FLAGSTAR BANCORP INC
Form 10-Q
November 05, 2018
Table of Contents

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

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

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

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

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | ý |
| Non-accelerated filer | o | Smaller reporting company | ¨ |
| | | Emerging growth company | ¨ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act ¨.

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

As of November 1, 2018, 57,627,630 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

Table of Contents

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2018
TABLE OF CONTENTS

Table of Contents

## GLOSSARY OF ABBREVIATIONS AND ACRONYMS

The following list of abbreviations and acronyms are provided as a tool for the reader and may be used throughout this Report, including the Consolidated Financial Statements and Notes:

| Term | Definition | Term | Definition |
|---|---|---|---|
| AFS | Available for Sale | HELOC | Home Equity Lines of Credit |
| Agencies | Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively | HELOAN | Home Equity Loan |
| ALCO | Asset Liability Committee | HOLA | Home Owners Loan Act |
| ALLL | Allowance for Loan & Lease Losses | Home equity | Second Mortgages, HELOANs, HELOCs |
| AOCI | Accumulated Other Comprehensive Income (Loss) | HTM | Held to Maturity |
| ASU | Accounting Standards Update | LIBOR | London Interbank Offered Rate |
| Basel III | Basel Committee on Banking Supervision Third Basel Accord | LHFI | Loans Held-for-Investment |
| C&I | Commercial and Industrial | LHFS | Loans Held-for-Sale |
| CDARS | Certificates of Deposit Account Registry Service | LTV | Loan-to-Value Ratio |
| CET1 | Common Equity Tier 1 | Loan Beta | The change in the annualized yield of our LHFI portfolio, compared to the change in the Federal Reserve discount rate |
| CFPB | Consumer Financial Protection Bureau | Management | Flagstar Bancorp's Management |
| CLTV | Combined Loan to Value Ratio | MBIA | MBIA Insurance Corporation |
| Common Stock | Common Shares | MBS | Mortgage-Backed Securities |
| CRE | Commercial Real Estate | MD&A | Management's Discussion and Analysis |
| DCB | Desert Community Bank | MSR | Mortgage Servicing Rights |
| Deposit Beta | The change in the annualized cost of our deposits, compared to the change in the Federal Reserve discount rate | N/A | Not Applicable |
| DFAST | Dodd-Frank Stress Test | NYSE | New York Stock Exchange |
| DOJ | United States Department of Justice | OCC | Office of the Comptroller of the Currency |
| DTA | Deferred Tax Asset | OTTI | Other-Than-Temporary-Impairment |
| EVE | Economic Value of Equity | QTL | Qualified Thrift Lending |
| Fannie Mae | Federal National Mortgage Association | REO | Real estate and other nonperforming assets, net |
| FASB | Financial Accounting Standards Board | RWA | Risk Weighted Assets |
| FDIC | Federal Deposit Insurance Corporation | SEC | Securities and Exchange Commission |
| FHA | Federal Housing Administration | SFR | Single Family Residence |
| FHLB | Federal Home Loan Bank | TARP Preferred | Troubled Asset Relief Program Fixed Rate Cumulative Perpetual Preferred Stock, Series C |
| FICO | Fair Isaac Corporation | TDR | Trouble Debt Restructuring |
| FRB | Federal Reserve Bank | UPB | Unpaid Principal Balance |
| Freddie Mac | Federal Home Loan Mortgage Corporation | U.S. Treasury | United States Department of Treasury |
| FTE | Full Time Equivalent Employees | VIE | Variable Interest Entities |

| | | | |
|---|---|---|---|
| GAAP | United States Generally Accepted Accounting Principles | XBRL | eXtensible Business Reporting Language |

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following is Management's Discussion and Analysis of the financial condition and results of operations of Flagstar Bancorp, Inc. for the third quarter of 2018, which should be read in conjunction with the financial statements and related notes set forth in Part I, Item 1 of this Form 10-Q and Part II, Item 8 of Exhibit 99.1 to our June 1, 2018 Form 8-K Report.

Certain statements in this Form 10-Q, including but not limited to statements included within Management’s Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements are based on the current beliefs and expectations of our management. Actual results may differ from those set forth in forward-looking statements. See Forward-Looking Statements on page 34 of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2017 Annual Report on Form 10-K for the year ended December 31, 2017. Additional information about Flagstar can be found on our website at www.flagstar.com.

Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference will include our wholly-owned subsidiary Flagstar Bank, FSB (the "Bank"). See the Glossary of Abbreviations and Acronyms on page 3 for definitions used throughout this Form 10-Q.

## Introduction

We are a 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. We provide commercial and consumer banking services and we are the 5th largest bank mortgage originator and the 7th largest sub-servicer of mortgage loans nationwide. At September 30, 2018, we had 3,496 full-time equivalent employees. Our common stock is listed on the NYSE under the symbol "FBC."

We have a relationship-based business model which leverages our full-service Bank’s capabilities with our national mortgage platform to create and build financial relationships with our customers. At September 30, 2018, we operated 108 full service banking branches that offer a full set of banking products to consumer, commercial, and government customers. Our banking footprint spans throughout Michigan and contiguous states as well as the high desert region of California.

In the first quarter of 2018, we closed the purchase of the mortgage loan warehouse business from Santander Bank, which added $499 million in outstanding warehouse loans and we completed the acquisition of eight Desert Community Bank branches in San Bernardino County, California, with $614 million in deposits and $59 million in loans.

In the second quarter 2018, we signed a definitive agreement to acquire 52 Wells Fargo branches in Indiana, Michigan, Wisconsin and Ohio. We expect to close this transaction at the beginning of December 2018.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, and our own loan officers from 81 retail locations in 27 states and two call centers, which includes our direct-to-consumer lending team. Flagstar is also a leading national servicer of mortgage loans and provides complementary ancillary offerings including, MSR lending, servicing advance lending and recapture services. Servicing and subservicing of loans provides fee income and generates a stable long-term source of funding through custodial deposits.

## Operating Segments

Our operations are conducted through our three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. For additional information, please see MD&A - Operating Segments and Note 18 - Segment Information.

Table of Contents

Selected Financial Ratios
(Dollars in millions, except share data)

| | Three Months Ended September 30, 2018 | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2018 | Nine Months Ended September 30, 2017 |
|---|---|---|---|---|
| | (In millions and percentages) | | | |
| Selected Mortgage Statistics: | | | | |
| Mortgage rate lock commitments (fallout-adjusted) (1) | $8,290 | $8,898 | $25,024 | $23,896 |
| Mortgage loans originated | 9,199 | 9,572 | 26,125 | 24,659 |
| Mortgage loans sold and securitized | 8,423 | 8,924 | 24,930 | 22,397 |
| Selected Ratios: | | | | |
| Interest rate spread (2) | 2.57 % | 2.58 % | 2.57 % | 2.56 % |
| Net interest margin | 2.93 % | 2.78 % | 2.85 % | 2.74 % |
| Return on average assets | 1.04 % | 0.99 % | 1.00 % | 0.94 % |
| Return on average equity | 12.80 % | 11.10 % | 12.10 % | 10.23 % |
| Equity-to-assets ratio (average for the period) | 8.13 % | 8.95 % | 8.23 % | 9.16 % |
| Efficiency ratio | 74.6 % | 73.5 % | 76.2 % | 73.9 % |
| Effective tax provision rate | 20.0 % | 32.4 % | 20.1 % | 32.3 % |
| Average Balances: | | | | |
| Average interest-earning assets | $16,786 | $14,737 | $16,050 | $13,709 |
| Average interest-paying liabilities | 13,308 | 12,297 | 13,150 | 11,481 |
| Average stockholders' equity | 1,514 | 1,471 | 1,468 | 1,412 |

| | September 30, 2018 | December 31, 2017 | September 30, 2017 |
|---|---|---|---|
| | (In millions, except per share data and percentages) | | |
| Selected Statistics: | | | |
| Book value per common share | $26.34 | $ 24.40 | $ 25.38 |
| Tangible book value per share (3) | $25.13 | $ 24.04 | $ 25.01 |
| Number of common shares outstanding | 57,625,439 | 57,321,228 | 57,181,536 |
| Common equity-to-assets ratio | 8.12 % | 8.27 % | 8.60 % |
| Tangible common equity to assets ratio (3) | 7.74 % | 8.15 % | 8.47 % |
| Capitalized value of mortgage servicing rights | 1.43 % | 1.16 % | 1.15 % |
| Bancorp Tier 1 leverage (to adjusted avg. total assets) (4) | 8.36 % | 8.51 % | 8.80 % |
| Bank Tier 1 leverage (to adjusted avg. total assets) (4) | 8.77 % | 9.04 % | 9.38 % |
| Number of bank branches | 108 | 99 | 99 |
| Number of FTE employees | 3,496 | 3,525 | 3,495 |

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

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

(3) Excludes goodwill and intangibles of $70 million, $21 million, and $21 million at September 30, 2018, December 31, 2017, and September 30, 2017, respectively. See Non-GAAP Financial Measures for further information.

(4) The Basel III transitional phase-in rules were applicable to December 31, 2017 and September 30, 2017.

5

Table of Contents

## Overview

The third quarter of 2018 resulted in net income of $48 million, or $0.83 per diluted share, up $8 million or $0.13 per diluted share compared to the third quarter of 2017. The increase in net income was primarily due to $21 million, or 20 percent, higher net interest income in the third quarter of 2018 compared to the same period a year ago, driven by growth in interest earning assets and net interest margin expansion.

Through the nine months ended September 30, 2018, consistent earnings performance demonstrated the strength of our Community Banking segment. When comparing the nine months ended September 30, 2018 to the same period in 2017, average commercial loans have increased $1.4 billion, or 42 percent, with broad based growth across all portfolios and average retail and government deposits have grown $955 million, or 13 percent. Additionally, the pending acquisition of 52 branches from Wells Fargo will provide us with over $2 billion of additional high quality, low cost deposits which we will use to fund balance sheet growth.

We continue to build the Mortgage Servicing segment, increasing the number of loans serviced 49 percent over the last 12 months and ending the third quarter of 2018 servicing nearly 620,000 accounts. We are positioned to continue to add scale to our servicing business which provides both stable deposits and a reliable source of fee income.

The mortgage market continued to be challenging through the third quarter 2018. Net gain on loan sales decreased $32 million, primarily driven by a 33 basis point decrease in net gain on loan sale margin in the three months ended September 30, 2018, compared to the same period in 2017. This loss was partially offset by stronger valuations and lower prepayments on our mortgage servicing assets, which improved $7 million.

Earnings Performance Highlights

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions, except share data) | | | | | |
| Net interest income | $124 | $103 | $21 | $345 | $283 | $62 |
| Provision (benefit) for loan losses | (2) | 2 | (4) | (3) | 4 | (7) |
| Total noninterest income | 107 | 130 | (23) | 341 | 346 | (5) |
| Total noninterest expense | 173 | 171 | 2 | 523 | 465 | 58 |
| Provision for income taxes | 12 | 20 | (8) | 33 | 52 | (19) |
| Net income | $48 | $40 | $8 | $133 | $108 | $25 |
| Income per share | | | | | | |
| Basic | $0.84 | $0.71 | $0.13 | $2.32 | $1.90 | $0.42 |
| Diluted | $0.83 | $0.70 | $0.13 | $2.28 | $1.86 | $0.42 |

Comparison to Prior Year Quarter

- Net income increased $8 million, or $0.13 per diluted share, to $48 million, or $0.83 per diluted share.
- Net interest income increased $21 million, primarily driven by $2.0 billion higher average interest-earnings assets and a 15 basis point increase in net interest margin.
- Noninterest income decreased $23 million, primarily due to lower gains on loan sales, partially offset by higher returns on MSRs.
-

Noninterest expense increased $2 million, primarily a result of organic growth and acquisitions, partially offset by a decrease in volume related expenses.

Comparison to Prior Year to Date

- Net income increased $25 million, or $0.42 per diluted share, to $133 million, or $2.28 per diluted share.
- Net interest income increased $62 million, primarily driven by 17 percent higher average interest-earning assets and net interest margin expansion of 11 basis points.
- The $7 million change in the provision for loan losses was driven by continued minimal net charge-offs and low levels of delinquencies.
- Noninterest expense increased $58 million, primarily resulting from growth initiatives and volume driven expenses.

Net Interest Income

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

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | |
| | Average Balance | Interest | Annualized Yield/ Rate | | Average Balance | Interest | Annualized Yield/ Rate | |
| | (Dollars in millions) | | | | | | | |
| Interest-Earning Assets | | | | | | | | |
| Loans held-for-sale | $4,393 | $ 52 | 4.69 | % | $4,476 | $ 45 | 3.99 | % |
| Loans held-for-investment | | | | | | | | |
| Residential first mortgage | 3,027 | 27 | 3.63 | % | 2,594 | 22 | 3.32 | % |
| Home equity | 695 | 9 | 5.12 | % | 486 | 6 | 5.11 | % |
| Other | 128 | 2 | 5.54 | % | 26 | — | 4.52 | % |
| Total consumer loans | 3,850 | 38 | 3.96 | % | 3,106 | 28 | 3.61 | % |
| Commercial real estate | 2,106 | 29 | 5.37 | % | 1,646 | 19 | 4.43 | % |
| Commercial and industrial | 1,330 | 18 | 5.28 | % | 1,073 | 13 | 4.77 | % |
| Warehouse lending | 1,586 | 21 | 5.10 | % | 978 | 12 | 4.82 | % |
| Total commercial loans | 5,022 | 68 | 5.26 | % | 3,697 | 44 | 4.63 | % |
| Total loans held-for-investment (1) | 8,872 | 106 | 4.70 | % | 6,803 | 72 | 4.16 | % |
| Loans with government guarantees | 292 | 3 | 4.20 | % | 264 | 3 | 4.58 | % |
| Investment securities | 3,100 | 21 | 2.81 | % | 3,101 | 20 | 2.58 | % |
| Interest-earning deposits | 129 | 1 | 2.38 | % | 93 | — | 1.23 | % |
| Total interest-earning assets | 16,786 | 183 | 4.32 | % | 14,737 | 140 | 3.77 | % |
| Other assets | 1,825 | | | | 1,702 | | | |
| Total assets | $18,611 | | | | $16,439 | | | |
| Interest-Bearing Liabilities | | | | | | | | |
| Retail deposits | | | | | | | | |
| Demand deposits | $727 | $ 3 | 1.62 | % | $489 | $ — | 0.14 | % |
| Savings deposits | 3,229 | 7 | 0.90 | % | 3,838 | 7 | 0.76 | % |
| Money market deposits | 252 | — | 0.62 | % | 276 | — | 0.57 | % |
| Certificates of deposit | 2,150 | 10 | 1.78 | % | 1,182 | 4 | 1.19 | % |
| Total retail deposits | 6,358 | 20 | 1.27 | % | 5,785 | 11 | 0.78 | % |
| Government deposits | | | | | | | | |
| Demand deposits | 283 | 1 | 0.59 | % | 250 | — | 0.43 | % |
| Savings deposits | 564 | 2 | 1.48 | % | 362 | 1 | 0.71 | % |
| Certificates of deposit | 327 | 1 | 1.52 | % | 329 | 1 | 0.89 | % |
| Total government deposits | 1,174 | 4 | 1.28 | % | 941 | 2 | 0.70 | % |
| Wholesale deposits and other | 537 | 3 | 2.03 | % | 35 | — | 1.49 | % |
| Total interest-bearing deposits | 8,069 | 27 | 1.32 | % | 6,761 | 13 | 0.78 | % |
| Short-term Federal Home Loan Bank advances and other | 3,465 | 18 | 2.10 | % | 3,809 | 11 | 1.17 | % |
| Long-term Federal Home Loan Bank advances | 1,280 | 7 | 2.11 | % | 1,234 | 6 | 1.99 | % |
| Other long-term debt | 494 | 7 | 5.62 | % | 493 | 7 | 5.09 | % |
| Total interest-bearing liabilities | 13,308 | 59 | 1.75 | % | 12,297 | 37 | 1.19 | % |
| Noninterest-bearing deposits (2) | 3,267 | | | | 2,244 | | | |
| Other liabilities | 522 | | | | 427 | | | |
| Stockholders’ equity | 1,514 | | | | 1,471 | | | |
| Total liabilities and stockholders' equity | $18,611 | | | | $16,439 | | | |

| | | | | |
|---|---|---|---|---|
| Net interest income | $ 124 | | $ 103 | |
| Interest rate spread (3) | 2.57 | % | 2.58 | % |
| Net interest margin (4) | 2.93 | % | 2.78 | % |
| Ratio of average interest-earning assets to interest-bearing liabilities | 126.1 | % | 119.9 | % |

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
(2) Includes noninterest-bearing custodial deposits that arise due to the servicing of loans for others.
(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.
(4) Net interest margin is net interest income divided by average interest-earning assets.

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | |
| | Average Balance | Interest | Annualized Yield/ Rate | | Average Balance | Interest | Annualized Yield/ Rate | |
| | (Dollars in millions) | | | | | | | |
| Interest-Earning Assets | | | | | | | | |
| Loans held-for-sale | $4,265 | $ 142 | 4.44 | % | $4,014 | $ 119 | 3.96 | % |
| Loans held-for-investment | | | | | | | | |
| Residential first mortgage | 2,893 | 76 | 3.52 | % | 2,497 | 62 | 3.34 | % |
| Home equity | 681 | 26 | 5.13 | % | 453 | 17 | 5.04 | % |
| Other | 71 | 3 | 5.37 | % | 26 | 1 | 4.52 | % |
| Total consumer loans | 3,645 | 105 | 3.86 | % | 2,976 | 80 | 3.61 | % |
| Commercial real estate | 2,026 | 79 | 5.12 | % | 1,482 | 47 | 4.15 | % |
| Commercial and industrial | 1,269 | 51 | 5.26 | % | 929 | 33 | 4.71 | % |
| Warehouse lending | 1,312 | 51 | 5.08 | % | 840 | 30 | 4.70 | % |
| Total commercial loans | 4,607 | 181 | 5.15 | % | 3,251 | 110 | 4.45 | % |
| Total loans held-for-investment (1) | 8,252 | 286 | 4.58 | % | 6,227 | 190 | 4.05 | % |
| Loans with government guarantees | 288 | 8 | 3.86 | % | 300 | 10 | 4.41 | % |
| Investment securities | 3,127 | 64 | 2.74 | % | 3,093 | 59 | 2.55 | % |
| Interest-earning deposits | 118 | 2 | 1.95 | % | 75 | 1 | 1.08 | % |
| Total interest-earning assets | 16,050 | 502 | 4.15 | % | 13,709 | 379 | 3.68 | % |
| Other assets | 1,784 | | | | 1,697 | | | |
| Total assets | $17,834 | | | | $15,406 | | | |
| Interest-Bearing Liabilities | | | | | | | | |
| Retail deposits | | | | | | | | |
| Demand deposits | $660 | $ 4 | 0.89 | % | $502 | $ 1 | 0.16 | % |
| Savings deposits | 3,376 | 21 | 0.85 | % | 3,899 | 22 | 0.76 | % |
| Money market deposits | 235 | 1 | 0.54 | % | 264 | 1 | 0.49 | % |
| Certificates of deposit | 1,927 | 24 | 1.64 | % | 1,116 | 9 | 1.12 | % |
| Total retail deposits | 6,198 | 50 | 1.09 | % | 5,781 | 33 | 0.76 | % |
| Government deposits | | | | | | | | |
| Demand deposits | 256 | 1 | 0.54 | % | 228 | 1 | 0.41 | % |
| Savings deposits | 512 | 5 | 1.29 | % | 410 | 2 | 0.59 | % |
| Certificates of deposit | 369 | 4 | 1.34 | % | 314 | 1 | 0.73 | % |
| Total government deposits | 1,137 | 10 | 1.14 | % | 952 | 4 | 0.59 | % |
| Wholesale deposits and other | 325 | 5 | 1.99 | % | 16 | — | 1.21 | % |
| Total interest-bearing deposits | 7,660 | 65 | 1.13 | % | 6,749 | 37 | 0.74 | % |
| Short-term Federal Home Loan Bank advances and other | 3,713 | 50 | 1.81 | % | 3,028 | 23 | 1.01 | % |
| Long-term Federal Home Loan Bank advances | 1,283 | 21 | 2.15 | % | 1,211 | 17 | 1.92 | % |
| Other long-term debt | 494 | 21 | 5.53 | % | 493 | 19 | 5.06 | % |
| Total interest-bearing liabilities | 13,150 | 157 | 1.58 | % | 11,481 | 96 | 1.12 | % |
| Noninterest-bearing deposits (2) | 2,721 | | | | 2,098 | | | |
| Other liabilities | 495 | | | | 415 | | | |
| Stockholders’ equity | 1,468 | | | | 1,412 | | | |
| Total liabilities and stockholders' equity | $17,834 | | | | $15,406 | | | |
| Net interest income | | $ 345 | | | | $ 283 | | |
| Interest rate spread (3) | | | 2.57 | % | | | 2.56 | % |
| Net interest margin (4) | | | 2.85 | % | | | 2.74 | % |
| | | | 122.1 | % | | | 119.4 | % |

Ratio of average interest-earning assets to interest-bearing liabilities

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
(2) Includes noninterest-bearing custodial deposits that arise due to the servicing of loans for others.
(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.
(4) Net interest margin is net interest income divided by average interest-earning assets.

