reverse stock splits effective on October 10, 2012 and May 27, 2010.

## Sale of Unregistered Securities

We made no unregistered sales of our equity securities during the fiscal year ended December 31, 2012.

## Issuer Purchases of Equity Securities

We made no purchases of equity securities during the quarter ended December 31, 2012.

Performance Graph

CUMULATIVE TOTAL STOCKHOLDER RETURN  
COMPARED WITH PERFORMANCE OF SELECTED INDICES  
DECEMBER 31, 2007 THROUGH DECEMBER 31, 2012

	Nasdaq Financial	Nasdaq Bank	S&P Small Cap 600	Russell 2000	Flagstar Bancorp
December 31, 2007	100	100	100	100	100
December 31, 2008	69	100	68	65	10
December 31, 2009	70	81	84	81	9
December 31, 2010	93	91	104	102	2
December 31, 2011	68	80	104	96	1
December 31, 2012	77	92	120	110	3

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## ITEM 6. SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(In thousands, except per share data and percentages)				
Summary of Consolidated Statements of Operations					
Interest income	\$480,970	\$465,409	\$532,781	\$696,865	\$777,997
Interest expense	183,739	220,036	322,118	477,798	555,472
Net interest income	297,231	245,373	210,663	219,067	222,525
Provision for loan losses	(276,047)	) (176,931)	) (426,353)	) (504,370)	) (343,963)
Net interest income (loss) after provision for loan losses	21,184	68,442	(215,690)	) (285,303)	) (121,438)
Non-interest income	1,021,242	385,516	453,680	523,286	130,123
Non-interest expense	989,695	634,680	610,699	679,653	432,052
Income (loss) before federal income taxes provision	52,731	(180,722)	) (372,709)	) (441,670)	) (423,367)
(Benefit) provision for federal income taxes	(15,645)	) 1,056	2,104	55,008	(147,960)
Net income (loss)	68,376	(181,778)	) (374,813)	) (496,678)	) (275,407)
Preferred stock dividends/accretion	(5,658)	) (17,165)	) (18,748)	) (17,124)	) —
Net income (loss) attributable to common stock	\$62,718	\$(198,943)	) \$(393,561)	) \$(513,802)	) \$(275,407)
Income (loss) per share					
Basic (1)	\$0.88	\$(3.62)	) \$(24.36)	) \$(161.75)	) \$(381.70)
Diluted (1)	\$0.87	\$(3.62)	) \$(24.36)	) \$(161.75)	) \$(381.70)
(1) Restated for one-for-ten reverse stock splits effective on October 10, 2012 and May 27, 2010.					

(1) Restated for one-for-ten reverse stock splits effective on October 10, 2012 and May 27, 2010.

	For the Years Ended December 31,					
	2012	2011	2010	2009	2008	
	(In thousands, except per share data and percentages)					
Return on average assets	0.43	% (1.49)	)% (2.81	)% (3.24	)% (1.83	)%
Return on average equity	5.26	% (16.78	)% (36.63	)% (62.87	)% (37.66	)%
Efficiency ratio	75.1	% 100.6	% 91.9	% 91.6	% 122.5	%
Efficiency ratio (credit-adjusted) (1)	57.0	% 64.8	% 61.9	% 70.4	% 104.4	%
Equity/assets ratio (average for the period)	8.10	% 8.88	% 7.66	% 5.15	% 4.86	%
Mortgage loans originated (2)	\$53,586,856	\$26,612,800	\$26,560,810	\$32,330,658	\$27,990,118	
Other loans originated	\$754,155	\$700,969	\$40,420	\$44,443	\$316,471	
Mortgage loans sold and securitized	\$53,094,326	\$27,451,362	\$26,506,672	\$32,326,643	\$27,787,884	
Interest rate spread-bank only (3)	1.98	% 1.86	% 1.45	% 1.55	% 1.76	%
Net interest margin-bank only (4)	2.31	% 2.13	% 1.75	% 1.68	% 1.78	%
Interest rate spread-consolidated (3)	1.96	% 1.85	% 1.43	% 1.51	% 1.71	%
Net interest margin-consolidated (4)	2.26	% 2.07	% 1.67	% 1.58	% 1.67	%
Average common shares outstanding (5)	55,762	55,434	16,157	3,177	722	
Average fully diluted shares outstanding (5)	56,194	55,434	16,157	3,177	722	
Average interest earning assets	\$13,104,401	\$11,803,670	\$12,522,639	\$13,799,361	\$13,316,390	
Average interest paying liabilities	\$10,786,252	\$10,539,369	\$11,437,410	\$13,542,712	\$13,439,660	
Average stockholders' equity	\$1,192,281	\$1,185,731	\$1,074,571	\$817,248	\$731,231	
Charge-offs to average investment loans (annualized) (6)	4.43	% 2.14	% 9.34	% 4.20	% 0.79	%