Rate/Volume Analysis

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

| | Three Months Ended September 30, 2018 Versus 2017 Increase (Decrease) Due to: | | |
|---|---|---|---|
| | Rate | Volume | Total |
| | (Dollars in millions) | | |
| Interest-Earning Assets | | | |
| Loans held-for-sale | $8 | $ (1 ) | $ 7 |
| Loans held-for-investment | | | |
| Residential first mortgage | 2 | 3 | 5 |
| Home equity | — | 3 | 3 |
| Other | 1 | 1 | 2 |
| Total consumer loans | 3 | 7 | 10 |
| Commercial real estate | 5 | 5 | 10 |
| Commercial and industrial | 2 | 3 | 5 |
| Warehouse lending | 1 | 8 | 9 |
| Total commercial loans | 8 | 16 | 24 |
| Total loans held-for-investment | 11 | 23 | 34 |
| Investment securities | 1 | — | 1 |
| Interest-earning deposits and other | 1 | — | 1 |
| Total interest-earning assets | $21 | $ 22 | $ 43 |
| Interest-Bearing Liabilities | | | |
| Interest-bearing deposits | $11 | $ 3 | $ 14 |
| Short-term Federal Home Loan Bank advances and other | 8 | (1 ) | 7 |
| Long-term Federal Home Loan Bank advances | 1 | — | 1 |
| Total interest-bearing liabilities | 20 | 2 | 22 |
| Change in net interest income | $1 | $ 20 | $ 21 |

| | Nine Months Ended September 30, 2018 Versus 2017 Increase (Decrease) Due to: | | |
|---|---|---|---|
| | Rate | Volume | Total |
| | (Dollars in millions) | | |
| Interest-Earning Assets | | | |
| Loans held-for-sale | $15 | $ 8 | $23 |
| Loans held-for-investment | | | |
| Residential first mortgage | 4 | 10 | 14 |
| Home equity | 1 | 8 | 9 |
| Other | — | 2 | 2 |
| Total consumer loans | 5 | 20 | 25 |
| Commercial real estate | 15 | 17 | 32 |
| Commercial and industrial | 6 | 12 | 18 |
| Warehouse lending | 4 | 17 | 21 |
| Total commercial loans | 25 | 46 | 71 |
| Total loans held-for-investment | 30 | 66 | 96 |
| Loans with government guarantees | (1 ) | (1 ) | (2 ) |
| Investment securities | 5 | — | 5 |
| Interest-earning deposits and other | 1 | — | 1 |
| Total interest-earning assets | $50 | $ 73 | $123 |
| Interest-Bearing Liabilities | | | |
| Interest-bearing deposits | $22 | $ 6 | $28 |
| Short-term Federal Home Loan Bank advances and other | 22 | 5 | 27 |
| Long-term Federal Home Loan Bank advances | 3 | 1 | 4 |
| Other long-term debt | 2 | — | 2 |
| Total interest-bearing liabilities | 49 | 12 | 61 |
| Change in net interest income | $1 | $ 61 | $62 |

Comparison to Prior Year Quarter

Net interest income increased $21 million, or 20 percent, for the three months ended September 30, 2018, compared to the same period in 2017. This increase was primarily driven by growth in average interest-earning assets, led by continued growth in the commercial loan portfolio.

Net interest margin for the three months ended September 30, 2018 was 2.93 percent, as compared to 2.78 percent for the three months ended September 30, 2017. The increase in net interest margin was primarily due to growth in our commercial loan portfolio, partially offset by higher average rates on deposits. Loans held-for-investment, driven by higher yielding commercial loans, saw a 54 basis point increase in average rates. This change in rates represents a loan beta of 54 percent, which is the change in the annualized yield of our LHFI portfolio, compared to the change in the Federal Reserve discount rate. Our deposit costs increased 36 basis points, representing a deposit beta of only 36 percent, primarily driven by holding a higher percentage of certificates of deposits, offset by lower cost deposits acquired from the DCB branch acquisition. The higher loan beta when compared to our deposit beta indicates that the yield on our LHFI portfolio is more responsive to changes in market rates than our deposit costs, driving a higher interest rate spread. In addition, average deposit growth of $2.3 billion allowed us to reduce higher cost FHLB borrowings, further benefiting margin expansion.

Average interest-earning assets increased $2.0 billion for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to an increase in both commercial and consumer LHFI average balances. The commercial loan portfolio increased $1.3 billion from broad based growth in warehouse, commercial real estate and C&I loans driven by organic growth and the acquisition of the Santander warehouse business from the first quarter of 2018. Additionally, we experienced growth of $744 million in our consumer loan portfolio as we continued to portfolio mortgage loan production and grow our indirect lending business.

Average interest-bearing liabilities increased $1.0 billion for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. This increase was primarily due to the DCB branch acquisition as well as organic growth in retail certificates of deposit partially offset by a decline in retail savings deposits. Additionally, we experienced an increase in wholesale deposits to bridge funding needs to December when these funds will be replaced with lower cost, more stable branch deposits from the Wells Fargo acquisition. As a result of deposit growth, average short term FHLB borrowings were reduced $344 million.

Comparison to Prior Year to Date

Net interest income increased $62 million, or 22 percent, for the nine months ended September 30, 2018, compared to the same period in 2017. This increase was primarily driven by growth in average interest-earnings assets, led by continued growth in the commercial loan portfolio.

Our net interest margin for the nine months ended September 30, 2018 was 2.85 percent, as compared to 2.74 percent for the nine months ended September 30, 2017. Margin expansion was primarily a driven by a 53 basis point increase in yields on our LHFI portfolios, which outweighed a 27 basis point increase in average costs of deposits. The increase in deposit costs was driven by a shift in mix to longer duration certificates of deposits, partially offset by the low cost deposits acquired from the DCB branch acquisition.

Average interest-earning assets increased $2.3 billion for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to broad based growth in the commercial loan portfolio of $1.4 billion, partially driven by the Santander warehouse business acquisition, and increases in residential mortgage loans and HELOCs of $669 million.

Average interest-bearing liabilities increased $1.7 billion for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. Interest-bearing deposits increased $911 million, primarily driven by the DCB branch acquisition along with higher retail and wholesale deposits. Additionally, to fund balance sheet growth, average short term FHLB advances increased $685 million.

Provision for Loan Losses

The provision for loan losses was a benefit of $2 million and $3 million for the three and nine months ended September 30, 2018, respectively, compared to a provision of $2 million and $4 million for the three and nine months ended September 30, 2017, respectively. The improvement in the provision reflects our continued strong credit quality with continued low levels of charge-offs, offset by growth of the portfolio in areas we believe to pose lower levels of credit risk.

For further information on the provision for loan losses see MD&A - Credit Quality.

Noninterest Income

The following tables provide information on our noninterest income along with other mortgage metrics:

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions) | | | | | |
| Net gain on loan sales | $43 | $75 | $ (32 ) | $166 | $189 | $ (23 ) |
| Loan fees and charges | 23 | 23 | — | 67 | 58 | 9 |
| Deposit fees and charges | 5 | 5 | — | 15 | 14 | 1 |
| Loan administration income | 5 | 5 | — | 15 | 16 | (1 ) |
| Net return on mortgage servicing rights | 13 | 6 | 7 | 26 | 26 | — |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other noninterest income | 18 | 16 | 2 | 52 | 43 | 9 |
| Total noninterest income | $107 | $130 | $ (23 ) | $341 | $346 | $ (5 ) |

Table of Contents

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions) | | | | | |
| Mortgage rate lock commitments (fallout-adjusted) (1) | $8,290 | $8,898 | $(608) | $25,024 | $23,896 | $1,128 |
| Net margin on mortgage rate lock commitments (fallout-adjusted) (1)(2) | 0.51 % | 0.84 % | (0.33 )% | 0.66 % | 0.79 % | (0.13 )% |
| Mortgage loans sold and securitized | 8,423 | 8,924 | (501 ) | 24,930 | 22,397 | 2,533 |

(1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on our historical experience and the impact of changes in interest rates.
(2) Gain on loan sale volume is based on net gain on loan sales to fallout-adjusted mortgage rate lock commitments.

Comparison to Prior Year Quarter

Total noninterest income decreased $23 million during the three months ended September 30, 2018, compared to the same period in 2017.

Net gain on loan sales decreased $32 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to a 33 basis point decrease in net gain on loan sale margin and $608 million decrease in fallout-adjusted rate lock volume. The mortgage market has seen a decrease in production and continued over capacity during the third quarter of 2018 compared to the same quarter a year ago. The decrease in gain on sale margin was primarily due to secondary margin compression and a shift in the channel mix toward lower margin, but lower cost delegated correspondent channel.

Net return on MSRs, including the impact of hedges, increased $7 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to higher net return from the MSR asset resulting from lower prepayments and stronger valuations, along with a higher average MSR balance.

Other noninterest income increased $2 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to higher FHLB stock dividend income attributable to an increase in FHLB stock holdings and higher rental income driven by growth within the equipment finance operating lease portfolio.

Comparison to Prior Year to Date

Total noninterest income decreased $5 million during the nine months ended September 30, 2018, compared to the same period in 2017.

Net gain on loan sales decreased $23 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to a 13 basis point decrease in net gain on loan sale margin driven by secondary margin compression and a mix shift toward the lower margin, but lower cost delegated correspondent channel, partially offset by securitizations. Margin compression was partially offset by a 5 percent increase in fallout-adjusted rate locks, boosted by our 2017 mortgage acquisitions.

Loan fees and charges increased $9 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to an increase in mortgage loan closings, boosted by our 2017 mortgage acquisitions, and shift in the channel mix from third party originations to retail channels.

Other noninterest income increased $9 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase was primarily due to higher FHLB stock dividend income attributable to an increase in FHLB stock holdings and a supplemental dividend from the FHLB received in the first quarter of 2018, higher rental income driven by growth within the equipment finance operating lease portfolio, and higher investment and insurance income.

Table of Contents

Noninterest Expense

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

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions) | | | | | |
| Compensation and benefits | $76 | $76 | $ — | $236 | $219 | $ 17 |
| Occupancy and equipment | 31 | 28 | 3 | 91 | 75 | 16 |
| Commissions | 21 | 23 | (2 ) | 64 | 49 | 15 |
| Federal insurance premiums | 6 | 5 | 1 | 18 | 12 | 6 |
| Loan processing expense | 14 | 15 | (1 ) | 43 | 41 | 2 |
| Legal and professional expense | 7 | 7 | — | 19 | 22 | (3 ) |
| Other noninterest expense | 18 | 17 | 1 | 52 | 47 | 5 |
| Total noninterest expense | $173 | $171 | $ 2 | $523 | $465 | $ 58 |
| Efficiency ratio | 74.6 % | 73.5 % | 1.1 % | 76.2 % | 73.9 % | 2.3 % |
| Average number of FTE | 3,570 | 3,500 | 70 | 3,617 | 3,233 | 384 |

Comparison to Prior Year Quarter

Noninterest expense increased $2 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017.

Occupancy and equipment increased $3 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to a higher average depreciable asset base resulting from technology upgrades and software.

Commissions decreased $2 million and loan processing expense decreased $1 million, during the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to a decrease in loan originations.

Comparison to Prior Year to Date

Noninterest expense increased $58 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017.

Compensation and benefits increased $17 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to 12 percent higher average FTE, driven by acquisitions and growth in our overall business, partially offset by cost reduction initiatives and lower incentive compensation.

Occupancy and equipment increased $16 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase was primarily due to a higher average depreciable asset base and an increase in vendor services supporting business growth.

Commissions increased $15 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase is primarily due to the acquisition of Opes in May of 2017, which has increased our retail mortgage originations versus our predominately third party origination model, and $1.4 billion higher loan originations in the nine months ended September 30, 2018, compared to the nine months ended

September 30, 2017.

FDIC insurance premiums increased $6 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to growth in our total assets.

Other noninterest expense increased $5 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to advertising expense to raise brand awareness.

Table of Contents

Provision for Income Taxes

Our provision for income taxes for the three and nine months ended September 30, 2018 was $12 million and $33 million, respectively, compared to a provision of $20 million and $52 million for the three and nine months ended September 30, 2017, respectively. These decreases are primarily due to the reduction in the statutory corporate tax rate from 35 percent to 21 percent as a result of the Tax Cuts and Jobs Act.

Our effective tax provision rate for the three and nine months ended September 30, 2018 was 20.0 percent and 20.1 percent, respectively, compared to 32.4 percent and 32.3 percent for the three and nine months ended September 30, 2017, respectively. Our effective tax provision rate differs from the combined federal and state statutory tax rate primarily due to non-taxable bank owned life insurance and other tax-exempt earnings, partially offset by nondeductible expenses.

Operating Segments

Our operations are conducted through three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. The Other segment includes the remaining reported activities. The operating segments have been determined based on the products and services offered and reflect the manner in which financial information is currently evaluated by management. Each of the operating segments is complementary to each other and because of the interrelationships of the segments, the information presented is not indicative of how the segments would perform if they operated as independent entities.

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 18 - Segment Information.

Community Banking

Our Community Banking segment services commercial, governmental and consumer customers in our banking footprint which spans throughout Michigan and contiguous states as well as the high desert region of California. We also serve home builders, correspondents, and commercial customers on a national basis. The Community Banking segment originates loans, and provides deposit and fee based services to consumer, business, and mortgage lending customers.

Our commercial customers are from a diversified range of industries including financial, insurance, service, manufacturing, and distribution. We offer financial products to these customers for use in their normal business operations and financing of working capital needs, capital investments, and equipment purchases and leases. Additionally, our commercial real estate business supports income producing real estate and home builders. The Community Bank also offers warehouse lines of credit to other mortgage lenders.

Our Community Banking segment has seen continued growth, both organically and through strategic acquisitions, and our transformation into a commercial bank continues to be a key component in our overall business model. Our commercial loan portfolio has grown 25 percent in the last twelve months, to $5.0 billion, at September 30, 2018, boosted by the Santander warehouse business acquisition. Additionally, the DCB branch acquisition expanded our banking footprint and drove an increase in deposits in the Community Banking segment. Average deposits, for the nine month ended September 30, 2018, have increased to $8.6 billion, compared to $7.4 billion, for the same period in 2017.

In the second quarter 2018, we signed a definitive agreement to acquire 52 Wells Fargo branches in Indiana, Michigan, Wisconsin and Ohio. These branches will provide us with over $2 billion of high-quality, low-cost deposits, allowing for balance sheet growth and further expansion of our banking footprint. We estimate post-closing deposit run-off of approximately 17 percent and anticipate fourth quarter 2018 integration costs to be approximately $10 million. The acquisition is expected to be moderately accretive to 2019 earnings per share with a payback period of less than five years. We expect to close this transaction at the beginning of December 2018.

Table of Contents

| Community Banking | Three Months Ended September 30, 2018 | 2017 | Change | Nine Months Ended September 30, 2018 | 2017 | Change |
|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | |
| Summary of Operations | | | | | | |
| Net interest income | $81 | $63 | $18 | $231 | $171 | $60 |
| Provision benefit for loan losses | (1) | (1) | — | (2) | (3) | 1 |
| Net interest income after (provision) benefit for loan losses | 80 | 62 | 18 | 229 | 168 | 61 |
| Net gain (loss) on loan sales | (3) | (4) | 1 | (10) | (7) | (3) |
| Other noninterest income | 10 | 8 | 2 | 27 | 22 | 5 |
| Total noninterest income | 7 | 4 | 3 | 17 | 15 | 2 |
| Compensation and benefits | (17) | (15) | (2) | (51) | (46) | (5) |
| Other noninterest expense and directly allocated overhead | (27) | (25) | (2) | (81) | (67) | (14) |
| Total noninterest expense | (44) | (40) | (4) | (132) | (113) | (19) |
| Income before indirect overhead allocations and income taxes | 43 | 26 | 17 | 114 | 70 | 44 |
| Overhead allocations | (9) | (10) | 1 | (29) | (30) | 1 |
| Provision for income taxes | 7 | 6 | 1 | 18 | 14 | 4 |
| Net income | $27 | $10 | $17 | $67 | $26 | $41 |
| Key Metrics | | | | | | |
| Efficiency Ratio | 51.2% | 59.7% | (8.5)% | 53.5 % | 60.8 % | (7.3)% |
| Return on average assets | 1.2 % | 0.6 % | 0.6 % | 1.1 % | 0.6 % | 0.5 % |
| Average number of FTE employees | 846 | 725 | 121 | 811 | 705 | 106 |

Comparison to Prior Year Quarter

The Community Banking segment reported net income of $27 million for the three months ended September 30, 2018, compared to $10 million for the three months ended September 30, 2017. The $17 million increase in net income was primarily due to an $18 million increase in net interest income driven by higher average commercial loans. Average commercial loans increased $1.3 billion for the three months ended September 30, 2018 compared to the three months ended September 30, 2017, due to organic growth and our 2018 acquisitions of Desert Community Bank branches and the Santander warehouse business. This increase was partially offset by a $4 million increase in noninterest expense primarily due to higher compensation and benefits driven by an increase in FTE to support growth initiatives and an increase in FDIC premiums primarily due to higher total assets.

Comparison to Prior Year to Date

The Community Banking segment reported net income of $67 million for the nine months ended September 30, 2018, compared to $26 million for the nine months ended September 30, 2017. The $41 million increase in net income was primarily due to a $60 million increase in net interest income driven by average commercial loan growth of $1.4 billion for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This average commercial loan growth was due to organic growth and our 2018 acquisitions of Desert Community Bank branches and the Santander warehouse business. The increase in net interest income was partially offset by a $19 million increase in noninterest expense driven by growth initiatives, which include higher compensation and benefits, commissions, occupancy and equipment expense, along with an increase in community reinvestment programs and FDIC premiums primarily due to higher total assets.

Mortgage Originations

We are a leading national originator of residential first mortgages. Our Mortgage Origination segment originates and acquires one-to-four family residential mortgage loans primarily to sell or in some instances to hold in our LHFI portfolio in the Community Banking segment. We utilize diversified channels to originate or acquire mortgage loans including more than 1,100 correspondent partners, more than 800 broker relationships and we operate 81 retail lending locations.

Table of Contents

| Mortgage Originations | Three Months Ended September 30, 2018 | 2017 | Change | Nine Months Ended September 30, 2018 | 2017 | Change |
|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | |
| Summary of Operations | | | | | | |
| Net interest income | $36 | $34 | $2 | $100 | $96 | $4 |
| Provision for loan losses | — | (1) | 1 | (1) | (3) | 2 |
| Net interest income after provision benefit for loan losses | 36 | 33 | 3 | 99 | 93 | 6 |
| Net gain on loan sales | 46 | 79 | (33) | 176 | 196 | (20) |
| Other noninterest income | 30 | 27 | 3 | 76 | 77 | (1) |
| Total noninterest income | 76 | 106 | (30) | 252 | 273 | (21) |
| Compensation and benefits | (26) | (28) | 2 | (83) | (72) | (11) |
| Other noninterest expense and directly allocated overhead | (41) | (49) | 8 | (129) | (114) | (15) |
| Total noninterest expense | (67) | (77) | 10 | (212) | (186) | (26) |
| Income before indirect overhead allocations and income taxes | 45 | 62 | (17) | 139 | 180 | (41) |
| Overhead allocation | (16) | (15) | (1) | (51) | (46) | (5) |
| Provision for income taxes | 6 | 16 | (10) | 18 | 47 | (29) |
| Net income | $23 | $31 | $(8) | $70 | $87 | $(17) |
| Key Metrics | | | | | | |
| Efficiency Ratio | 59.1% | 55.0% | 4.1% | 60.1% | 50.4% | 9.7% |
| Return on average assets | 1.6% | 2.2% | (0.6)% | 1.7% | 2.2% | (0.5)% |
| Mortgage rate lock commitments (fallout-adjusted) (1) | $8,290 | $8,898 | $(608) | $25,024 | $23,896 | $1,128 |
| Average number of FTE employees | 1,464 | 1,618 | (154) | 1,575 | 1,381 | 194 |

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

Comparison to Prior Year Quarter

The Mortgage Originations segment reported net income of $23 million for the three months ended September 30, 2018, compared to $31 million for the three months ended September 30, 2017. The decrease in net income, was primarily due to a $33 million lower net gain on loan sales driven by a 33 basis point decrease in net gain on loan sale margin and $608 million lower fallout adjusted locks. Secondary margin compression and a mix shift toward lower margin, but lower cost delegated correspondent channel, drove margin compression. The decrease in net interest income was partially offset by a $10 million decrease in noninterest expense due to lower volume related expenses and a decrease in compensation and benefits resulting from lower headcount, in addition to a $7 million increase in net return on MSRs primarily driven by lower prepayments and stronger valuations, along with a higher average UPB MSR balance.

Comparison to Prior Year to Date

The Mortgage Originations segment reported net income of $70 million for the nine months ended September 30, 2018, compared to $87 million for the nine months ended September 30, 2017. The decrease was primarily due to $20 million decrease in net gain on loan sales driven by a 13 basis point decrease in net gain on loan sale margins, partially offset by $1.1 billion higher fallout adjusted locks driven by 2017 acquisitions. The increase in mortgage volumes drove a $13 million increase in commission expense and a partially offsetting $2 million favorable impact on loan fees and charges. Additionally, an increase in headcount, primarily driven by acquisitions, resulted in $11 million higher compensation and benefits.

Mortgage Servicing

The Mortgage Servicing segment services loans, in which we hold the MSR asset, and subservices mortgage loans for others through a scalable servicing platform on a fee for service basis. We may also collect ancillary fees and earn income through the use of noninterest bearing escrows. The loans we service generate custodial deposits which provide a stable funding source. Revenue for those serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the delinquency status of the underlying loans. The Mortgage Servicing segment also services residential mortgages for our LHFI portfolio in the Community Banking segment and our own MSR portfolio in the Mortgage Originations segment for which it earns intersegment revenue.

Table of Contents

| Mortgage Servicing | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions) | | | | | |
| Summary of Operations | | | | | | |
| Net interest income (1) | $2 | $4 | $(2) | $5 | $9 | $(4) |
| Provision for loan losses | — | — | — | — | — | — |
| Net interest income after provision for loan losses | 2 | 4 | (2) | 5 | 9 | (4) |
| Total noninterest income | 24 | 14 | 10 | 65 | 47 | 18 |
| Compensation and benefits | (4) | (4) | — | (13) | (12) | (1) |
| Other noninterest expense and directly allocated overhead | (18) | (13) | (5) | (49) | (45) | (4) |
| Total noninterest expense | (22) | (17) | (5) | (62) | (57) | (5) |
| Income (loss) before indirect overhead allocations and income taxes | 4 | 1 | 3 | 8 | (1) | 9 |
| Overhead allocations | (5) | (6) | 1 | (15) | (17) | 2 |
| Provision (benefit) for income taxes | — | (1) | 1 | (2) | (6) | 4 |
| Net income (loss) | $(1) | $(4) | $3 | $(5) | $(12) | $7 |
| Key Metrics | | | | | | |
| Efficiency Ratio | 86.9% | 94.4% | (7.5)% | 88.6% | 101.8% | (13.2)% |
| Return on average assets | (14.5)% | (53.3)% | 38.8% | (24.5)% | (44.4)% | 19.9% |
| Average number of residential loans serviced | 591,769 | 401,792 | 189,977 | 515,292 | 397,558 | 117,734 |
| Average number of FTE employees | 238 | 197 | 41 | 221 | 197 | 24 |

(1) Includes intersegment interest earned, net of interest paid on custodial deposits.

The following table presents residential loans serviced and the number of accounts associated with those loans.

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Unpaid Principal Balance (1) | Number of accounts | Unpaid Principal Balance (1) | Number of accounts |
| | (Dollars in millions) | | | |
| Residential loan servicing | | | | |
| Subserviced for others (2) | $106,297 | 494,950 | $65,864 | 309,814 |
| Serviced for others | 21,835 | 88,410 | 25,073 | 103,137 |
| Serviced for own loan portfolio (3) | 8,033 | 35,185 | 7,013 | 29,493 |
| Total residential loans serviced | $136,165 | 618,545 | $97,950 | 442,444 |

(1) UPB, net of write downs, does not include premiums or discounts.

(2) Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs. Includes repossessed assets.

(3) Includes LHFI (residential first mortgage and home equity), LHFS (residential first mortgage), loans with government guarantees (residential first mortgage), and repossessed assets.

Comparison to Prior Year Quarter

The Mortgage Servicing segment reported net loss of $1 million for the three months ended September 30, 2018, compared to a net loss of $4 million for the three months ended September 30, 2017. The increase in net income was primarily due to an increase in loans serviced which drove higher volume related income, including a $6 million increase in loan administration income and a $3 million increase in ancillary fees, partially offset by higher volume related noninterest expense.

Comparison to Prior Year to Date

The Mortgage Servicing segment reported a net loss of $5 million for the nine months ended September 30, 2018, compared to a net loss of $12 million for the nine months ended September 30, 2017. The increase in net income was primarily due to an increase in the number of loans serviced which drove higher volume related income, including a $10 million increase in loan administration income and an $8 million increase in ancillary fees. This increase was partially offset by higher volume related costs driving an increase in noninterest expense.

Table of Contents

## Other

The Other segment includes the treasury functions, which include, the impact of interest rate risk management, balance sheet funding activities and the administration of the investment securities portfolios, as well as other expenses of a corporate nature, including corporate staff, risk management, and legal expenses. In addition, the Other segment includes revenue and expenses not directly assigned or allocated to the Community Banking, Mortgage Originations or Mortgage Servicing segments.

| Other | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | (Dollars in millions) | | | | | |
| Summary of Operations | | | | | | |
| Net interest income (1) | $5 | $ 2 | $ 3 | $9 | $ 7 | $ 2 |
| (Provision) benefit for loan losses | 3 | — | 3 | 6 | 2 | 4 |
| Net interest income after (provision) benefit for loan losses | 8 | 2 | 6 | 15 | 9 | 6 |
| Net gain (loss) on loan sales | — | — | — | — | — | — |
| Other noninterest income (1) | — | 6 | (6 ) | 7 | 11 | (4 ) |
| Total noninterest income | — | 6 | (6 ) | 7 | 11 | (4 ) |
| Compensation and benefits | (29 ) | (29 ) | — | (89) | (89 ) | — |
| Other noninterest expense and directly allocated overhead (1) | (11 ) | (8 ) | (3 ) | (28) | (20 ) | (8 ) |
| Total noninterest expense | (40 ) | (37 ) | (3 ) | (117) | (109) | (8 ) |
| Income (loss) before indirect overhead allocations and income taxes | (32 ) | (29 ) | (3 ) | (95) | (89 ) | (6 ) |
| Overhead allocations | 30 | 31 | (1 ) | 95 | 93 | 2 |
| Provision (benefit) for income taxes | (1 ) | (1 ) | — | (1 ) | (3 ) | 2 |
| Net income (loss) | $(1) | $ 3 | $ (4 ) | $1 | $ 7 | $ (6 ) |
| Key Metrics | | | | | | |
| Average number of FTE employees | 1,022 | 960 | 62 | 1,010 | 950 | 60 |

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

### Comparison to Prior Year Quarter

The Other segment reported net loss of $1 million, for the three months ended September 30, 2018, compared to net income of $3 million for the three months ended September 30, 2017. This decrease was primarily due to a $3 million increase in noninterest expense to support growth. Higher custodial deposit expense, included in an inter-segment reclassification adjustment, resulted in an increase in net interest income and decrease in noninterest income. Additionally, the benefit for loan losses was $3 million for the three months ended September 30, 2018, compared to zero for the same period in 2017.

### Comparison to Prior Year to Date

The Other segment reported net income of $1 million for the nine months ended September 30, 2018, compared to net income of $7 million for the nine months ended September 30, 2017. This decrease was primarily due to an $8 million increase in noninterest expense to support growth. The $4 million decrease in noninterest income primarily resulted from higher custodial deposit expense, partially offset by an increase in dividend income on FHLB stock and a FHLB stock supplemental dividend which we received in the first quarter 2018. Additionally, the benefit for loan losses increased $4 million in the nine months ended September 30, 2018, compared to the same period in 2017.

RISK MANAGEMENT

Certain risks are inherent in our business and include, but are not limited to, credit, regulatory compliance, legal, reputation, liquidity, market, operational, and strategic. We continuously invest in our risk management activities which are focused on ensuring we properly identify, measure and manage such risks across the entire enterprise to maintain safety and soundness and maximize profitability. We hold capital to protect from unexpected loss arising from these risks.

A comprehensive discussion of risks affecting us can be found in the Risk Factors section included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017. Some of the more significant processes used to manage and control credit, market, liquidity and operational risks are described in the following paragraphs.

Table of Contents

## Credit Risk

Credit risk is the risk of loss to us arising from an obligor’s inability or failure to meet contractual payment or performance terms. We provide loans, extend credit, and enter into financial derivative contracts, all of which have related credit risk.

We maintain credit limits, in compliance with regulatory requirements. Under the Home Owners Loan Act ("HOLA"), the Bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15 percent of Tier 1 and Tier 2 capital plus any portion of the allowance for loan losses not included in the Tier 2 capital. This limit was $263 million as of September 30, 2018.

We maintain a more conservative maximum internal Bank limit than required by HOLA, of $100 million (commitment level) to any one borrower/obligor relationship, with the exception of warehouse borrower/obligor relationships, which have a higher internal Bank limit of $125 million as all advances are fully collateralized by residential mortgage loans. We have a tracking and reporting process to monitor lending concentration levels and all credit exposures to a single borrower that exceed $50 million must be approved by the Board of Directors.

### Loans held-for-investment

The following table summarizes loans held-for-investment by category:

| | September 30, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| | (Dollars in millions) | | |
| Consumer loans | | | |
| Residential first mortgage | $3,085 | $ 2,754 | $331 |
| Home equity (1) | 704 | 664 | 40 |
| Other | 150 | 25 | 125 |
| Total consumer loans | 3,939 | 3,443 | 496 |
| Commercial loans | | | |
| Commercial real estate | 2,160 | 1,932 | 228 |
| Commercial and industrial | 1,317 | 1,196 | 121 |
| Warehouse lending | 1,550 | 1,142 | 408 |
| Total commercial loans | 5,027 | 4,270 | 757 |
| Total loans held-for-investment | $8,966 | $ 7,713 | $1,253 |

(1) Includes second mortgages and HELOC/HELOAN loans.

Loans held-for-investment increased $1.3 billion from December 31, 2017 to September 30, 2018. This increase was due to growth in our Community Banking segment, combined with the acquisitions of Santander Bank’s warehouse lending business and Desert Community Bank branches which occurred during the first quarter of 2018.

As we continue to strengthen our Community Banking segment by growing interest earning assets, our commercial loan portfolio has grown $757 million, or 18 percent, from December 31, 2017 to September 30, 2018, led by a $408 million increase in our warehouse loans, primarily due to our Santander warehouse business acquisition. In addition, our consumer loan portfolio has increased $496 million, or 14 percent, from December 31, 2017 to September 30, 2018, led by a $331 million and $125 million increase in residential first mortgage loans and other consumer loans, respectively.

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

Table of Contents

The following table presents our total residential first mortgage LHFI by major category:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Estimated LTVs (1) | | |
| Less than 80% and refreshed FICO scores (2): | | |
| Equal to or greater than 660 | $2,538 | $ 2,441 |
| Less than 660 | 75 | 73 |
| 80% and greater and refreshed FICO scores (2): | | |
| Equal to or greater than 660 | 397 | 168 |
| Less than 660 | 31 | 12 |
| U.S. government guaranteed | 44 | 60 |
| Total | $3,085 | $ 2,754 |
| Geographic region | | |
| California | $1,286 | $ 1,127 |
| Michigan | 312 | 275 |
| Washington | 207 | 169 |
| Texas | 200 | 182 |
| Florida | 198 | 201 |
| Illinois | 103 | 101 |
| New York | 77 | 62 |
| Arizona | 75 | 76 |
| Colorado | 73 | 69 |
| Maryland | 59 | 65 |
| Others | 495 | 427 |
| Total | $3,085 | $ 2,754 |

(1) LTVs reflect UPB at the date reported, as a percentage of property values as appraised at loan origination.
(2) FICO scores are updated at least on a quarterly basis or more frequently, if available.

The following table presents our total residential first mortgage LHFI as of September 30, 2018, by year of origination:

| | 2018 | 2017 | 2016 | 2015 | 2014 and Prior | Total |
|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | |
| Residential first mortgage loans | $639 | $790 | $592 | $676 | $388 | $3,085 |
| Percent of total | 20.7 % | 25.6 % | 19.2 % | 21.9 % | 12.6 % | 100.0 % |

Home equity. Our home equity portfolio includes first and second lien positions for HELOANs and HELOCs. These loans require full documentation and are underwritten and priced in an effort to ensure credit quality and loan profitability. Our debt-to-income ratio on HELOANS is capped at 43 percent and for HELOCs is capped at 45 percent. We currently limit the maximum CLTV to 89.99 percent and FICO scores to a minimum of 660. Second mortgage loans/HELOANS are fixed rate loans and are available with terms up to 20 years. HELOC loans are variable-rate loans that contain a 10-year draw period followed by a 20-year amortizing period. At September 30, 2018, we had $146 million first lien HELOCs and HELOANs included in residential first mortgage loans and $693 million second lien HELOCs and HELOANs included in home equity.

Commercial real estate loans. The commercial real estate portfolio contains loans collateralized by diversified property types which are primarily income producing in the normal course of business. The majority of our retail exposure is to high-quality, single tenant locations, including many drug stores, with limited exposure to big box retail centers. This portfolio also includes owner occupied real estate loans and secured home builder loans. Generally, the maximum LTV is 80 percent, or 85 percent for owner-occupied real estate, and debt service coverage of 1.20 to 1.35 times. At September 30, 2018, our average LTV and average debt service coverage for our CRE portfolio was 54 percent and 2.00 times, respectively. Our CRE loans earn interest at a variable rate.

Table of Contents

Our national home builder finance program has helped grow our balance sheet, increase commercial deposits and generate incremental revenue through our retail purchase mortgage channel. Through this program, we finance and have active relationships with homebuilders nationwide. At September 30, 2018, loans committed to home builders totaled $1.2 billion, of which $741 million UPB was drawn or used. Of that, $141 million UPB is unsecured which is included in our C&I portfolio and $600 million UPB is collateralized and included in either the single family residence or land-residential categories of our CRE portfolio.

The following table presents our total CRE LHFI by collateral location and collateral type:

| | Michigan | Texas | Colorado | Florida | California | Other | Total | % by collateral type |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | | |
| September 30, 2018 | | | | | | | | |
| Single family residence (1) | $20 | $91 | $ 127 | $97 | $ 44 | $76 | $455 | 21.1 % |
| Owner occupied | 239 | 4 | — | 6 | 27 | 56 | 332 | 15.4 % |
| Retail (2) | 185 | 2 | 6 | 1 | 7 | 120 | 321 | 14.9 % |
| Multi family | 102 | 35 | 17 | 32 | 7 | 92 | 285 | 13.2 % |
| Office | 177 | — | — | 3 | 16 | 20 | 216 | 10.0 % |
| Land - Residential (3) | 5 | 43 | 36 | 25 | 31 | 39 | 179 | 8.3 % |
| Hotel/motel | 105 | 17 | — | — | 3 | 31 | 156 | 7.2 % |
| Senior Living facility | 13 | — | — | — | — | 64 | 77 | 3.6 % |
| Industrial | 41 | — | — | — | — | 33 | 74 | 3.4 % |
| All other (4) | 26 | 3 | 1 | 11 | 2 | 22 | 65 | 2.9 % |
| Total | $913 | $195 | $ 187 | $175 | $ 137 | $553 | $2,160 | 100.0 % |
| Percent by state | 42.3 % | 9.0 % | 8.7 % | 8.1 % | 6.3 % | 25.6 % | 100.0 % | |

(1) Includes home builder loans secured by SFR 1-4 properties whether under construction or completed.
(2) Includes multipurpose retail space, neighborhood centers, strip centers and single-use retail space.
(3) Includes development and unimproved vacant land and home builder loans secured by land.
(4) All other primarily includes: parking garage, non-profit, mini-storage facilities, data centers, movie theater, etc.

Commercial and industrial loans. Commercial and industrial LHFI facilities typically include lines of credit and term loans and leases to businesses for use in normal business operations to finance working capital, equipment and capital purchases, acquisitions and expansion projects. We lend to customers with a history of profitability and a long-term business model. Generally, leverage conforms to industry standards and the minimum debt service coverage is 1.20 times. Most of our C&I loans earn interest at a variable rate.

The following table presents our total C&I LHFI by borrower's geographic location and industry type:

| | Michigan | Texas | California | Connecticut | Virginia | Other | Total | % by industry |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | | |
| September 30, 2018 | | | | | | | | |
| Services | $119 | $17 | $ 46 | $ 44 | $ — | $74 | $300 | 22.8 % |
| Financial & Insurance | 15 | — | — | 6 | 72 | 185 | 278 | 21.1 % |
| Manufacturing | 82 | 13 | 4 | — | — | 116 | 215 | 16.3 % |
| Homebuilder | — | 75 | 20 | — | — | 46 | 141 | 10.7 % |
| Distribution | 87 | — | 19 | — | — | — | 106 | 8.0 % |
| Healthcare | 2 | 10 | 9 | — | — | 79 | 100 | 7.6 % |
| Government & Education | 28 | — | 4 | 24 | — | 24 | 80 | 6.1 % |
| Rental & Leasing | 49 | — | — | — | — | 30 | 79 | 6.0 % |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Servicing Advances | — | — | — | — | — | 9 | 9 | 0.7 % |
| Commodities | 4 | — | — | — | — | 5 | 9 | 0.7 % |
| Total | $386 | $115 | $ 102 | $ 74 | $ 72 | $568 | $1,317 | 100.0 % |
| Percent by state | 29.3 % | 8.7 % | 7.7 % | 5.5 % | 5.5 % | 43.1 % | 100.0 % | |

Warehouse lending. We offer warehouse lines of credit to other mortgage lenders which allow the lender to fund the closing of residential mortgage loans. Each extension, advance, or draw-down on the line is fully collateralized by residential mortgage loans and is paid off when the lender sells the loan to an outside investor or, in some instances, to the Bank.