(1) Based on efficiency ratios as calculated, less representation and warranty reserve change in estimate and asset resolution expense, see Non-GAAP reconciliation.

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

(3) Interest rate spread is the difference between the annualized average yield earned on average interest-earning assets for the period and the annualized average rate of interest paid on average interest-bearing liabilities for the period.

(4) Net interest margin is the annualized effect of the net interest income divided by that period's average interest-earning assets.

(5) Restated for one-for-ten reverse stock splits effective on October 10, 2012 and May 27, 2010.

(6) For the year ended December 31, 2010, net charge-off ratio to average loans held-for-investment ratio was 4.82 percent excluding the \$327.3 million charge-off recorded on the non-performing loan sale in November 2010.

	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008	
(In thousands, except per share data and percentages)						
Summary of Consolidated Statements of Financial Condition						
Total assets	\$14,082,012	\$13,637,473	\$13,643,504	\$14,013,331	\$14,203,657	
Loans receivable	\$10,914,163	\$10,420,739	\$10,291,435	\$9,964,908	\$10,566,801	
Mortgage servicing rights	\$710,791	\$510,475	\$580,299	\$652,374	\$520,763	
Total deposits	\$8,294,295	\$7,689,988	\$7,998,099	\$8,778,469	\$7,841,005	
FHLB advances	\$3,180,000	\$3,953,000	\$3,725,083	\$3,900,000	\$5,200,000	
Security repurchase agreements	\$—	\$—	\$—	\$108,000	\$108,000	
Long-term debt	\$247,435	\$248,585	\$248,610	\$300,182	\$248,660	
Stockholders' equity (1)	\$1,159,362	\$1,079,716	\$1,259,663	\$596,724	\$472,293	
Equity-to-assets ratio	8.23	% 7.92	% 9.23	% 4.26	% 3.33	%
Tier 1 capital ratio (to adjusted total assets) (2)	9.26	% 8.95	% 9.61	% 6.19	% 4.95	%
Total risk-based capital ratio (to risk-weighted assets) (2)	17.18	% 16.64	% 18.55	% 11.68	% 9.10	%
Book value per common share (3)	\$16.12	\$14.80	\$18.30	\$75.30	\$565.00	
Number of common shares outstanding (3)	55,863	55,578	55,331	4,688	836	
Mortgage loans serviced for others	\$76,821,222	\$63,770,676	\$56,040,063	\$56,521,902	\$55,870,207	
Weighted average service fee (basis points)	29.2	30.8	30.8	32.1	33.3	
Capitalized value of mortgage servicing rights	0.93	% 0.80	% 1.04	% 1.15	% 0.93	%
Ratio of allowance for loan losses to non-performing loans held-for-investment (4)	76.3	% 65.1	% 86.1	% 48.9	% 52.1	%
Ratio of allowance for loan losses to loans held-for-investment (4)	5.61	% 4.52	% 4.35	% 6.79	% 4.14	%
Ratio of non-performing assets to total assets (4)	3.70	% 4.43	% 4.35	% 9.24	% 5.97	%
Number of banking centers	111	111	162	165	175	
Number of loan origination centers	31	27	27	32	121	
Number of employees (excluding loan officers and account executives)	3,328	2,839	3,001	3,075	3,246	
Number of loans officers and account executives	334	297	278	336	674	

(1) Includes preferred stock totaling \$260.4 million, \$254.7 million, \$249.2 million and \$243.8 million for 2012, 2011, 2010 and 2009, respectively, no other year includes preferred stock.

(2) Based on adjusted total assets for purposes of tangible capital and core capital, and risk-weighted assets for purposes of risk-based capital and total risk-based capital. These ratios are applicable to the Bank only.