Table of Contents

The following table presents our warehouse advance amount of loans sold to the Bank:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| UPB of warehouse loans sold to the bank | $2,269 | $2,927 | $6,938 | $8,039 |
| Loans sold to the bank as a percentage of advances | 24 % | 36 % | 27 % | 39 % |

Underlying mortgage loans are predominantly originated using the Agencies' underwriting standards. The guideline for debt to tangible net worth is 15 to 1. We have a national platform with relationship managers across the country. The aggregate committed amount of adjustable-rate warehouse lines of credit granted to other mortgage lenders at September 30, 2018 was $4.0 billion, of which $1.6 billion was outstanding, compared to $2.8 billion at December 31, 2017, of which $1.1 billion was outstanding. This increase is primarily due to our acquisition of the warehouse business from Santander Bank.

Credit Quality

Trends in certain credit quality characteristics remain very strong and are a result of our focus on effectively managing credit risk. The credit quality of our loan portfolios is demonstrated by low delinquency levels, minimal charge-offs and low levels of nonperforming loans.

For all loan categories within the consumer and commercial loan portfolio, loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due (or nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank. When a loan is placed on nonaccrual status, the accrued interest income is reversed. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Nonperforming assets

The following table sets forth our nonperforming assets:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| LHFI | | |
| Consumer loans | | |
| Residential first mortgage | $11 | $ 12 |
| Home equity | 1 | 1 |
| Total nonperforming LHFI | 12 | 13 |
| TDRs | | |
| Consumer loans | | |
| Residential first mortgage | 9 | 12 |
| Home equity | 4 | 4 |
| Total nonperforming TDRs | 13 | 16 |
| Total nonperforming LHFI and TDRs (1) | 25 | 29 |
| Real estate and other nonperforming assets, net | 7 | 8 |

| | | |
|---|---|---|
| LHFS | 10 | 9 |
| Total nonperforming assets | $42 | $ 46 |
| Nonperforming assets to total assets (2) | 0.17% | 0.22 % |
| Nonperforming LHFI and TDRs to LHFI | 0.28% | 0.38 % |
| Nonperforming assets to LHFI and repossessed assets (2) | 0.35% | 0.48 % |

(1) Includes less than 90 day past due performing loans placed on nonaccrual. Interest is not being accrued on these loans.

(2) Ratio excludes LHFS.

Table of Contents

At September 30, 2018, we had $42 million of nonperforming assets compared to $46 million of nonperforming assets at December 31, 2017. The consistent, low levels of nonperforming loans reflect our focus on growing our loan portfolios with strong credit quality loans.

The following table sets forth activity related to our nonperforming LHFI and TDRs:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Beginning balance | $27 | $30 | $29 | $40 |
| Additions | 1 | 6 | 9 | 19 |
| Reductions | | | | |
| Principal payments and loan sales (1) | (1 ) | (1 ) | (5 ) | (23 ) |
| Charge-offs | — | (1 ) | (1 ) | (2 ) |
| Returned to performing status | (1 ) | (1 ) | (4 ) | (1 ) |
| Transfers to REO | (1 ) | (2 ) | (3 ) | (2 ) |
| Total nonperforming LHFI and TDRs (2) | $25 | $31 | $25 | $31 |

(1) Carrying value of loans as of sale date.

(2) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans

During the nine months ended September 30, 2018, we did not sell any nonperforming loans. In an effort to improve the credit quality of our portfolio, during the nine months ended September 30, 2017, we sold $25 million UPB, of nonperforming consumer loans, of which $11 million UPB, was nonperforming TDRs.

Delinquencies

The following table sets forth our 30-89 days past due performing LHFI:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Performing loans past due 30-89: | | |
| Consumer loans | | |
| Residential first mortgage | $ 2 | $ 4 |
| Home equity | 1 | 1 |
| Total performing loans past due 30-89 days | $ 3 | $ 5 |

As a result of our continued focus on growing our loan portfolio with high quality loans, early stage delinquencies remained low as loans 30 to 89 days past due were $3 million at September 30, 2018 and $5 million at December 31, 2017.

For further information, see Note 4 - Loans Held-for-Investment.

Troubled debt restructurings (held-for-investment)

Troubled debt restructurings ("TDRs") are modified loans in which a borrower demonstrates financial difficulties and for which a concession has been granted. Nonperforming TDRs are included in nonaccrual loans and remain in nonperforming status until a borrower has made at least six consecutive months of payments under the modified terms. Performing TDRs are excluded from nonaccrual loans, because based on our evaluation, it is reasonably assured that all contractual principal and interest due under the restructured terms will be collected.

Table of Contents

The following table sets forth a summary of TDRs by performing status:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Performing TDRs | | |
| Residential first mortgage | $ 22 | $ 19 |
| Home equity | 21 | 24 |
| Total performing TDRs | 43 | 43 |
| Nonperforming TDRs | | |
| Nonperforming TDRs | 4 | 5 |
| Nonperforming TDRs at inception but performing for less than six months | 9 | 11 |
| Total nonperforming TDRs | 13 | 16 |
| Total TDRs (1) | $ 56 | $ 59 |

(1) The ALLL on TDR loans totaled $11 million and $13 million at September 30, 2018 and December 31, 2017.

At September 30, 2018 our total TDR loans decreased $3 million as compared to December 31, 2017 primarily due to pay-downs. Of our total TDR loans, 76.9 percent were in performing status at September 30, 2018, as compared to 73.7 percent at December 31, 2017.

For further information, see Note 4 - Loans Held-for-Investment.

Allowance for Loan Losses

The ALLL represents management's estimate of probable losses that are inherent in our LHFI portfolio but which have not yet been realized. For further information, see Note 4 - Loans Held-for-Investment.

The ALLL was $134 million at September 30, 2018, as compared to $140 million at December 31, 2017. The decrease was primarily driven by continued strong credit quality, including sustained lower levels of net charge-offs and delinquencies, offset by growth in the LHFI portfolio.

The ALLL as a percentage of LHFI decreased to 1.5 percent as of September 30, 2018 from 1.8 percent as of December 31, 2017, primarily attributable to growth of $1.3 billion UPB consisting of both consumer and commercial loans, in addition to sustained levels of low charge-offs and delinquencies, and growth of the portfolio in areas we believe to pose lower levels of credit risk. At September 30, 2018, we had a 1.6 percent allowance coverage of our consumer loan portfolio and a 1.4 percent allowance coverage of our commercial loan portfolio.

The following table sets forth certain information regarding the allocation of our ALLL to each loan category:

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Investment Loan Portfolio | Percent of Portfolio | Allowance Amount | Allowance as a Percent of Loan Portfolio |
| | (Dollars in millions) | | | |
| Consumer loans | | | | |
| Residential first mortgage | $3,077 | 34.4 % | $ 40 | 0.5 % |
| Home Equity | 701 | 7.8 % | 20 | 0.2 % |
| Other | 150 | 1.7 % | 2 | — % |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total consumer loans | 3,928 | 43.9 | % | 62 | | 0.7 | % |
| Commercial loans | | | | | | | |
| Commercial real estate | 2,160 | 24.1 | % | 46 | | 0.5 | % |
| Commercial and industrial | 1,317 | 14.7 | % | 20 | | 0.2 | % |
| Warehouse lending | 1,550 | 17.3 | % | 6 | | 0.1 | % |
| Total commercial loans | 5,027 | 56.1 | % | 72 | | 0.8 | % |
| Total consumer and commercial loans (1) | $8,955 | 100.0 | % | $ | 134 | 1.5 | % |

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

Table of Contents

The following table presents changes in ALLL:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Beginning balance | $137 | $140 | $140 | $142 |
| Provision (benefit) for loan losses | (2) | 2 | (3) | 4 |
| Charge-offs | | | | |
| Consumer loans | | | | |
| Residential first mortgage | (2) | (1) | (3) | (6) |
| Home equity | — | (2) | (2) | (3) |
| Other consumer | — | — | (1) | (1) |
| Total charge offs | (2) | (3) | (6) | (10) |
| Recoveries | | | | |
| Consumer loans | | | | |
| Residential first mortgage | 1 | — | 1 | 1 |
| Home equity | — | 1 | 2 | 2 |
| Other consumer | — | — | — | 1 |
| Total recoveries | 1 | 1 | 3 | 4 |
| Charge-offs, net of recoveries | (1) | (2) | (3) | (6) |
| Ending balance | $134 | $140 | $134 | $140 |
| Net charge-off to LHFI ratio (annualized) (1) | 0.05 % | 0.08 % | 0.05 % | 0.12 % |

(1) Excludes loans carried at fair value.

Net charge-offs for the three and nine months ended September 30, 2018 were $1 million and $3 million, respectively, compared to $2 million and $6 million for the three and nine months ended September 30, 2017, respectively. Net charge-offs as a percentage of average LHFI were 0.05 percent for both the three and nine months ended September 30, 2018, compared to 0.08 percent and 0.12 percent, for the three and nine months ended September 30, 2017, respectively.

## Market Risk

Market risk is the risk of reduced earnings and/or declines in the net market value of the balance sheet due to changes in market rates. Our primary market risk is interest rate risk which impacts our net interest income, fee income related to interest sensitive activities such as mortgage origination and servicing income, and loan and deposit demand.

We are subject to interest rate risk due to:

- The maturity or repricing of assets and liabilities at different times or for different amounts
- Differences in short-term and long-term market interest rate changes
- The remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change

The Asset/Liability Committee ("ALCO"), which is composed of our executive officers and certain members of other management, monitors interest rate risk on an on-going basis in accordance with policies approved by our board of directors. The ALCO reviews interest rate positions and considers the impact projected interest rate scenarios have on earnings, capital, liquidity, business strategies, and other factors. However, management has the latitude to change interest rate positions within certain limits if, in management's judgment, the change will enhance profitability or minimize risk.

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

Net interest income sensitivity

Management uses a simulation model to analyze the sensitivity of net interest income to changes in interest rates across various interest rate scenarios which demonstrates the level of interest rate risk inherent in the existing balance sheet. The analysis holds the current balance sheet values constant and does not take into account management intervention. In addition, we assume certain correlation rates, often referred to as a "deposit beta," for interest-bearing deposits, wherein the rates paid to customers change relative to changes in benchmark interest rates. The effect on net interest income over a 12 month time horizon due to hypothetical changes in market interest rates is presented in the table below. In this interest rate shock simulation, as of the periods presented, interest rates have been adjusted by instantaneous parallel changes rather than in a ramp simulation which applies interest rate changes over time. All rates, short-term and long-term, are changed by the same amount (plus or minus 200 basis points) resulting in the shape of the yield curve remaining unchanged. For the scenarios simulated, our established internal policy limit on the change in net interest income, is 15 percent. At September 30, 2018 and December 31, 2017, the results of the simulation were within the internal policy limit.

| September 30, 2018 | | | |
|---|---|---|---|
| Scenario | Net interest income | $ Change | % Change |
| | (Dollars in millions) | | |
| 200 | $533 | $26 | 5.0% |
| Constant | 507 | — | —% |
| (200) | 486 | (21) | (4.2)% |
| December 31, 2017 | | | |
| Scenario | Net interest income | $ Change | % Change |
| | (Dollars in millions) | | |
| 200 | $449 | $16 | 3.6% |
| Constant | 433 | — | —% |
| (200) | 397 | (37) | (8.5)% |

In the net interest income simulations, our balance sheet exhibits slight asset sensitivity. When interest rates rise our net interest income increases. Conversely, when interest rates fall our net interest income decreases. At September 30, 2018, the $74 million increase in the net interest income in the constant scenario as compared to December 31, 2017 was primarily driven by the increased size of the average balance sheet.

As of September 30, 2018, we have also projected the potential impact to net interest income in a hypothetical "bear flattener" interest rate scenario, in which short-term interest rates have been instantaneously increased by 100 basis points while holding the longer term interest rates constant. Over a 12-month and 24-month period, based on our existing balance sheet, the simulation resulted in a loss of $18 million and $90 million, respectively.

The net interest income sensitivity analysis has certain limitations and makes various assumptions. Key elements of this interest rate risk exposure assessment include maintaining a static balance sheet and parallel rate shocks. The direction of future interest rates not moving in a parallel manner across the yield curve, how the balance sheet will respond and shift based on a change in future interest rates and how the Company will respond are not included in this analysis and limit the predictive value of these scenarios.

Economic value of equity

Management also utilizes EVE, a point in time analysis of the economic value of our current balance sheet position, which measures interest rate risk over a longer term. The EVE calculation represents a hypothetical valuation of equity, and is defined as the market value of assets, less the market value of liabilities, adjusted for the market value of off-balance sheet instruments. The assessment of both short-term earnings (Net Interest Income Sensitivity) and long-term valuation (EVE) approaches provides a more comprehensive analysis of interest rate risk exposure than Net Interest Income Sensitivity alone.

There are assumptions and inherent limitations in any methodology used to estimate the exposure to changes in market interest rates and as such, sensitivity calculations used in this analysis are hypothetical and should not be considered to be predictive of future results. This analysis evaluates risks to the current balance sheet only and does not incorporate future growth assumptions. Additionally, the analysis assumes interest rate changes are instantaneous and the new rate environment is constant but does not include actions management may undertake to manage risk in response to interest rate changes. Each rate scenario reflects unique prepayment and repricing assumptions. Management derives these assumptions by considering published market prepayment expectations, repricing characteristics, our historical experience, and our asset and liability management strategy. This analysis assumes that changes in interest rates may not affect or could partially affect certain instruments based on their characteristics.

Table of Contents

The following table is a summary of the changes in our EVE that are projected to result from hypothetical changes in market interest rates as well as our internal policy limits for changes in our EVE based on the different scenarios. The interest rates, as of the dates presented, are adjusted by instantaneous parallel rate increases and decreases as indicated in the scenarios shown in the table below.

| September 30, 2018 | | | | | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Scenario | EVE | EVE% | $ Change | % Change | Scenario | EVE | EVE% | $ Change | % Change | Policy Limits |
| (Dollars in millions) | | | | | | | | | | |
| 300 | $1,542 | 8.4 % | $ (242) | (13.6)% | 300 | $1,941 | 11.6 % | $ (172) | (8.1)% | 22.5 % |
| 200 | 1,639 | 8.9 % | (145) | (8.1)% | 200 | 2,020 | 12.0 % | (93) | (4.4)% | 15.0 % |
| 100 | 1,733 | 9.4 % | (51) | (2.9)% | 100 | 2,089 | 12.4 % | (24) | (1.2)% | 7.5 % |
| Current | 1,784 | 9.7 % | — | — % | Current | 2,113 | 12.6 % | — | — % | — % |
| (100) | 1,790 | 9.7 % | 6 | 0.4 % | (100) | 2,082 | 12.4 % | (31) | (1.5)% | 7.5 % |

Our balance sheet exhibits liability sensitivity in a rising interest rate scenario. The decrease in EVE is the result of the amount of liabilities that would be expected to reprice exceeding the amount of assets repriced in the +200 scenario. At September 30, 2018 and December 31, 2017, for each scenario shown, the percentage change in our EVE is within our internal policy limit.

Derivative financial instruments

As a part of our risk management strategy, we use derivative financial instruments to minimize fluctuation in earnings caused by interest rate risk. We use forward sales commitments to hedge our unclosed mortgage origination pipeline and funded mortgage LHFS. All of our derivatives and mortgage loan production originated for sale are accounted for at fair market value. Changes to mortgage commitments are based on changes in fair value of the underlying loan, which is impacted most significantly by changes in interest rates and changes in the probability that the loan will not fund within the terms of the commitment, referred to as a fallout factor or pull through rate. Market risk on interest rate lock commitments and mortgage LHFS is managed using corresponding forward sale commitments. The adequacy of these hedging strategies, the ability to fully or partially hedge market risk, rely on various assumptions or projections, including a fallout factor, which is based on a statistical analysis of our actual rate lock fallout history. For further information, see Note 8 - Derivative Financial Instruments and Note 17 - Fair Value Measurements.

Mortgage Servicing Rights (MSRs)

Our MSRs are sensitive to interest rate volatility and are highly susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve. We utilize derivatives, including interest rate swaps and swaptions, as part of our overall hedging strategy to manage the impact of changes in the fair value of the MSRs, however these risk management strategies do not completely eliminate repricing risk. Our hedging strategies rely on assumptions and projections regarding assets and general market factors, many of which are outside of our control. If one or more of these assumptions or projections proves to be incorrect our hedging strategies may not adequately mitigate the impact of changes in interest rates or prepayment speeds, and as a result may negatively impact earnings. For further information, see Note 7 - Mortgage Servicing Rights, Note 8 - Derivative Financial Instruments and Note 17 - Fair Value Measurements.

Liquidity Risk

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

Parent Company Liquidity

The Company currently obtains its liquidity primarily from dividends from the Bank. The primary uses of the Company's liquidity are debt service and operating expenses, which includes compensation and benefits, legal and professional expense and general and administrative expenses. At September 30, 2018, the Company held $204 million of cash at the Bank, or 7.7 years of expense and debt service coverage when excluding the redemption of $250 million of senior notes which mature on July 15, 2021.

The OCC and FRB regulates all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. A subsidiary of a savings and loan holding company, such as the Bank, is required to file a notice with the FRB or application with the OCC at least 30 days prior to each proposed capital distribution. Whether an application is required is based on a number of factors including whether the institution qualifies as an eligible association under the OCC rules and regulations, the institution would not be at least adequately capitalized following the distribution or if the total amount of all capital distributions (including each proposed capital distribution) for the applicable calendar year exceeds net income for that year to date plus the retained net income for the preceding two years. Additional restrictions on dividends apply if the Bank fails the QTL test. At September 30, 2018, as reported to the OCC, we passed the QTL test. In addition, as a subsidiary of a savings and loan holding company a 30-day notice from the Bank must be provided to the Federal Reserve prior to declaring or paying dividends to the holding company.

For further information and restrictions related to the Bank's payment of dividends, see MD&A - Capital.

Bank Liquidity

We primarily originate agency-eligible LHFS and therefore the majority of new residential first mortgage loan originations are readily convertible to cash, either by selling them as part of our monthly agency sales, RMBS, private party whole loan sales, or by pledging them to the FHLB of Indianapolis and borrowing against them. We use the FHLB of Indianapolis as a significant source for funding our residential mortgage banking business due to the flexibility in terms which allows us to borrow or repay borrowings as daily cash needs require. Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. We balance the liquidity of our loan assets to our available funding sources. Our LHFI portfolio is funded with stable core deposits whereas our warehouse and LHFS may be funded with FHLB borrowings and custodial deposits.

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

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

Management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity.