(3) Restated for one-for-ten reverse stock splits effective on October 10, 2012 and May 27, 2010.

(4) Bank only and does not include non-performing loans held-for-sale.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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## OPERATING SEGMENTS

### Overview

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Item 1: Business section and with Note 30 of the Notes to Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, and other sections for a full understanding of our consolidated financial performance.

In late 2012, we reorganized the way our operations are managed. The operating segments are based on an internally-aligned segment leadership structure, which is how the results are monitored and performance assessed. We have three major operating segments: Community Banking, Mortgage Banking and Other. The Community Banking segment originates loans and deposits to consumer and business customers through Commercial, Business, Government and Branch Banking groups. Products offered through these teams include checking accounts, savings accounts, money market accounts, certificates of deposit, consumer loans and commercial loans. 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 Mortgage Banking segment originates, acquires, sells and services mortgage loans. The origination and acquisition of mortgage loans is the majority of the lending activity. Mortgage loans are originated through home lending centers, national call centers, the Internet, unaffiliated banks and mortgage brokerage companies, where the net interest income and the gains from sales associated with these loans are recognized in the Mortgage Banking segment. Also, the Mortgage Banking segment services mortgage loans for others and sells MSRs into the secondary market. The Other segment includes corporate treasury, income and expense impact of equity and cash, the effect of eliminations of transactions between segments, tax benefits not assigned to specific operating segments, the impact of interest rate risk management, the impact of balance sheet funding activities, charges or credits of unusual or infrequent nature that are not reflective of the normal operations of the operating segments and miscellaneous other expenses of a corporate nature. Each operating segment supports and complements the operations of the other, with funding for the Mortgage Banking segment primarily provided by deposits obtained through Community Banking and with the Community Banking segment providing warehouse lines of credit to mortgage originators, most of which sell loans to the Mortgage Banking segment. All periods presented have been reclassified to conform to the current period presentation. A discussion of our three operating segments is set forth below.

The operating segment results are generated utilizing our management reporting system, which assigns balance sheet and income statement items to each of the operating segments. The process is designed around our organizational and management structure and, accordingly, the results derived may not be directly comparable with similar information published by other financial institutions. Revenue is recorded in the operating segment responsible for the related product or service.

The management accounting process that develops the operating segment reporting utilizes various estimates and allocation methodologies to measure the performance of the operating segments. Expenses are allocated to operating segments using a two-phase approach. The first phase consists of measuring and assigning costs to activities within each operating area to create a driver-based cost. These driver-based costs are then allocated, with the resulting amount allocated to operating segments that own the related products. The second phase consists of the allocation of overhead costs to all three operating segments from the Other segment.

The net income (loss) by operating segment for the past three years is presented in the following table.

Year Ended December 31,		
2012	2011	2010
(Dollars in thousands)		

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Community Banking	\$(47,333	) \$(100,869	) \$(136,086	)
Mortgage Banking	183,627	(31,335	) (179,255	)
Other	(67,918	) (49,574	) (59,472	)
Total net income (loss)	\$68,376	\$(181,778	) \$(374,813	)

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The selected average balances by operating segment for the three years is presented in the following table.

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Average loans held-for-sale			
Community Banking	\$2,535	\$—	\$—
Mortgage Banking	3,076,155	1,928,339	1,945,913
Other	—	—	—
Average loans held-for-investment			
Community Banking	\$2,951,143	\$2,031,748	\$2,188,639
Mortgage Banking	3,560,560	4,158,032	5,053,894
Other	8,357	13,913	—
Average total assets			
Community Banking	\$3,076,297	\$2,194,841	\$2,263,763
Mortgage Banking	9,616,825	8,953,593	10,214,598
Other	2,033,648	2,200,160	1,551,811
Average interest-bearing deposits			
Community Banking	\$6,606,247	\$6,109,708	\$5,842,816
Mortgage Banking	—	—	—
Other	233,083	551,696	1,404,311

Community Banking	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Net interest income	\$153,197	\$125,368	\$120,348
Provision for loan losses	(40,008)	(62,321)	(95,808)
Non-interest income	43,580	42,601	43,159
Non-interest expense	(204,102)	(206,517)	(203,785)
Net loss	(47,333)	(100,869)	(136,086)
Average balances			
Total loans held-for-investment	\$2,951,143	\$2,031,748	\$2,188,639
Total assets	3,076,297	2,194,841	2,263,763
Total interest-bearing deposits	6,606,247	6,109,708	5,842,816