Table of Contents

Liquidity Table

| | September 30, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| | (Dollars in millions) | | |
| Demand deposit accounts | $2,072 | $ 1,257 | $815 |
| Savings accounts | 3,112 | 3,553 | (441 ) |
| Money market demand accounts | 285 | 193 | 92 |
| Certificates of deposit/CDARS | 2,208 | 1,494 | 714 |
| Total retail deposits | 7,677 | 6,497 | 1,180 |
| Government deposits | 1,466 | 1,073 | 393 |
| Wholesale deposits | 653 | 43 | 610 |
| Custodial deposits | 1,793 | 1,321 | 472 |
| Total deposits | $11,589 | $ 8,934 | $2,655 |
| Federal Home Loan Bank advances | $4,479 | $ 5,665 | $(1,186) |
| Other long-term debt | 495 | 494 | 1 |
| Total borrowed funds | $4,974 | $ 6,159 | $(1,185) |

Deposits

The following table presents a composition of our deposits:

| | September 30, 2018 | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|
| | Balance | % of Deposits | | Balance | % of Deposits | | Change |
| | (Dollars in millions) | | | | | | |
| Retail deposits | | | | | | | |
| Branch retail deposits | | | | | | | |
| Demand deposit accounts | $664 | 5.7 | % | $560 | 6.3 | % | $104 |
| Savings accounts | 2,800 | 24.2 | % | 3,295 | 36.9 | % | (495 ) |
| Money market demand accounts | 105 | 0.9 | % | 91 | 1.0 | % | 14 |
| Certificates of deposit/CDARS (1) | 2,208 | 19.1 | % | 1,494 | 16.7 | % | 714 |
| Total branch retail deposits | 5,777 | 49.8 | % | 5,440 | 60.9 | % | 337 |
| Commercial deposits (2) | | | | | | | |
| Demand deposit accounts | 1,408 | 12.1 | % | 697 | 7.8 | % | 711 |
| Savings accounts | 312 | 2.7 | % | 258 | 2.9 | % | 54 |
| Money market demand accounts | 180 | 1.6 | % | 102 | 1.1 | % | 78 |
| Total commercial retail deposits | 1,900 | 16.4 | % | 1,057 | 11.8 | % | 843 |
| Total retail deposits | $7,677 | 66.2 | % | $6,497 | 72.7 | % | $1,180 |
| Government deposits | | | | | | | |
| Demand deposit accounts | $384 | 3.3 | % | $251 | 2.8 | % | $133 |
| Savings accounts | 763 | 6.6 | % | 446 | 5.0 | % | 317 |
| Certificates of deposit/CDARS (1) | 319 | 2.8 | % | 376 | 4.2 | % | (57 ) |
| Total government deposits (3) | 1,466 | 12.7 | % | 1,073 | 12.0 | % | 393 |
| Wholesale deposits | 653 | 5.6 | % | 43 | 0.5 | % | 610 |
| Custodial deposits (4) | 1,793 | 15.5 | % | 1,321 | 14.8 | % | 472 |
| Total deposits (5) | $11,589 | 100.0 | % | $8,934 | 100.0 | % | $2,655 |

(1) The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was approximately $1.8 billion and $1.4 billion at September 30, 2018 and December 31, 2017, respectively.

(2) Contains deposits from commercial and business banking customers.

(3) Government deposits include funds from municipalities and schools.

(4) These accounts represent a portion of the investor custodial accounts and escrows controlled by us in connection with loans serviced for others that have been placed on deposit with the Bank.

(5) Total exposure related to uninsured deposits over $250,000 was approximately $3.1 billion and $2.6 billion at September 30, 2018 and December 31, 2017, respectively.

Table of Contents

Total deposits increased $2.7 billion, or 30 percent at September 30, 2018, compared to December 31, 2017, primarily driven by the acquisition of eight Desert Community Bank branches and an increase in commercial deposits. In addition, brokered CD's and custodial deposits increased over that same period, allowing us to reduce higher cost FHLB borrowings.

We utilize local governmental agencies and other public units, as an additional source for deposit funding. We are not required to hold collateral against our government deposits from Michigan government entities as they are covered by the Michigan Business and Growth Fund. We are required to hold collateral on our government deposits in California that are in excess of $250,000. Government deposit accounts include $319 million of certificates of deposit with maturities typically less than one year and $1.1 billion in checking and savings accounts at September 30, 2018.

Custodial deposits arise due to our servicing or sub-servicing of loans for others and represent the portion of the investor custodial accounts on deposit with the Bank. Certain deposits require us to reimburse the owner for the spread on these funds. This cost is a component of net loan administration income. Custodial deposits and short term FHLB advances are used to fund our most liquid assets including LHFS and warehouse loans. As not all asset categories require the same level of liquidity, our loan-to-deposit ratio shows how we manage our liquidity position, how much liquidity we have and the agility of our balance sheet. The Company's HFI loan-to-deposit ratio, which excludes warehouse loans and custodial deposits, was 78 percent at September 30, 2018.

We participate in the CDARS program, through which certain customer CDs are exchanged for CDs of similar amounts from other participating banks. This gives customers the potential to receive FDIC insurance up to $50 million. At September 30, 2018, we had $177 million of total CDs enrolled in the CDARS program, a decrease of $13 million from December 31, 2017.

FHLB Advances

The FHLB provides loans, also referred to as advances, on a fully collateralized basis, to savings banks and other member financial institutions. We rely upon advances from the FHLB as a source of funding for the origination or purchase of loans for sale in the secondary market and for providing duration specific short-term and long-term financing. The outstanding balance of FHLB advances fluctuates from time to time depending on our current inventory of mortgage LHFS and the availability of lower cost funding sources. Our portfolio includes short-term fixed rate advances, long-term LIBOR adjustable advances, and long-term fixed rate advances. Interest rates on the LIBOR index advances reset every three months and the advances may be prepaid without penalty, with notification, at scheduled three-month intervals.

We are currently authorized through a resolution of our board of directors to apply for advances from the FHLB using approved loan types as collateral, which includes residential first mortgage loans, home equity lines of credit, and commercial real estate loans. At September 30, 2018, our Board of Directors authorized and approved a line of credit with the FHLB of up to $10.0 billion, which is further limited based on our total assets and qualified collateral, as determined by the FHLB. At September 30, 2018, we had $4.5 billion of advances outstanding and an additional $2.1 billion of collateralized borrowing capacity available at the FHLB. Further, as a result of the pending acquisition of 52 Wells Fargo branches, which includes over $2 billion in deposits, we will have increased flexibility in our liquidity position as we expect to use this funding to repay short-term FHLB advances.

Federal Reserve Discount Window

We have arrangements with the FRB of Chicago to borrow from its discount window. The discount window is a borrowing facility that we may utilize for short-term liquidity needs arising from special or unusual circumstances. The amount we are allowed to borrow is based on the lendable value of the collateral that we provide. To collateralize the line, we pledge investment securities and loans that are eligible based on FRB of Chicago guidelines.

At September 30, 2018, we pledged collateral to the Federal Reserve Discount Window amounting to $462 million with a lendable value of $414 million. At December 31, 2017, we pledged collateral to the Federal Reserve Discount Window amounting to $467 million with a lendable value of $433 million. At September 30, 2018 and December 31, 2017, we had no borrowings outstanding against this line of credit.

Debt

As part of our overall capital strategy, we previously raised capital through the issuance of junior subordinated notes to our special purpose trusts formed for the offerings, which issued Tier 1 qualifying preferred stock (trust preferred securities). The trust preferred securities are callable by us at any time. Interest is payable on a quarterly basis; however, we may defer

Table of Contents

interest payments for up to 20 quarters without default or penalty. At September 30, 2018, we are current on all interest payments.

For further information, see Note 9 - Borrowings.

Operational Risk

Operational risk is the risk of loss due to human error; inadequate or failed internal systems and controls; violations of, or noncompliance with, laws, rules and regulations, prescribed practices, or ethical standards; and external influences such as market conditions, fraudulent activities, disasters, and security risks. We continuously strive to adapt our system of internal controls to ensure compliance with laws, rules, and regulations, and to improve the oversight of our operational risk.

We evaluate internal systems, processes, and controls to mitigate loss from cyber-attacks and, to date, have not experienced any material losses. The goal of this framework is to implement effective operational risk techniques and strategies, minimize operational and fraud losses, and enhance our overall performance.

Loans with government guarantees

Substantially all of our loans with government guarantees continue to be insured or guaranteed by the FHA or the U.S. Department of Veterans Affairs. In the event of a government guaranteed loan borrower default, Flagstar has a unilateral option to repurchase loans sold to GNMA that are 90 days past due and recover losses through a claims process from the insurer. Nonperforming repurchased loans in this portfolio earn interest at a rate based upon the 10-year U.S. Treasury note rate from the time the underlying loan becomes delinquent, which is not paid by the FHA until claimed. Additionally, if the Bank cures the loan, it can be re-sold to GNMA. If not, the Bank can begin the process of collecting the government guarantee by filing a claim in accordance with established guidelines. Certain loans within our portfolio may be subject to indemnifications and insurance limits which expose us to limited credit risk.

In both the three and nine months ended September 30, 2018, we experienced net charge-offs of $1 million and have reserved for the remaining risks within other assets and as a component of our ALLL on residential first mortgages. These charge-offs arise due to insurance limits on VA insured loans and FHA property foreclosure and preservation requirements that may result in a loss, all or in part, of the guarantee.

Our loans with government guarantees portfolio totaled $305 million at September 30, 2018, as compared to $271 million at December 31, 2017. The increase is primarily due to new purchases out-pacing loans transferred to LHFS and resold to Ginnie Mae.

For further information, see Note 5 - Loans with Government Guarantees.

Representation and warranty reserve

When we sell mortgage loans, we make customary representations and warranties to the purchasers, including sponsored securitization trusts and their insurers (primarily Fannie Mae and Freddie Mac). An estimate of the fair value of the guarantee associated with the mortgage loans is recorded in other liabilities in the Consolidated Statements of Financial Condition, which was $10 million at September 30, 2018, as compared to $15 million at December 31, 2017.

Regulatory Risks

Consent Order

On September 29, 2014, the Bank entered into a Consent Order with the CFPB. The Consent Order relates to alleged violations of federal consumer financial laws arising from the Bank's residential first mortgage loan loss mitigation practices and default servicing operations dating back to 2011. Under the terms of the Consent Order, the Bank paid $28 million for borrower remediation and $10 million in civil money penalties. The settlement does not involve any admission of wrongdoing on the part of the Bank or our employees, directors, officers, or agents. For further information and a complete description of all of the terms of the Consent Order, please refer to our Current Report on Form 8-K filed on September 29, 2014.

Table of Contents

Supervisory Agreement

The Supervisory Agreement originally dated January 27, 2010, was lifted by the Federal Reserve on August 14, 2018. For further information and a complete description of all of the terms of the Supervisory Agreement, please refer to the copy of the Supervisory Agreement filed with the SEC as an exhibit to our 2016 Form 10-K for the year ended December 31, 2016.

Department of Justice Settlement Agreement

On February 24, 2012, the Bank entered into a Settlement Agreement with the DOJ under which we made an initial payment of $15 million and agreed to make future payments totaling $118 million in annual increments of up to $25 million upon meeting all of the following conditions which are evaluated quarterly and include: (a) the reversal of the DTA valuation allowance, which occurred at the end of 2013; (b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred"), which occurred in July 2016; and (c) the Bank having a Tier 1 Leverage Capital Ratio of 11 percent or greater as filed in the Call Report with the OCC. At September 30, 2018, the Company had a Tier 1 Leverage Capital Ratio of 8.77 percent.

No payment would be required until six months after the Bank files its Call Report first reporting that its Tier 1 Leverage Capital Ratio was 11 percent or greater. If all other conditions were then satisfied, an initial annual payment of $25 million would be due at that time. The next annual payment is only made if all conditions continue to be satisfied otherwise payments are delayed until all such conditions are met. Further, making such a payment must not violate any material banking regulatory requirement, and the OCC must not object in writing.
The combination of (a) future dividends from the Bank to Bancorp and (b) continued growth in earning assets at the Bank are expected to continue to limit the growth rate of the Bank’s Tier 1 Leverage Capital Ratio, which could have an impact on the timing of expected cash flows under the Settlement Agreement.

Consistent with our business and regulatory requirements, Flagstar shall seek in good faith to fulfill the conditions, and will not undertake any conduct or fail to take any action the purpose of which is to frustrate or delay our ability to fulfill any of the conditions.

Additionally, if the Bank or Bancorp become party to a business combination in which the Bank and Bancorp represent less than 33.3 percent of the resulting company’s assets, annual payments would commence twelve months after the date of that business combination.

The Settlement Agreement meets the definition of a financial instrument for which we elected the fair value option. We consider the assumptions a market participant would make to transfer the liability and evaluate the potential ways we might satisfy the Settlement Agreement and our estimates of the likelihood of these outcomes, which may change over time. The fair value of the liability is subject to significant uncertainty and is impacted by forecasted estimates of the timing of potential payments, which are impacted by estimates of equity, earnings, timing and amount of dividends and growth of the balance sheet and their related impacts on forecasted Tier 1 Leverage Capital Ratio. For further information on the fair value of the liability, see Note 17 - Fair Value Measurements.

Capital

Management actively reviews and manages our capital position and strategy. We conduct quarterly capital stress tests and capital adequacy assessments which utilize internally defined scenarios. These analyses are designed to help management and the Board better understand the integrated sensitivity of various risk exposures through quantifying the potential financial and capital impacts of hypothetical stressful events and scenarios. We make adjustments to our balance sheet composition taking into consideration potential business risks, regulatory requirements and the flexibility to support future growth. We prudently manage our capital position and work with our regulators to ensure that our capital levels are appropriate considering our risk profile.

The capital standards we are subject to include requirements contemplated by the Dodd-Frank Act as well as guidelines under Basel III. These risk-based capital adequacy guidelines are intended to measure capital adequacy with regard to a banking organization’s balance sheet, including off-balance sheet exposures such as unused portions of loan commitments, letters of credit, and recourse arrangements. Our capital ratios are maintained at levels in excess of those considered to be "well-capitalized" by regulators. Tier 1 leverage was 8.36 percent at September 30, 2018 providing a 336 basis point stress buffer above the minimum level needed to be considered “well-capitalized.” Additionally, total risk-based capital to RWA was 14.20 percent at September 30, 2018 providing a 420 basis point stress buffer above the minimum level needed to be considered "well-capitalized". For additional information on our capital requirements, see Note 15 - Regulatory Capital.

Dodd-Frank Act Section 171, commonly known as the Collins Amendment, established minimum Tier 1 leverage and risk-based capital requirements for insured depository institutions, depository institution holding companies, and non-bank financial companies that are supervised under the Federal Reserve. Under the amendment, certain hybrid securities, such as

Table of Contents

trust preferred securities, may be included in Tier 1 capital for bank holding companies that had total assets below $15 billion as of December 31, 2009. As we were below $15 billion in assets as of December 31, 2009, the trust preferred securities classified as long term debt on our balance sheet will be included as Tier 1 capital while they are outstanding, unless we complete an acquisition of a depository institution holding company.

Regulatory Capital Simplification

The Bank and Flagstar have been subject to the capital requirements of the Basel III rules since January 1, 2015. On October 27, 2017, the agencies issued a notice of proposed rulemaking (“NPR”) which would simplify certain aspects of the Basel III capital rules. The agencies expect that the capital treatment and transition provisions for items covered by this final rule will change once the simplification proposal is finalized and effective. Specifically, the proposal would increase the individual limit on MSRs and temporary difference DTAs to 25 percent of CET1 and eliminate the aggregate 15 percent CET1 deduction threshold for MSRs and temporary difference DTAs. In response to comments received from bankers and trade associations, the regulators may change these proposed rules prior to issuing them and it is uncertain when the rules will be issued in their final form.

In preparation for the NPR, the Basel III implementation phase-in has been halted for the treatment of MSRs and certain DTAs. The agencies issued a final rule that will maintain the capital rules’ 2017 transition provisions for several regulatory capital deductions and certain other requirements that are subject to multi-year phase-in schedules in the regulatory capital rules. Specifically, the final rule will maintain the capital rules’ 2017 transition provisions at 80 percent for the regulatory capital treatment of the following items: (i) MSRs, (ii) DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, (iii) investments in the capital of unconsolidated financial institutions, and (iv) minority interests. As of September 30, 2018, we had $313 million in MSRs, $30 million in DTAs arising from temporary differences and no material investments in unconsolidated financial institutions or minority interest. This final rule will maintain the 2017 transition provisions for certain items for non-advanced approach banks. For additional information on our capital requirements, see Note 15 - Regulatory Capital.

Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes non-GAAP financial measures such as tangible book value per share and tangible common equity to assets ratio. We believe these non-GAAP financial measures provide additional information that is useful to investors in helping to understand the underlying performance and trends of the Company.

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

Tangible book value per share and tangible common equity to assets ratio. The Company believes that tangible book value per share and tangible common equity to assets ratio provides a meaningful representation of its operating performance on an ongoing basis. Management uses these measures to assess performance of the Company against its peers and evaluate overall performance. The Company believes these non-GAAP financial measures provides useful information for investors, securities analysts and others because it provides a tool to evaluate the Company's performance on an ongoing basis and compared to its peers.

Table of Contents

| | September 30, 2018 | December 31, 2017 | September 30, 2017 |
|---|---|---|---|
| | (Dollars in millions, except share data) | | |
| Total stockholders' equity | $1,518 | $ 1,399 | $ 1,451 |
| Less: Goodwill and intangibles | 70 | 21 | 21 |
| Tangible book value | $1,448 | $ 1,378 | $ 1,430 |
| | | | |
| Number of common shares outstanding | 57,625,439 | 57,321,228 | 57,181,536 |
| Tangible book value per share | $25.13 | $ 24.04 | $ 25.01 |
| | | | |
| Total Assets | $18,697 | $ 16,912 | $ 16,880 |
| Tangible common equity to assets ratio | 7.74 % | 8.15 % | 8.47 % |

Critical Accounting Estimates

Various elements of our accounting policies, by their nature, are subject to estimation techniques, valuation assumptions and other subjective assessments. Certain accounting policies that, due to the judgment, estimates and assumptions are critical to an understanding of our Consolidated Financial Statements and the Notes, are described in Item 1. These policies relate to: (a) the determination of our ALLL; and (b) fair value measurements. We believe the judgment, estimates and assumptions used in the preparation of our Consolidated Financial Statements and the Notes are appropriate given the factual circumstances at the time. However, given the sensitivity of our Consolidated Financial Statements and the Notes to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations and/or financial condition. For further information on our critical accounting policies, please refer to the Critical Accounting Estimates section of Item 7 of Exhibit 99.1 to our June 1, 2018 Form 8-K Report, which is available on our website, flagstar.com, under the Investor Relations section, or on the website of the Securities and Exchange Commission, at sec.gov.

FORWARD – LOOKING STATEMENTS

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

Generally, forward-looking statements are not based on historical facts but instead represent management’s beliefs regarding future events. Such statements may be identified by words such as believe, expect, anticipate, intend, plan, estimate, may increase, may fluctuate, and similar expressions or future or conditional verbs such as will, should, would and could. Such statements are based on management’s current expectations and are subject to risks, uncertainties and changes in circumstances. Actual results and capital and other financial conditions may differ materially from those included in these statements due to a variety of factors, including without limitation the precautionary statements included within each individual business’ discussion and analysis of our results of operations and the risk factors listed and described in Item 1A. to Part I, of our Annual Report on Form 10-K for the year ended December 31, 2017 and Item 1A. to Part II, of this Quarterly Report on Form 10-Q, which are incorporated by reference herein.