The Community Banking segment reported a \$53.5 million decrease in net loss. This improvement was largely driven by an increase in net interest income of \$27.8 million and a \$22.3 million decrease in provision for loan losses. The increase in net interest income was primarily due to higher Warehouse Lending balances from December 31, 2011 to December 31, 2012. The improvement in provision for loan losses reflected lower charge offs, higher recoveries, and the reversal of \$12.6 million in reserves associated with the December 2012 sale of commercial loans under the CIT Agreement.

Non-interest income remained relatively flat for the year ended December 31, 2012, as compared to the year ended December 31, 2011, reflecting higher loan fees within the Warehouse Lending and Commercial Banking groups offset by lower deposit fees from Branch Banking. The decrease in deposit fees from Branch Banking was primarily due to the sale of the Georgia and Indiana branches during the fourth quarter of 2011.

Non-interest expense also remained relatively flat for the year ended December 31, 2012, as compared to the year ended December 31, 2011, reflecting a decrease in Branch Banking costs (due to the Georgia and Indiana branch sales) offset by increases in Warehouse Lending and Commercial Banking costs and in allocated expenses from

various corporate departments.

## Mortgage Banking

Our Mortgage Banking segment originates, acquires, sells and services one-to-four family residential first mortgage loans. The Mortgage Banking segment also services mortgage loans on a fee basis for others and sells MSR's into the secondary market. Funding for our Mortgage Banking segment is provided primarily by deposits and borrowings obtained by our Community Banking segment.

	For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Net interest income	\$195,312	\$125,821	\$94,150
Provision for loan losses	(236,039)	) (114,610	) (330,545)
Net gain on loan sales	990,175	300,268	296,419
Representation and warranty reserve - change in estimate	(256,289)	) (150,055	) (61,523)
Other non-interest income	225,835	186,708	164,603
Asset resolution	(84,363)	) (113,857	) (113,755)
Other non-interest expense	(651,004)	) (265,610	) (228,604)
Net income (loss)	183,627	(31,335)	(179,255)
Average balances			
Total loans held-for-sale	\$3,076,155	\$1,928,339	\$1,945,913
Total loans held-for-investment	3,560,560	4,158,032	5,053,894
Total assets	9,616,825	8,953,593	10,214,598

The Mortgage Banking segment income increased \$215.0 million primarily due to a \$689.9 million increase in net gain on loan sales, partially offset by an increase in the legal accruals for pending and threatened litigation (included in other non-interest expense) and provision for loan losses and representation and warranty reserve - change in estimate. The increase in gain on loan sales was primarily due to increases in both residential first mortgage rate lock commitments and sales of residential first mortgage loans, as well as an increase in gain on loan sale margin. The loan loss provision expense increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, primarily due to the refinements to existing loss models adopted during the first quarter 2012 and increased loss mitigation activities throughout 2012, as we work to provide solutions to distressed homeowners. For the year ended December 31, 2012, net loan fees and charges increased to \$131.2 million, as compared to \$70.0 million for the year ended December 31, 2011.

Net servicing revenue, which is the combination of net loan administration income (including the off-balance sheet hedges of mortgage servicing rights) and the gain (loss) on trading securities (i.e., the on-balance sheet hedges of mortgage servicing rights), decreased to \$97.7 million for the year ended December 31, 2012, as compared to \$116.1 million for the year ended December 31, 2011.

The increase in our representation and warranty reserve due to our change in estimate of expected losses from probable repurchase obligations related to loans sold in prior periods, reflects two major components. First, recent changes in behavior by and enhanced transparency from Fannie Mae, Freddie Mac and Ginnie Mae (collectively, government sponsored entities or the "GSEs"), primarily related to loans originated prior to 2009 (i.e., pre-2009 vintages), caused an increase in forecasted demands. Second, during the year ended December 31, 2012 we made a number of enhancements to the repurchase operations, including installing new leadership, adding full-time employees and increasing processing capacity. Part of our enhancements included an effort during the year ended December 31, 2012 to reduce the size and improve the aging of our current repurchase demand pipeline. As a result of these efforts, net-charge offs of loans repurchases increased for the year ended December 31, 2012, compared to the year ended December 31, 2011.