Other than as required under United States securities laws, Flagstar Bancorp does not undertake to update the forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Table of Contents

Item 1. Financial Statements

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

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| Assets | | |
| Cash | $ 150 | $ 122 |
| Interest-earning deposits | 114 | 82 |
| Total cash and cash equivalents | 264 | 204 |
| Investment securities available-for-sale | 1,857 | 1,853 |
| Investment securities held-to-maturity | 724 | 939 |
| Loans held-for-sale ($4,815 and $4,300 measured at fair value, respectively) | 4,835 | 4,321 |
| Loans held-for-investment ($11 and $12 measured at fair value, respectively) | 8,966 | 7,713 |
| Loans with government guarantees | 305 | 271 |
| Less: allowance for loan losses | (134) | (140) |
| Total loans held-for-investment and loans with government guarantees, net | 9,137 | 7,844 |
| Mortgage servicing rights | 313 | 291 |
| Net deferred tax asset | 111 | 136 |
| Federal Home Loan Bank stock | 303 | 303 |
| Premises and equipment, net | 360 | 330 |
| Goodwill and intangible assets | 70 | 21 |
| Other assets | 723 | 670 |
| Total assets | $ 18,697 | $ 16,912 |
| Liabilities and Stockholders' Equity | | |
| Noninterest bearing deposits | $ 3,096 | $ 2,049 |
| Interest bearing deposits | 8,493 | 6,885 |
| Total deposits | 11,589 | 8,934 |
| Short-term Federal Home Loan Bank advances | 3,199 | 4,260 |
| Long-term Federal Home Loan Bank advances | 1,280 | 1,405 |
| Other long-term debt | 495 | 494 |
| Other liabilities ($60 and $60 measured at fair value, respectively) | 616 | 420 |
| Total liabilities | 17,179 | 15,513 |
| Stockholders' Equity | | |
| Common stock $0.01 par value, 80,000,000 and 80,000,000 shares authorized; 57,625,439 and 57,321,228 shares issued and outstanding, respectively | 1 | 1 |
| Additional paid in capital | 1,519 | 1,512 |
| Accumulated other comprehensive loss | (42) | (16) |
| Retained earnings/(accumulated deficit) | 40 | (98) |
| Total stockholders' equity | 1,518 | 1,399 |
| Total liabilities and stockholders' equity | $ 18,697 | $ 16,912 |

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

Table of Contents

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Unaudited) | | | |
| Interest Income | | | | |
| Loans | $161 | $ 120 | $436 | $ 319 |
| Investment securities | 21 | 20 | 64 | 59 |
| Interest-earning deposits and other | 1 | — | 2 | 1 |
| Total interest income | 183 | 140 | 502 | 379 |
| Interest Expense | | | | |
| Deposits | 27 | 13 | 65 | 37 |
| Short-term Federal Home Loan Bank advances and other | 18 | 11 | 50 | 23 |
| Long-term Federal Home Loan Bank advances | 7 | 6 | 21 | 17 |
| Other long-term debt | 7 | 7 | 21 | 19 |
| Total interest expense | 59 | 37 | 157 | 96 |
| Net interest income | 124 | 103 | 345 | 283 |
| Provision (benefit) for loan losses | (2 ) | 2 | (3 ) | 4 |
| Net interest income after provision (benefit) for loan losses | 126 | 101 | 348 | 279 |
| Noninterest Income | | | | |
| Net gain on loan sales | 43 | 75 | 166 | 189 |
| Loan fees and charges | 23 | 23 | 67 | 58 |
| Deposit fees and charges | 5 | 5 | 15 | 14 |
| Loan administration income | 5 | 5 | 15 | 16 |
| Net return on mortgage servicing rights | 13 | 6 | 26 | 26 |
| Other noninterest income | 18 | 16 | 52 | 43 |
| Total noninterest income | 107 | 130 | 341 | 346 |
| Noninterest Expense | | | | |
| Compensation and benefits | 76 | 76 | 236 | 219 |
| Commissions | 21 | 23 | 64 | 49 |
| Occupancy and equipment | 31 | 28 | 91 | 75 |
| Federal insurance premiums | 6 | 5 | 18 | 12 |
| Loan processing expense | 14 | 15 | 43 | 41 |
| Legal and professional expense | 7 | 7 | 19 | 22 |
| Other noninterest expense | 18 | 17 | 52 | 47 |
| Total noninterest expense | 173 | 171 | 523 | 465 |
| Income before income taxes | 60 | 60 | 166 | 160 |
| Provision for income taxes | 12 | 20 | 33 | 52 |
| Net income | $48 | $ 40 | $133 | $ 108 |
| Net income per share | | | | |
| Basic | $0.84 | $ 0.71 | $2.32 | $ 1.90 |
| Diluted | $0.83 | $ 0.70 | $2.28 | $ 1.86 |
| Weighted average shares outstanding | | | | |
| Basic | 57,600,360 | 57,162,025 | 57,483,807 | 57,062,696 |
| Diluted | 58,332,598 | 58,186,593 | 58,301,928 | 58,133,296 |

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

Table of Contents

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Unaudited) | | | |
| Net income | $48 | $ 40 | $133 | $108 |
| Other comprehensive income (loss), net of tax | | | | |
| Investment securities | (9 ) | 1 | (47 ) | 3 |
| Derivatives and hedging activities | (1 ) | — | 21 | (4 ) |
| Other comprehensive income (loss), net of tax | (10 ) | 1 | (26 ) | (1 ) |
| Comprehensive income | $38 | $ 41 | $107 | $107 |

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

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

| | Common Stock | | | | | |
|---|---|---|---|---|---|---|
| | Number of Shares Outstanding | Amount of Common Stock | Additional Paid in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Accumulated Deficit) | Total Stockholders' Equity |
| Balance at December 31, 2016 (Unaudited) | 56,824,802 | $ 1 | $ 1,503 | $ (7 ) | $ (161 ) | $ 1,336 |
| Net income | — | — | — | — | 108 | 108 |
| Total other comprehensive income (loss) | — | — | — | (1 ) | — | (1 ) |
| Shares issued from Employee Stock Purchase Plan | 19,897 | — | — | — | — | — |
| Warrant exercise | 154,313 | — | 4 | — | — | 4 |
| Stock-based compensation | 182,524 | — | 4 | — | — | 4 |
| Balance at September 30, 2017 | 57,181,536 | $ 1 | $ 1,511 | $ (8 ) | $ (53 ) | $ 1,451 |
| Balance at December 31, 2017 (Unaudited) | 57,321,228 | $ 1 | $ 1,512 | $ (16 ) | $ (98 ) | $ 1,399 |
| Net income | — | — | — | — | 133 | 133 |
| Total other comprehensive income (loss) | — | — | — | (21 ) | — | (21 ) |
| Shares issued from Employee Stock Purchase Plan | 88,566 | — | — | — | — | — |
| Stock-based compensation | 215,645 | — | 7 | — | — | 7 |
| Reclassification of certain income tax effects (1) | — | — | — | (5 ) | 5 | — |
| Balance at September 30, 2018 (1) | 57,625,439 | $ 1 | $ 1,519 | $ (42 ) | $ 40 | $ 1,518 |

Income tax effects of the Tax Cuts and Jobs Act are reclassified from AOCI to retained earnings due to the adoption of ASU 2018-02.

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

Table of Contents

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| | (Unaudited) | |
| Operating Activities | | |
| Net cash used in operating activities | $(19,002) | $(19,266) |
| Investing Activities | | |
| Proceeds from sale of AFS securities including loans that have been securitized | $18,362 | $17,949 |
| Collection of principal on investment securities AFS | 152 | 158 |
| Purchase of investment securities AFS and other | (48) | (593) |
| Collection of principal on investment securities HTM | 72 | 116 |
| Proceeds received from the sale of LHFI | 4 | 78 |
| Net origination, purchase, and principal repayments of LHFI | (695) | (1,231) |
| Purchase of bank owned life insurance | — | (50) |
| Net purchase of FHLB stock | — | (84) |
| Acquisition of premises and equipment, net of proceeds | (50) | (74) |
| Proceeds from the sale of MSRs | 267 | 252 |
| Other, net | (14) | 4 |
| Net cash provided by investing activities | $18,050 | $16,525 |
| Financing Activities | | |
| Net change in deposit accounts | $2,040 | $361 |
| Net change in short-term FHLB borrowings and other short-term debt | (1,061) | 2,285 |
| Proceeds from increases in FHLB long-term advances | 200 | 150 |
| Repayment of FHLB long-term advances | (325) | (50) |
| Net receipt of payments of loans serviced for others | 140 | 24 |
| Net receipt of escrow payments | 25 | 19 |
| Other | (6) | — |
| Net cash provided by financing activities | $1,013 | $2,789 |
| Net increase in cash, cash equivalents and restricted cash (1) | 61 | 48 |
| Beginning cash, cash equivalents and restricted cash (1) | 223 | 208 |
| Ending cash, cash equivalents and restricted cash (1) | $284 | $256 |
| Supplemental disclosure of cash flow information | | |
| Non-cash reclassification of investment securities HTM to AFS | $144 | $— |
| Non-cash reclassification of loans originated LHFI to LHFS | $6 | $106 |
| Non-cash reclassification of LHFS to AFS securities | $18,360 | $17,657 |
| MSRs resulting from sale or securitization of loans | $283 | $178 |
| Operating section supplemental disclosures | | |
| Cash proceeds from sales of LHFS | $7,028 | $5,547 |
| Origination, premium paid and purchase of LHFS, net of principal repayments | $(26,038) | $(24,518) |

(1) For further information on restricted cash, see Note 8 - Derivatives.

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

Table of Contents

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

Note 1 - Basis of Presentation

The accompanying financial statements of Flagstar Bancorp, Inc. ("Flagstar," or the "Company"), including its wholly owned principal subsidiary, Flagstar Bank, FSB (the "Bank"), have been prepared using U.S. GAAP for interim financial statements. Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," "our," the "Company" or "Flagstar" will include the Bank.

These consolidated financial statements do not include all of the information and footnotes required by GAAP for a full year presentation and certain disclosures have been condensed or omitted in accordance with rules and regulations of the SEC. These interim financial statements are unaudited and include, in our opinion, all adjustments necessary for a fair statement of the results for the periods indicated, which are not necessarily indicative of results which may be expected for the full year. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and footnotes thereto included in Part II, Item 8 of Exhibit 99.1 to our Current Report on Form 8-K dated June 1, 2018 ("June 1, 2018 Form 8-K Report"), which is available on our website, at flagstar.com, and on the SEC website, at sec.gov. Certain prior period amounts have been reclassified to conform to the current period presentation.

Acquisitions

On June 4, 2018, we signed a definitive agreement to acquire 52 Wells Fargo Bank branches in Indiana, Michigan, Wisconsin, and Ohio, with over $2 billion in deposits and over $100 million in loans. The transaction is subject to the satisfaction of customary closing conditions and is expected to close at the beginning of December 2018.

On March 12, 2018, we closed the purchase of the mortgage loan warehouse business from Santander Bank, with $499 million outstanding warehouse loans and $1.7 billion in commitments. Additionally, on March 19, 2018, we completed the acquisition of eight Desert Community Bank branches in San Bernardino County, California, with $614 million in deposits and $59 million in loans. Together, these acquisitions increased goodwill and intangible assets by $51 million.

Table of Contents

Note 2 - Investment Securities

The following table presents our investment securities:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| September 30, 2018 | | | | |
| Available-for-sale securities | | | | |
| Agency - Commercial | $1,142 | $ — | $ (48) | $1,094 |
| Agency - Residential | 713 | — | (39) | 674 |
| Municipal obligations | 33 | — | (1) | 32 |
| Corporate debt obligations | 41 | — | — | 41 |
| Other MBS | 16 | — | — | 16 |
| Total available-for-sale securities (1) | $1,945 | $ — | $ (88) | $1,857 |
| Held-to-maturity securities | | | | |
| Agency - Commercial | $357 | $ — | $ (17) | $340 |
| Agency - Residential | 367 | — | (17) | 350 |
| Total held-to-maturity securities (1) | $724 | $ — | $ (34) | $690 |
| December 31, 2017 | | | | |
| Available-for-sale securities | | | | |
| Agency - Commercial | $1,004 | $ — | $ (17) | $987 |
| Agency - Residential | 811 | — | (17) | 794 |
| Municipal obligations | 35 | — | (1) | 34 |
| Corporate debt obligations | 37 | 1 | — | 38 |
| Total available-for-sale securities (1) | $1,887 | $ 1 | $ (35) | $1,853 |
| Held-to-maturity securities | | | | |
| Agency - Commercial | $526 | $ — | $ (9) | $517 |
| Agency - Residential | 413 | — | (6) | 407 |
| Total held-to-maturity securities (1) | $939 | $ — | $ (15) | $924 |

(1) There were no securities of a single issuer, which are not governmental or government-sponsored, that exceeded 10 percent of stockholders' equity at September 30, 2018 or December 31, 2017.

We evaluate AFS and HTM investment securities for OTTI on a quarterly basis. An OTTI is considered to have occurred when the fair value of a debt security is below its amortized costs and we (1) have the intent to sell the security, (2) will more likely than not be required to sell the security before recovery of its amortized cost, or (3) do not expect to recover the entire amortized cost basis of the security. Investments that have an OTTI are written down through a charge to earnings for the amount representing the credit loss on the security. Gains and losses related to all other factors are recognized in other comprehensive income (loss). Agency securities, which are either explicitly or implicitly backed by the federal government, comprised 97 percent of our total securities at September 30, 2018. This factor is considered when evaluating our investment securities for OTTI. During the three and nine months ended September 30, 2018 and September 30, 2017, we had no OTTI.

Available-for-sale securities

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

We purchased $43 million and $48 million of AFS securities, which were comprised of U.S. government sponsored agency MBS and corporate debt obligations during the three and nine months ended September 30, 2018, respectively. In addition, we retained zero and $16 million of passive interests in our own private MBS during the three and nine months ended September 30, 2018, respectively. We purchased $300 million and $600 million of AFS securities, which included U.S. government sponsored agency MBS, corporate debt obligations, and municipal obligations during the three and nine months ended September 30, 2017, respectively.

Gains on sales of AFS securities are reported in other noninterest income in the Consolidated Statements of Operations. We had no sales of AFS securities during both the three and nine months ended September 30, 2018, except those related to mortgage loans that had been securitized for sale in the normal course of business. We sold $227 million and $289 million of AFS securities during the three and nine months ended September 30, 2017, respectively, which did not include

Table of Contents

those related to mortgage loans that had been securitized for sale in the normal course of business. These sales resulted in a realized gain of $2 million and $3 million during the three and nine months ended September 30, 2017, respectively.

Held-to-maturity securities

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

In conjunction with adoption of ASU 2017-12 (Targeted Improvements to Accounting for Hedging Activities) the Company elected to transfer $144 million of investment securities from HTM to AFS during the first quarter of 2018, as permitted by the standard, which resulted in a de minimis impact to OCI.

There were no purchases or sales of HTM securities during both the three and nine months ended September 30, 2018 and September 30, 2017.

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

| | Unrealized Loss Position with Duration 12 Months and Over | | | Unrealized Loss Position with Duration Under 12 Months | | |
|---|---|---|---|---|---|---|
| | Fair Value | Number of Securities | Unrealized Loss | Fair Value | Number of Securities | Unrealized Loss |
| | (Dollars in millions) | | | | | |
| September 30, 2018 | | | | | | |
| Available-for-sale securities | | | | | | |
| Agency - Commercial | $819 | 54 | $ (41) | $274 | 23 | $ (7) |
| Agency - Residential | 535 | 57 | (34) | 139 | 27 | (5) |
| Municipal obligations | 25 | 11 | (1) | 6 | 10 | — |
| Corporate debt obligations | — | — | — | 13 | 4 | — |
| Other MBS | — | — | — | 14 | 1 | — |
| Held-to-maturity securities | | | | | | |
| Agency - Commercial | $330 | 25 | $ (17) | $10 | 1 | $ — |
| Agency - Residential | 292 | 46 | (15) | 58 | 14 | (2) |
| December 31, 2017 | | | | | | |
| Available-for-sale securities | | | | | | |
| Agency - Commercial | $218 | 20 | $ (7) | $744 | 41 | $ (11) |
| Agency - Residential | 452 | 36 | (14) | 263 | 33 | (3) |
| Municipal obligations | 6 | 3 | — | 22 | 9 | — |
| Corporate debt obligations | — | — | — | 3 | 1 | — |
| Held-to-maturity securities | | | | | | |
| Agency - Commercial | $348 | 25 | $ (8) | $99 | 8 | $ (1) |
| Agency - Residential | 111 | 16 | (3) | 293 | 43 | (3) |

The following table shows the amortized cost and estimated fair value of securities by contractual maturity:

| | Investment Securities Available-for-Sale | | | Investment Securities Held-to-maturity | | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value | Weighted Average | Amortized Cost | Fair Value | Weighted Average |

| | | | Yield | | | | Yield | |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | | |
| September 30, 2018 | | | | | | | | |
| Due after one year through five years | $60 | $58 | 2.51 | % | $10 | $10 | 2.45 | % |
| Due after five years through 10 years | 60 | 59 | 4.40 | % | 11 | 11 | 2.21 | % |
| Due after 10 years | 1,825 | 1,740 | 2.43 | % | 703 | 669 | 2.46 | % |
| Total | $1,945 | $1,857 | | | $724 | $690 | | |

We pledge investment securities, primarily agency collateralized and municipal taxable mortgage obligations, to collateralize lines of credit and/or borrowings. At both September 30, 2018 and December 31, 2017, we had pledged investment securities of $2.0 billion.

Table of Contents

Note 3 - Loans Held-for-Sale

The majority of our mortgage loans originated as LHFS are ultimately sold into the secondary market on a whole loan basis or by securitizing the loans into agency, government, or private label mortgage-backed securities. LHFS totaled $4.8 billion and $4.3 billion at September 30, 2018 and December 31, 2017, respectively. For the three and nine months ended September 30, 2018 we had net gain on loan sales associated with LHFS of $43 million and $166 million, respectively, as compared to $75 million and $189 million for the three and nine months ended September 30, 2017, respectively.

At September 30, 2018 and December 31, 2017, $20 million and $21 million, respectively, of LHFS were recorded at lower of cost or fair value. The remainder of the loans in the portfolio are recorded at fair value as we have elected the fair value option.

Note 4 - Loans Held-for-Investment

The following table presents our loans held-for-investment:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Consumer loans | | |
| Residential first mortgage | $3,085 | $ 2,754 |
| Home equity | 704 | 664 |
| Other | 150 | 25 |
| Total consumer loans | 3,939 | 3,443 |
| Commercial loans | | |
| Commercial real estate | 2,160 | 1,932 |
| Commercial and industrial | 1,317 | 1,196 |
| Warehouse lending | 1,550 | 1,142 |
| Total commercial loans | 5,027 | 4,270 |
| Total loans held-for-investment | $8,966 | $ 7,713 |

The following table presents the UPB of our loan sales and purchases in the loans held-for-investment portfolio:

| | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Loans Sold (1) | | |
| Performing loans | $ 4 | $ 78 |
| Nonperforming loans | — | 25 |
| Total performing and nonperforming loans sold | $ 4 | $ 103 |
| Net gain associated with loan sales (2) | $ — | $ 1 |
| Loans Purchased | | |
| Residential first mortgage loans | $ — | $ 6 |
| HELOC | — | 100 |
| Total loans purchased | $ — | $ 106 |

| | |
|---|---|
| Premium associated with loans purchased | $ — $ 4 |

(1) Upon a change in our intent, the loans were transferred to LHFS and subsequently sold.
(2) Recorded in net gain on loan sales on Consolidated Statement of Operations.

We have pledged certain LHFI, LHFS, and loans with government guarantees to collateralize lines of credit and/or borrowings with the FHLB of Indianapolis and the FRB of Chicago. At September 30, 2018 we had pledged loans of $7.7 billion, compared to $7.1 billion of pledged loans at December 31, 2017.

Table of Contents

Allowance for Loan Losses

We determine the estimate of the ALLL on at least a quarterly basis. Refer to Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Policies in Part II, Item 8 of Exhibit 99.1 to our June 1, 2018 Form 8-K Report for a description of the methodology. The ALLL, other than for loans that have been identified for individual evaluation for impairment, is determined on a loan pool basis by grouping loan types with common risk characteristics to determine our best estimate of incurred losses.

The following table presents changes in ALLL, by class of loan:

| | Residential First Mortgage (1) | Home Equity | Other Consumer | Commercial Real Estate | Commercial and Industrial | Warehouse Lending | Total |
|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | |
| Three Months Ended September 30, 2018 | | | | | | | |
| Beginning balance ALLL | $45 | $ 19 | $ 1 | $ 45 | $ 21 | $ 6 | $137 |
| Charge-offs | (2 ) | — | — | — | — | — | (2 ) |
| Recoveries | 1 | — | — | — | — | — | 1 |
| Provision (benefit) | (4 ) | 1 | 1 | 1 | (1 ) | — | (2 ) |
| Ending balance ALLL | $40 | $ 20 | $ 2 | $ 46 | $ 20 | $ 6 | $134 |
| Three Months Ended September 30, 2017 | | | | | | | |
| Beginning balance ALLL | $56 | $ 19 | $ 1 | $ 37 | $ 21 | $ 6 | $140 |
| Charge-offs | (1 ) | (2 ) | — | — | — | — | (3 ) |
| Recoveries | — | 1 | — | — | — | — | 1 |
| Provision (benefit) | (3 ) | 2 | — | 5 | (2 ) | — | 2 |
| Ending balance ALLL | $52 | $ 20 | $ 1 | $ 42 | $ 19 | $ 6 | $140 |
| Nine Months Ended September 30, 2018 | | | | | | | |
| Beginning balance ALLL | $47 | $ 22 | $ 1 | $ 45 | $ 19 | $ 6 | $140 |
| Charge-offs | (3 ) | (2 ) | (1 ) | — | — | — | (6 ) |
| Recoveries | 1 | 2 | — | — | — | — | 3 |
| Provision (benefit) | (5 ) | (2 ) | 2 | 1 | 1 | — | (3 ) |
| Ending balance ALLL | $40 | $ 20 | $ 2 | $ 46 | $ 20 | $ 6 | $134 |
| Nine Months Ended September 30, 2017 | | | | | | | |
| Beginning balance ALLL | $65 | $ 24 | $ 1 | $ 28 | $ 17 | $ 7 | $142 |
| Charge-offs | (6 ) | (3 ) | (1 ) | — | — | — | (10 ) |
| Recoveries | 1 | 2 | 1 | — | — | — | 4 |
| Provision (benefit) | (8 ) | (3 ) | — | 14 | 2 | (1 ) | 4 |
| Ending balance ALLL | $52 | $ 20 | $ 1 | $ 42 | $ 19 | $ 6 | $140 |

(1) Includes loans with government guarantees.

Table of Contents

The following table sets forth the method of evaluation, by class of loan:

| | Residential First Mortgage (1) | Home Equity | Other Consumer | Commercial Real Estate | Commercial and Industrial | Warehouse Lending | Total |
|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | |
| September 30, 2018 | | | | | | | |
| Loans held-for-investment (2) | | | | | | | |
| Individually evaluated | $33 | $ 24 | $ — | $ — | $ — | $ — | $57 |
| Collectively evaluated | 3,044 | 677 | 150 | 2,160 | 1,317 | 1,550 | 8,898 |
| Total loans | $3,077 | $ 701 | $ 150 | $ 2,160 | $ 1,317 | $ 1,550 | $8,955 |
| Allowance for loan losses (2) | | | | | | | |
| Individually evaluated | $5 | $ 8 | $ — | $ — | $ — | $ — | $13 |
| Collectively evaluated | 35 | 12 | 2 | 46 | 20 | 6 | 121 |
| Total allowance for loan losses | $40 | $ 20 | $ 2 | $ 46 | $ 20 | $ 6 | $134 |
| | | | | | | | |
| December 31, 2017 | | | | | | | |
| Loans held-for-investment (2) | | | | | | | |
| Individually evaluated | $34 | $ 27 | $ — | $ — | $ — | $ — | $61 |
| Collectively evaluated | 2,712 | 633 | 25 | 1,932 | 1,196 | 1,142 | 7,640 |
| Total loans | $2,746 | $ 660 | $ 25 | $ 1,932 | $ 1,196 | $ 1,142 | $7,701 |
| Allowance for loan losses (2) | | | | | | | |
| Individually evaluated | $6 | $ 10 | $ — | $ — | $ — | $ — | $16 |
| Collectively evaluated | 41 | 12 | 1 | 45 | 19 | 6 | 124 |
| Total allowance for loan losses | $47 | $ 22 | $ 1 | $ 45 | $ 19 | $ 6 | $140 |

(1) Includes allowance related to loans with government guarantees.
(2) Excludes loans carried under the fair value option.

Loans are considered to be past due when any payment of principal or interest is 30 days past the scheduled payment date. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank.

We cease the accrual of interest on all classes of consumer and commercial loans upon the earlier of, becoming 90 days past due, or when doubt exists as to the ultimate collection of principal or interest (classified as nonaccrual or nonperforming loans). When a loan is placed on nonaccrual status, the accrued interest income is reversed and the loan may only return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Table of Contents

The following table sets forth the LHFI aging analysis of past due and current loans:

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due (1)(2) | Total Past Due | Current | Total LHFI |
|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | |
| September 30, 2018 | | | | | | |
| Consumer loans | | | | | | |
| Residential first mortgage | $1 | $ 1 | $ 20 | $ 22 | $3,063 | $3,085 |
| Home equity | 1 | — | 5 | 6 | 698 | 704 |
| Other | — | — | — | — | 150 | 150 |
| Total consumer loans | 2 | 1 | 25 | 28 | 3,911 | 3,939 |
| Commercial loans | | | | | | |
| Commercial real estate | — | — | — | — | 2,160 | 2,160 |
| Commercial and industrial | — | — | — | — | 1,317 | 1,317 |
| Warehouse lending | — | — | — | — | 1,550 | 1,550 |
| Total commercial loans | — | — | — | — | 5,027 | 5,027 |
| Total loans | $2 | $ 1 | $ 25 | $ 28 | $8,938 | $8,966 |
| December 31, 2017 | | | | | | |
| Consumer loans | | | | | | |
| Residential first mortgage | $2 | $ 2 | $ 23 | $ 27 | $2,727 | $2,754 |
| Home Equity | 1 | — | 6 | 7 | 657 | 664 |
| Other | — | — | — | — | 25 | 25 |
| Total consumer loans | 3 | 2 | 29 | 34 | 3,409 | 3,443 |
| Commercial loans | | | | | | |
| Commercial real estate | — | — | — | — | 1,932 | 1,932 |
| Commercial and industrial | — | — | — | — | 1,196 | 1,196 |
| Warehouse lending | — | — | — | — | 1,142 | 1,142 |
| Total commercial loans | — | — | — | — | 4,270 | 4,270 |
| Total loans | $3 | $ 2 | $ 29 | $ 34 | $7,679 | $7,713 |

(1) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans.

(2) Includes $4 million of loans accounted for under the fair value option at both September 30, 2018 and December 31, 2017.

Interest income is recognized on nonaccrual loans using a cash basis method. Interest that would have been accrued on impaired loans totaled less than $1 million and $1 million during the three and nine months ended September 30, 2018 and zero and $1 million during the three and nine months ended September 30, 2017, respectively. At September 30, 2018 and December 31, 2017, we had no loans 90 days past due and still accruing interest.

Troubled Debt Restructurings

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

TDRs if the loan was nonperforming prior to the restructuring, or based upon the results of a contemporaneous credit evaluation. Such loans will continue on nonaccrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months, after which they will be classified as performing TDRs and begin to accrue interest. Performing and nonperforming TDRs remain impaired as interest and principal will not be received in accordance with the original contractual terms of the loan agreement.

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, but may give rise to potential incremental losses. We measure impairments using a discounted cash flow method for performing TDRs and measure impairment based on collateral values for nonperforming TDRs.

Table of Contents

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

| | TDRs | | |
|---|---|---|---|
| | Performing | Nonperforming | Total |
| | (Dollars in millions) | | |
| September 30, 2018 | | | |
| Consumer loans | | | |
| Residential first mortgage | $22 | $ 9 | $ 31 |
| Home equity | 21 | 4 | 25 |
| Total TDRs (1)(2) | $43 | $ 13 | $ 56 |
| December 31, 2017 | | | |
| Consumer loans | | | |
| Residential first mortgage | $19 | $ 12 | $ 31 |
| Home Equity | 24 | 4 | 28 |
| Total TDRs (1)(2) | $43 | $ 16 | $ 59 |

(1) The ALLL on TDR loans totaled $11 million and $13 million at September 30, 2018 and December 31, 2017, respectively.

(2) Includes $3 million of TDR loans accounted for under the fair value option at both September 30, 2018 and December 31, 2017.

The following table provides a summary of newly modified TDRs:

| | New TDRs | | | |
|---|---|---|---|---|
| | Number of Accounts | Pre-Modification Unpaid Principal Balance | Post-Modification Unpaid Principal Balance (1) | Increase in Allowance at Modification |
| | | (Dollars in millions) | | |
| Three Months Ended September 30, 2018 | | | | |
| Residential first mortgages | 2 | $ — | $ — | $ — |
| Home equity (2)(3) | 6 | 1 | 1 | — |
| Total TDR loans | 8 | $ 1 | $ 1 | $ — |
| Three Months Ended September 30, 2017 | | | | |
| Residential first mortgages | 9 | $ 3 | $ 3 | $ — |
| Home equity (2)(3) | 37 | 2 | 2 | 1 |
| Total TDR loans | 46 | $ 5 | $ 5 | $ 1 |
| Nine Months Ended September 30, 2018 | | | | |
| Residential first mortgages | 13 | $ 2 | $ 2 | $ — |
| Home equity (2)(3) | 14 | 1 | 1 | — |
| Total TDR loans | 27 | $ 3 | $ 3 | $ — |
| Nine Months Ended September 30, 2017 | | | | |
| Residential first mortgages | 17 | $ 4 | $ 4 | $ — |
| Home equity (2)(3) | 71 | 5 | 5 | 2 |
| Other consumer | 1 | — | — | — |
| Total TDR loans | 89 | $ 9 | $ 9 | $ 2 |

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

(2) Home equity post-modification UPB reflects write downs.

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

There were no residential first mortgage loans modified in the previous 12 months, that subsequently defaulted during the three and nine months ended September 30, 2018, compared to one residential first mortgage loan with UPB of less than $1 million modified in the previous 12 months, that subsequently defaulted during both the three and nine months ended September 30, 2017. There was no change in the allowance associated with these TDRs at subsequent default. All TDR classes within the consumer and commercial portfolios are considered subsequently defaulted when greater than 90 days past due within 12 months of the restructuring date.

Table of Contents

Impaired Loans

The following table presents individually evaluated impaired loans and the associated allowance:

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Net Unpaid Principal Balance | Related Allowance | Recorded Investment | Net Unpaid Principal Balance | Related Allowance |
| | (Dollars in millions) | | | | | |
| With no related allowance recorded | | | | | | |
| Consumer loans | | | | | | |
| Residential first mortgage | $13 | $ 16 | $ — | $11 | $ 12 | $ — |
| Home equity | 1 | 4 | — | — | — | — |
| Total loans with no related allowance recorded | $14 | $ 20 | $ — | $11 | $ 12 | $ — |
| With an allowance recorded | | | | | | |
| Consumer loans | | | | | | |
| Residential first mortgage | $20 | $ 21 | $ 5 | $22 | $ 22 | $ 6 |
| Home equity | 23 | 24 | 8 | 24 | 27 | 10 |
| Total loans with an allowance recorded | $43 | $ 45 | $ 13 | $46 | $ 49 | $ 16 |
| | | | | | | |
| Total Impaired loans | | | | | | |
| Consumer Loans | | | | | | |
| Residential first mortgage | $33 | $ 37 | $ 5 | $33 | $ 34 | $ 6 |
| Home equity | 24 | 28 | 8 | 24 | 27 | 10 |
| Total impaired loans | $57 | $ 65 | $ 13 | $57 | $ 61 | $ 16 |

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

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2018 | | 2017 | |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| | (Dollars in millions) | | | | | | | |
| Consumer loans | | | | | | | | |
| Residential first mortgage | $34 | $ 1 | $ 37 | $ 1 | $34 | $ 1 | $ 39 | $ 1 |
| Home equity | 24 | — | 28 | — | 25 | 1 | 28 | 1 |
| Commercial loans | | | | | | | | |
| Commercial real estate | — | — | 1 | — | — | — | — | — |
| Commercial and industrial | — | — | — | — | 2 | — | — | — |
| Total impaired loans | $58 | $ 1 | $ 66 | $ 1 | $61 | $ 2 | $ 67 | $ 2 |

Credit Quality

We utilize an internal risk rating system which is applied to all consumer and commercial loans. Descriptions of our internal risk ratings as they relate to credit quality follow the ratings used by the U.S. bank regulatory agencies as listed below.

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

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

Special mention. Assets identified as special mention possess credit deficiencies or potential weaknesses deserving management's close attention. Special mention assets have a potential weakness or pose an unwarranted financial risk that, if

Table of Contents

not corrected, could weaken the assets and increase risk in the future. Special mention assets are criticized, but do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Assets identified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the full collection or liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. For home equity loans and other consumer loans, we evaluate credit quality based on the aging and status of payment activity and any other known credit characteristics that call into question full repayment of the asset. Nonperforming loans are classified as either substandard, doubtful or loss.

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

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

Consumer Loans

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

Commercial Loans

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

Table of Contents

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Pass | Watch | Special Mention | Substandard | Total Loans |
| | (Dollars in millions) | | | | |
| Consumer Loans | | | | | |
| Residential first mortgage | $3,037 | $ 27 | $ — | $ 21 | $3,085 |
| Home equity | 678 | 21 | — | 5 | 704 |
| Other consumer | 150 | — | — | — | 150 |
| Total consumer loans | $3,865 | $ 48 | $ — | $ 26 | $3,939 |
| | | | | | |
| Commercial Loans | | | | | |
| Commercial real estate | $2,135 | $ 23 | $ — | $ 2 | $2,160 |
| Commercial and industrial | 1,228 | 52 | 37 | — | 1,317 |
| Warehouse | 1,445 | 90 | 15 | — | 1,550 |
| Total commercial loans | $4,808 | $ 165 | $ 52 | $ 2 | $5,027 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | Pass | Watch | Special Mention | Substandard | Total Loans |
| | (Dollars in millions) | | | | |
| Consumer Loans | | | | | |
| Residential first mortgage | $2,706 | $ 23 | $ — | $ 25 | $2,754 |
| Home equity | 633 | 25 | — | 6 | 664 |
| Other consumer | 25 | — | — | — | 25 |
| Total consumer loans | $3,364 | $ 48 | $ — | $ 31 | $3,443 |
| | | | | | |
| Commercial Loans | | | | | |
| Commercial real estate | $1,902 | $ 23 | $ 7 | $ — | $1,932 |
| Commercial and industrial | 1,135 | 32 | 24 | 5 | 1,196 |
| Warehouse | 1,014 | 128 | — | — | 1,142 |
| Total commercial loans | $4,051 | $ 183 | $ 31 | $ 5 | $4,270 |

Note 5 - Loans with Government Guarantees

Substantially all loans with government guarantees are insured or guaranteed by the FHA or the U.S. Department of Veterans Affairs. FHA loans earn interest at a rate based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent, which is not paid by the FHA or the U.S. Department of Veterans Affairs until claimed. Certain loans within our portfolio may be subject to indemnifications and insurance limits which expose us to limited credit risk. We have reserved for these risks within other assets and as a component of our ALLL on residential first mortgages.

At September 30, 2018 and December 31, 2017 loans with government guarantees totaled $305 million and $271 million, respectively.

At September 30, 2018 and December 31, 2017 repossessed assets and the associated claims recorded in other assets totaled $58 million and $84 million, respectively.

Note 6 - Variable Interest Entities

We have no consolidated VIEs as of September 30, 2018 and December 31, 2017.

In connection with our securitization activities, we have retained a five percent interest in the investment securities ("other MBS") of one trust and are contracted as the sub-servicer of the underlying loans, compensated based on market rates, which constitutes a continuing involvement in the trust. Although we have a variable interest in the securitization trust, we are not its primary beneficiary due to the relative size of our investment in comparison to the total amount of securities issued by the VIE and our inability to direct activities that most significantly impact the VIE’s economic performance. As a result, we have not consolidated the assets and liabilities of the VIE in our Statements of Financial Condition. The Bank’s maximum

Table of Contents

exposure to loss is limited to our investment in the VIE, as well as the standard representations and warranties made in conjunction with the loan transfer. See Note 2 - Investment Securities and Note 17 - Fair Value Measurements, for additional information.

In addition, we have a continuing involvement, but are not the primary beneficiary for an unconsolidated VIE related to the FSTAR 2007-1 mortgage securitization trust. In accordance with the settlement agreement with MBIA, there is no further recourse to us related to FSTAR 2007-1, unless MBIA fails to meet their obligations. At September 30, 2018 and December 31, 2017, the FSTAR 2007-1 mortgage securitization trust included 1,598 loans and 1,911 loans, respectively, with an aggregate principal balance of $53 million and $65 million, respectively.

Note 7 - Mortgage Servicing Rights

We have investments in MSRs that result from the sale of loans to the secondary market for which we retain the servicing. We account for MSRs at their fair value. A primary risk associated with MSRs is the potential reduction in fair value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates or government intervention. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. We utilize derivatives as economic hedges to offset changes in the fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. There is also a risk of valuation decline due to higher than expected increases in default rates, which we do not believe can be effectively managed using derivatives. For further information regarding the derivative instruments utilized to manage our MSR risks, see Note 8 - Derivative Financial Instruments.

Changes in the fair value of residential first mortgage MSRs were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Balance at beginning of period | $257 | $184 | $291 | $335 |
| Additions from loans sold with servicing retained | 100 | 75 | 283 | 178 |
| Reductions from sales | (51) | (4) | (273) | (260) |
| Changes in fair value due to (1): | | | | |
| Decrease in MSR value due to pay-offs, pay-downs and run-off | (3) | (5) | (11) | (15) |
| Changes in estimates of fair value (2) | 10 | (4) | 23 | 8 |
| Fair value of MSRs at end of period | $313 | $246 | $313 | $246 |

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

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

| September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|
| | Fair value impact due to | | | Fair value impact due to | |
| Actual | 10% adverse | 20% adverse | Actual | 10% adverse | 20% adverse |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | change | change | | change | change |
| | | (Dollars in millions) | | | (Dollars in millions) | |
| Option adjusted spread | 5.03 % | $308 | $ 304 | 6.29 % | $286 | $ 282 |
| Constant prepayment rate | 8.98 % | 303 | 294 | 9.93 % | 283 | 277 |
| Weighted average cost to service per loan | $80.79 | 310 | 307 | $73.00 | 288 | 286 |

The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. Changes in fair value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. To isolate the effect of the specified change, the fair value shock analysis is consistent with the identified adverse change, while holding all other assumptions constant. In practice, a change in one assumption generally impacts other assumptions, which may either magnify or counteract the effect of the change. For further information on the fair value of MSRs, see Note 17 - Fair Value Measurements.