# Other

	For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Net interest expense	\$ (51,278	) \$ (5,816	) (3,835
Non-interest income	17,941	5,994	11,022
Non-interest expense	(50,226	) (48,696	) (64,555
Income (loss) before taxes	(83,563	) (48,518	) (57,368
Benefit (provision) for income taxes	15,645	(1,056	) (2,104
Net loss	(67,918	) (49,574	) (59,472
Average balances			
Total assets	\$2,033,648	\$2,200,160	\$1,551,811

The Other segment includes the treasury, income and expense impact of equity and cash, the effect of eliminations of transactions between segments, tax benefits not assigned to specific operating segments, the funding revenue associated with shareholders' equity, the impact of interest rate risk management, the impact of balance sheet funding activities, and changes or credit of an unusual or infrequent nature that are not reflective of the normal operations of the operating segments and miscellaneous other expenses of a corporate nature. The financial impact associated with our allocation methodology is also included.

Net interest income includes the impact of administering our investment securities portfolios and the net impact of derivatives used to hedge interest rate sensitivity. Non-interest income includes insurance income, miscellaneous fee income not allocated to other operating segments, such as bank owned life insurance income and any Treasury related items and trading asset gains or losses.

Non-interest expense includes certain corporate administrative and other miscellaneous expenses. The provision for income taxes is not allocated to the operating segments as new corporate income tax liability will not occur until after the utilization of the existing deferred tax assets.

The Other segment net loss increased \$18.3 million primarily due to a \$45.5 million increase in net interest expense, offset by a \$16.7 million increase in benefit for income taxes. The increase in benefit for income taxes was primarily due to the sale of the remaining non-agency CMOs and seasoned agency securities completed during the year ended December 31, 2012, which resulted in \$19.9 million of tax benefits representing the recognition of the residual tax effect associated with previously unrealized losses on these securities recorded in other comprehensive income (loss).

## Summary of Operations

Our net income applicable to common stock for year ended December 31, 2012 was \$62.7 million (\$0.87 per diluted share), compared to a loss of \$(198.9) million (loss of \$(3.62) per diluted share) for the year ended December 31, 2011 and to a loss of \$(393.6) million (loss of \$(24.36) per diluted share) for the year ended December 31, 2010. All per share amounts and share counts have been adjusted to reflect the one-for-ten reverse stock split which began trading on a post-split basis on October 11, 2012 following receipt of stockholder approval at our 2012 Annual Meeting of Stockholders. The increase during the year ended December 31, 2012, compared to the year ended December 31, 2011, was affected by the following factors:

Net interest margin improved to 2.26 percent, as compared to 2.07 percent for the year ended December 31, 2011, primarily due to a decrease in our cost of funds and an increase in the average balances in our loans held-for-sale loan portfolio;

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Net interest income increased by \$51.9 million to \$297.2 million for the year ended December 31, 2012, primarily due to a decrease in deposit rates of 40 basis points and in FHLB advances rate of 38 basis points;

Provision for loan losses increased by \$99.1 million from the year ended December 31, 2011, to \$276.0 million for the year ended December 31, 2012, primarily as a result of refinements to existing loss models during the first quarter 2012, partially offset by the reversal of \$12.6 million in reserves associated with the December 2012 sale of commercial loans under the Agreement with CIT;

Net gain on loan sales increased \$690.1 million from the year ended December 31, 2011, to \$990.9 million for the year ended December 31, 2012, primarily due to an increase in volume of loan sales and margins;

Representation and warranty reserve - change in estimate increased \$106.2 million to \$256.3 million for the year ended December 31, 2012, primarily due to refinements in the estimation process that occurred during the first quarter 2012 and an increased demand of repurchase requests from GSEs; and

Legal and professional expense increased \$235.0 million to \$300.5 million for the year ended December 31, 2012, primarily due a \$195.1 million increase in the assessment of overall litigation exposure from pending and threatened litigation and a \$22.7 million increase in consulting fee expense.

#### Net Interest Income

Net interest income is primarily the dollar value of the average yield we earn on the average balances of our interest-earning assets, less the dollar value of the average cost of funds we incur on the average balances of our interest-bearing liabilities. Interest income recorded on loans is reduced by the amortization net premiums and net deferred loan origination costs.

Net interest income increased 21.1 percent for the year ended December 31, 2012, as compared to the year ended December 31, 2011 and increased \$86.6 million as compared to the year ended December 31, 2010. The increase for year ended December 31, 2012, is primarily due to a decrease in overall cost of funds to 1.70 percent from 2.09 percent in the year ended December 31, 2011 and from 2.82 percent during the year ended December 31, 2010. Net interest income represented 22.5 percent of our total revenue during the year ended December 31, 2012, compared to 38.9 percent for the year ended December 31, 2011 and 31.7 percent for the year ended December 31, 2010.

The increase in interest income was primarily driven by an increase in the average balance of available-for-sale loans due to the increase in residential first mortgage originations during the year ended December 31, 2012, and an increase in commercial loans held-for-investment. The increase in average interest-earning assets for the year ended December 31, 2012, as compared to the year ended December 31, 2011 reflects a \$1.2 billion increase in average loans held-for-sale and a \$316.4 million increase in average loans held-for-investment. Average-interest-bearing liabilities increased \$255.9 million during the year ended December 31, 2012, as compared to the year ended December 31, 2011 primarily due to a \$177.9 million increase in average deposits as we continue to focus on increasing our core deposits while reducing the level of higher cost retail deposits.

Interest expense for the year ended December 31, 2012 decreased \$36.3 million, compared to the year ended December 31, 2011 and decreased \$138.4 million as compared to the year ended December 31, 2010.

Our consolidated net interest margin for the year ended December 31, 2012 was 2.26 percent, as compared to 2.07 percent for the year ended December 31, 2011 and 1.67 percent for the year ended December 31, 2010. The Bank recorded a net interest margin of 2.31 percent for the year ended December 31, 2012, as compared to 2.13 percent for the year ended December 31, 2011 and 1.75 percent for the year ended December 31, 2010.

On June 30, 2011, we implemented a reclassification in the treatment of amounts due from FHA relating to the servicing of delinquent FHA loans to recognize the accrued credit from FHA as interest income. Previously, income from FHA was applied as an offset to non-interest expense (asset resolution expense) relating to the servicing of delinquent FHA loans, and recorded on a net basis as asset resolution expense. The impact of the reclassification on the year ended December 31, 2010, was an increase in net interest income of \$35.0 million, with an offsetting increase to asset resolution expense and an increase in net interest margin of 11 basis points.

The following tables present on a consolidated basis (rather than on a Bank-only basis) interest income from average earning assets, expressed in dollars and yields, and interest expense on average interest-bearing liabilities, expressed in dollars and rates. Interest income recorded on our loans is adjusted by the amortization of net premiums, net deferred loan origination costs and the amount of negative amortization (i.e., capitalized interest) arising from our option ARM loans. Interest income from earning assets was reduced by \$3.8 million, \$1.0 million and \$0.9 million of amortization of net premiums and net deferred loan origination costs during the years ended December 31, 2012, 2011, and 2010, respectively. Non-accruing loans were included in the average loans outstanding. The amount of net negative amortization included in our interest income during the years ended December 31, 2012, 2011 and 2010 were \$0.2 million, \$2.2 million, and \$2.1 million, respectively.

	For the Years Ended December 31,											
	2012				2011				2010			
	Average Balance	Interest	Average Yield/ Rate		Average Balance	Interest	Average Yield/ Rate		Average Balance	Interest	Average Yield/ Rate	
	(Dollars in thousands)											
Interest-Earning Assets												
Loans held-for-sale	\$3,078,690	\$115,425	3.75 %		\$1,928,339	\$83,025	4.31 %		\$1,945,913	\$91,321	4.69 %	
Loans repurchased with government guarantees	2,018,079	64,887	3.22 %		1,784,927	56,916	3.19 %		1,307,070	35,045	2.68 %	
Loans held-for-investment												
Consumer loans (1)	4,737,553	205,040	4.33 %		4,830,127	221,006	4.58 %		5,776,292	279,370	4.84 %	
Commercial loans (1)	1,782,507	70,789	3.91 %		1,373,566	66,075	4.74 %		1,466,241	69,034		