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Net return on mortgage servicing rights | | | | |
| Servicing fees, ancillary income and late fees (1) | $17 | $14 | $46 | $43 |
| Changes in fair value | 7 | (9 ) | 12 | (7 ) |
| Gain (loss) on MSR derivatives (2) | (11 ) | — | (27 ) | (3 ) |
| Net transaction costs | — | 1 | (5 ) | (7 ) |
| Total return included in net return on mortgage servicing rights | $13 | $6 | $26 | $26 |

(1) Servicing fees are recorded on an accrual basis. Ancillary income and late fees are recorded on a cash basis.
(2) Changes in the derivatives utilized as economic hedges to offset changes in fair value of the MSRs.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Loan administration income on mortgage loans subserviced | | | | |
| Servicing fees, ancillary income and late fees (1) | $14 | $ 9 | $36 | $26 |
| Other servicing charges | (9 ) | (4 ) | (21 ) | (10 ) |
| Total income on mortgage loans subserviced, included in loan administration | $5 | $ 5 | $15 | $16 |

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

Note 8 - Derivative Financial Instruments

Derivative financial instruments are recorded at fair value in other assets and other liabilities on the Consolidated Statements of Financial Condition. The Company's policy is to present its derivative assets and derivative liabilities on the Consolidated Statement of Financial Condition on a gross basis, even when provisions allowing for set-off are in place. However, for derivative contracts cleared through certain central clearing parties, variation margin payments are recognized as settlements. We are exposed to non-performance risk by the counterparties to our various derivative financial instruments. A majority of our derivatives are centrally cleared through a Central Counterparty Clearing House or consist of residential mortgage interest rate lock commitments further limiting our exposure to non-performance risk. We believe that the non-performance risk inherent in our remaining derivative contracts is minimal based on credit standards and the collateral provisions of the derivative agreements.

Derivatives not designated as hedging instruments: We maintain a derivative portfolio of interest rate swaps, futures and forward commitments used to manage exposure to changes in interest rates, MSR asset values and to meet the needs of customers. We also enter into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Market risk on interest rate lock commitments and mortgage LHFS is managed using corresponding forward sale commitments. Changes in fair value of derivatives not designated as hedging instruments are recognized in the Consolidated Statements of Income.

Derivatives designated as hedging instruments: We have designated certain interest rate swaps as fair value hedges of fixed rate certificates of deposit.

During the second quarter of 2018, we de-designated all of our remaining cash flow hedge relationships. The fair value of our derivatives designated as cash flow hedges are recorded in other comprehensive income (loss) on the Consolidated Statement of Financial Condition and reclassified into interest expense in the same period in which the hedged transaction is recognized in earnings. At September 30, 2018, we had $23 million (net-of-tax) of accumulated unrealized gains on derivatives previously designated as cash flow hedges recorded in accumulated other comprehensive income, compared to $2 million (net-of-tax) of accumulated unrealized gains on derivatives designated as cash flow hedges recorded in accumulated other comprehensive income at December 31, 2017. We evaluate the probability of hedged transactions occurring on at least a

Table of Contents

quarterly basis relating to amounts deferred in OCI. The estimated amount scheduled to be reclassified from other comprehensive income into earnings during the next 12 months represents $3 million of gains (net-of-tax). For further information, see Note 11 - Accumulated Other Comprehensive Income.

Derivatives that are designated in hedging relationships are assessed for effectiveness using regression analysis at inception. All hedge relationships were highly effective as of September 30, 2018. Cash flows and the income impact associated with designated hedges are reported in the same line item as the underlying hedged item.

The following table presents the notional amount, estimated fair value and maturity of our derivative financial instruments:

| | September 30, 2018 (1) | | |
|---|---|---|---|
| | Notional Amount | Fair Value (2) | Expiration Dates |
| | (Dollars in millions) | | |
| Derivatives in fair value hedge relationships: | | | |
| Liabilities | | | |
| Interest rate swaps on CDs | $30 | $ — | 2019 |
| Derivatives not designated as hedging instruments: | | | |
| Assets | | | |
| Futures | $2,494 | $ — | 2018-2023 |
| Mortgage backed securities forwards | 4,670 | 19 | 2018 |
| Rate lock commitments | 3,121 | 20 | 2018-2019 |
| Interest rate swaps and swaptions | 2,195 | 23 | 2018-2038 |
| Total derivative assets | $12,480 | $ 62 | |
| Liabilities | | | |
| Futures | $309 | $ — | 2018-2023 |
| Mortgage backed securities forwards | 1,903 | 6 | 2018 |
| Rate lock commitments | 419 | 1 | 2018 |
| Interest rate swaps | 765 | 13 | 2018-2048 |
| Total derivative liabilities | $3,396 | $ 20 | |

| | December 31, 2017 (1) | | |
|---|---|---|---|
| | Notional Amount | Fair Value (2) | Expiration Dates |
| | (Dollars in millions) | | |
| Derivatives in cash flow hedge relationships: | | | |
| Liabilities | | | |
| Interest rate swaps on FHLB advances | $830 | $ 1 | 2023-2026 |
| Derivatives not designated as hedging instruments: | | | |
| Assets | | | |
| Futures | $1,597 | $ — | 2018-2022 |
| Mortgage backed securities forwards | 2,646 | 4 | 2018 |
| Rate lock commitments | 3,629 | 24 | 2018 |
| Interest rate swaps and swaptions | 1,441 | 11 | 2018-2048 |
| Total derivative assets | $9,313 | $ 39 | |
| Liabilities | | | |
| Futures | $209 | $ — | 2018-2021 |
| Mortgage backed securities forwards | 3,197 | 6 | 2018 |

| | | | |
|---|---|---|---|
| Rate lock commitments | 214 | — | 2018 |
| Interest rate swaps | 617 | 4 | 2018-2027 |
| Total derivative liabilities | $4,237 | $ 10 | |

(1) Variation margin pledged to or received from a Central Counterparty Clearing House to cover the prior day's fair value of open positions, is considered settlement of the derivative position for accounting purposes.

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

Table of Contents

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

| | Gross Amount | Gross Amounts Netted in the Statement of Financial Position | Net Amount Presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments | Gross Amounts Not Offset in the Statement of Financial Position: Cash Collateral |
|---|---|---|---|---|---|
| | (Dollars in millions) | | | | |
| September 30, 2018 | | | | | |
| Derivatives not designated as hedging instruments: | | | | | |
| Assets | | | | | |
| Mortgage backed securities forwards | $19 | $ — | $ 19 | $ — | $ 18 |
| Interest rate swaps and swaptions (1) | 23 | — | 23 | — | 26 |
| Total derivative assets | $42 | $ — | $ 42 | $ — | $ 44 |
| Liabilities | | | | | |
| Futures | $— | $ — | $ — | $ — | $ 2 |
| Mortgage backed securities forwards | 6 | — | 6 | — | 2 |
| Interest rate swaps (1) | 13 | — | 13 | — | 20 |
| Total derivative liabilities | $19 | $ — | $ 19 | $ — | $ 24 |
| | | | | | |
| December 31, 2017 | | | | | |
| Derivatives designated as hedging instruments: | | | | | |
| Liabilities | | | | | |
| Interest rate swaps on FHLB advances (1) | $1 | $ — | $ 1 | $ — | $ 17 |
| | | | | | |
| Derivatives not designated as hedging instruments: | | | | | |
| Assets | | | | | |
| Mortgage-backed securities forwards | $4 | $ — | $ 4 | $ — | $ 8 |
| Interest rate swaps and swaptions (1) | 11 | — | 11 | — | 10 |
| Total derivative assets | $15 | $ — | $ 15 | $ — | $ 18 |
| Liabilities | | | | | |
| Futures | $— | $ — | $ — | $ — | $ 2 |
| Mortgage-backed securities forwards | 6 | — | 6 | — | 2 |
| Interest rate swaps (1) | 4 | — | 4 | — | 5 |
| Total derivative liabilities | $10 | $ — | $ 10 | $ — | $ 9 |

(1) Variation margin pledged to or received from a Central Counterparty Clearing House to cover the prior day's fair value of open positions, is considered settlement of the derivative position for accounting purposes.

The fair value basis adjustment on our hedged CDs is included in interest bearing deposits on our Consolidated Statements of Operations. The carrying amount of our hedged CDs was $30 million at September 30, 2018 and zero at December 31, 2017 and the cumulative amount of fair value hedging adjustment included in the carrying amount of the hedged CDs was de minimis and zero at September 30, 2018 and December 31, 2017, respectively.

At September 30, 2018, we pledged a total of $24 million related to derivative financial instruments, consisting of $4 million of cash collateral on derivative liabilities and $20 million of maintenance margin on centrally cleared derivatives and had an obligation to return cash of $44 million on derivative assets. We pledged a total of $26 million related to derivative financial instruments, consisting of $7 million of cash collateral on derivatives and $19 million of maintenance margin on centrally cleared derivatives and had an obligation to return cash of $18 million on derivative assets at December 31, 2017. Within the Consolidated Statements of Financial Condition, the collateral related to derivative activity is included in other assets and other liabilities and the cash pledged as maintenance margin is restricted and included in in other assets.

Table of Contents

The following table presents the net gain (loss) recognized on designated instruments, net of the impact of offsetting positions:

| | Amount Recorded in Net Interest Income (1) | | | |
|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Gain on cash flow hedging relationships in interest contracts | | | | |
| Amount of gain reclassified from AOCI into income | $1 | $ — | $ — | $ 5 |
| Total gain on hedges | $1 | $ — | $ — | $ 5 |

(1) We had no gain/(loss) on fair value hedging relationships in interest contracts for the three and nine months ending September 30, 2018 and September 30, 2017.

The following table presents net gain (loss) recognized in income on derivative instruments, net of the impact of offsetting positions:

| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|---|
| | | 2018 | 2017 | 2018 | 2017 |
| | | (Dollars in millions) | | | |
| Derivatives not designated as hedging instruments: | Location of Gain (Loss) | | | | |
| Futures | Net return on mortgage servicing rights | $(1) | $(1) | $(4) | $(1) |
| Interest rate swaps and swaptions | Net return on mortgage servicing rights | (8) | (2) | (16) | (7) |
| Mortgage-backed securities forwards | Net return on mortgage servicing rights | (2) | 2 | (6) | 5 |
| Rate lock commitments and forward agency and loan sales | Net gain on loan sales | 21 | (8) | 12 | (16) |
| Interest rate swaps (1) | Other noninterest income | 1 | — | 2 | 1 |
| Total derivative gain (loss) | | $11 | $(9) | $(12) | $(18) |

(1) Includes customer-initiated commercial interest rate swaps.

Note 9 - Borrowings

Federal Home Loan Bank Advances

The following is a breakdown of our FHLB advances outstanding:

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Amount | Rate | Amount | Rate |
| | (Dollars in millions) | | | |

| | | | | |
|---|---|---|---|---|
| Short-term fixed rate term advances | $3,194 | 2.18% | $4,260 | 1.40% |
| Short-term variable adjustable rate (1) | 5 | 2.54% | — | — % |
| Total Short-term Federal Home Loan Bank advances | 3,199 | | 4,260 | |
| Long-term LIBOR adjustable advances | 1,130 | 2.55% | 1,130 | 1.76% |
| Long-term fixed rate advances (2) | 150 | 1.53% | 275 | 1.41% |
| Total Long-term Federal Home Loan Bank advances | 1,280 | | 1,405 | |
| Total Federal Home Loan Bank advances | $4,479 | | $5,665 | |

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

(2) Includes the current portion of fixed rate advances of $50 million and $125 million at September 30, 2018 and December 31, 2017, respectively.

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

At September 30, 2018, our Board of Directors authorized and approved a line of credit with the FHLB of up to $10.0 billion, which is further limited based on our total assets and qualified collateral, as determined by the FHLB. At September 30, 2018, we had $4.5 billion of advances outstanding and an additional $2.1 billion of collateralized borrowing capacity available at the FHLB.

Table of Contents

At September 30, 2018, $1.1 billion of the outstanding advances were long-term adjustable rate, with interest rates that reset every three months and are based on the three-month LIBOR index. The advances may be prepaid without penalty, with notification at scheduled three month intervals.

The following table contains detailed information on our FHLB advances and other borrowings:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Maximum outstanding at any month end | $5,085 | $5,365 | $5,740 | $5,365 |
| Average outstanding balance | 4,745 | 5,043 | 4,996 | 4,239 |
| Average remaining borrowing capacity | 2,165 | 1,182 | 1,830 | 1,297 |
| Weighted average interest rate | 2.08 % | 1.36 % | 1.88 % | 1.26 % |

The following table outlines the maturity dates of our FHLB advances and other borrowings:

| | September 30, 2018 |
|---|---|
| | (Dollars in millions) |
| 2018 | $ 3,199 |
| 2019 | 50 |
| 2020 | — |
| 2021 | — |
| Thereafter | 1,230 |
| Total | $ 4,479 |

Parent Company Senior Notes and Trust Preferred Securities

The following table presents long-term debt, net of debt issuance costs:

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Amount | Interest Rate | Amount | Interest Rate |
| | (Dollars in millions) | | | |
| Senior Notes | | | | |
| Senior notes, matures 2021 | $248 | 6.125% | $247 | 6.125% |
| Trust Preferred Securities | | | | |
| Floating Three Month LIBOR Plus: | | | | |
| 3.25%, matures 2032 | $26 | 5.62 % | $26 | 4.92 % |
| 3.25%, matures 2033 | 26 | 5.59 % | 26 | 4.61 % |
| 3.25%, matures 2033 | 26 | 5.59 % | 26 | 4.94 % |
| 2.00%, matures 2035 | 26 | 4.34 % | 26 | 3.36 % |
| 2.00%, matures 2035 | 26 | 4.34 % | 26 | 3.36 % |
| 1.75%, matures 2035 | 51 | 4.08 % | 51 | 3.34 % |
| 1.50%, matures 2035 | 25 | 3.84 % | 25 | 2.86 % |
| 1.45%, matures 2037 | 25 | 3.78 % | 25 | 3.04 % |
| 2.50%, matures 2037 | 16 | 4.83 % | 16 | 4.09 % |
| Total Trust Preferred Securities | 247 | | 247 | |
| Total other long-term debt | $495 | | $494 | |

Senior Notes

On July 11, 2016, we issued $250 million of senior notes (“Senior Notes”) which mature on July 15, 2021. The notes are unsecured and rank equally and ratably with the unsecured senior indebtedness of Flagstar Bancorp, Inc.

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

Table of Contents

Trust Preferred Securities

We sponsor nine trust subsidiaries, which issued preferred stock to third party investors. We issued trust preferred securities to those trusts, which we include in long-term debt. The trust preferred securities are the sole assets of those trusts. The trust preferred securities are callable by us at any time. Interest is payable quarterly; however, we may defer interest payments for up to 20 quarters without default or penalty. As of September 30, 2018, we had no deferred interest.

Note 10 - Warrants

May Investor Warrant

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

During the nine months ended September 30, 2017, a total of 237,627 May Investor Warrants were exercised, resulting in the issuance of 154,313 shares of Common Stock. As of September 30, 2018, there were no remaining May Investor Warrants outstanding and the related liability was reduced to zero.

TARP Warrant

On January 30, 2009, in conjunction with the sale of 266,657 shares of TARP Preferred, we issued a warrant to purchase up to approximately 645,138 shares of Common Stock at an exercise price of $62.00 per share (the "Warrant").

The Warrant is exercisable through January 30, 2019 and remains outstanding.

Note 11 - Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Investment securities | | | | |
| Beginning balance | $(56) | $(6) | $(18) | $(8) |
| Unrealized gain (loss) | (11) | — | (55) | 2 |
| Less: Tax provision (benefit) | (2) | — | (13) | 1 |
| Net unrealized gain (loss) | (9) | — | (42) | 1 |
| Reclassifications out of AOCI (1) | — | 1 | — | 3 |
| Less: Tax provision | — | — | — | 1 |
| Net unrealized gain reclassified out of AOCI | — | 1 | — | 2 |
| Reclassification of certain income tax effects (2) | — | — | (5) | — |
| Other comprehensive income (loss), net of tax | (9) | 1 | (47) | 3 |
| Ending balance | $(65) | $(5) | $(65) | $(5) |

| | | | | |
|---|---|---|---|---|
| Cash Flow Hedges | | | | |
| Beginning balance | $24 | $(3) | $2 | $1 |
| Unrealized gain (loss) | — | — | 28 | (2) |
| Less: Tax provision (benefit) | — | — | 7 | (1) |
| Net unrealized gain (loss) | — | — | 21 | (1) |
| Reclassifications out of AOCI (1) | (1) | — | — | (5) |
| Less: Tax provision (benefit) | — | — | — | (2) |
| Net unrealized gain (loss) reclassified out of AOCI | (1) | — | — | (3) |
| Other comprehensive income (loss), net of tax | (1) | — | 21 | (4) |
| Ending balance | $23 | $(3) | $23 | $(3) |

(1) Reclassifications are reported in interest expense on the Consolidated Statement of Operations.

(2) Income tax effects of the Tax Cuts and Jobs Act are reclassified from AOCI to retained earnings due to early adoption of ASU 2018-02.

Table of Contents

## Note 12 - Earnings Per Share

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions, except share data) | | | |
| Net income | $48 | $ 40 | $133 | $ 108 |
| Weighted Average Shares | | | | |
| Weighted average common shares outstanding | 57,600,360 | 57,162,025 | 57,483,807 | 57,062,696 |
| Effect of dilutive securities | | | | |
| May Investor Warrants | — | — | — | 16,383 |
| Stock-based awards | 732,238 | 1,024,568 | 818,118 | 1,054,217 |
| Weighted average diluted common shares | 58,332,598 | 58,186,593 | 58,301,925 | 58,133,296 |
| Earnings per common share | | | | |
| Basic earnings per common share | $0.84 | $ 0.71 | $2.32 | $ 1.90 |
| Effect of dilutive securities | | | | |
| May Investor Warrants | — | — | — | — |
| Stock-based awards | (0.01) | (0.01) | (0.04) | (0.04) |
| Diluted earnings per common share | $0.83 | $ 0.70 | $2.28 | $ 1.86 |

## Note 13 - Stock-Based Compensation

We had stock-based compensation expense of $4 million and $8 million for the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2017 stock-based compensation expense was $2 million and $8 million, respectively.

### Restricted Stock and Restricted Stock Units

The following table summarizes restricted stock and restricted stock units activity:

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2018 | |
|---|---|---|---|---|
| | Shares | Weighted — Average Grant-Date Fair Value per Share | Shares | Weighted — Average Grant-Date Fair Value per Share |
| Restricted Stock and Restricted Stock Units | | | | |
| Non-vested balance at beginning of period | 1,796,628 | $ 27.33 | 1,290,450 | $ 20.52 |
| Granted | — | — | 863,342 | 34.36 |
| Vested | (4,901) | 26.73 | (239,688) | 19.68 |
| Canceled and forfeited | (8,312) | 31.23 | (130,689) | 20.72 |
| Non-vested balance at end of period | 1,783,415 | $ 27.32 | 1,783,415 | $ 27.32 |

### 2017 Employee Stock Purchase Plan

The Employee Stock Purchase Plan ("2017 ESPP") was approved on March 20, 2017 by our Board of Directors ("the Board") and on May 23, 2017 by our shareholders. The 2017 ESPP became effective July 1, 2017 and will remain effective until terminated by the Board. A total of 800,000 shares of the Company’s common stock are reserved and authorized for issuance for purchase under the 2017 ESPP. There were 23,623 and 88,566 shares issued under the 2017 ESPP during the three and nine months ended September 30, 2018, respectively, and the associated compensation expense was de minimis for both periods.

Table of Contents

Note 14 - Income Taxes

The provision for income taxes in interim periods requires us to make a best estimate of the effective tax rate expected to be applicable for the full year, adjusted for any discreet items for the applicable period. This estimated effective tax rate is then applied to interim consolidated pre-tax operating income to determine the interim provision for income taxes. The 2018 effective tax rate includes our assessment of the impact of the Tax Cuts and Jobs Act.

The following table presents our provision for income tax and effective tax provision rate:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Provision for income taxes | $12 | $20 | $33 | $52 |
| Effective tax provision rate | 20.0% | 32.4% | 20.1% | 32.3% |

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

Note 15 - Regulatory Matters

Regulatory Capital

We, along with the Bank, must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that could have a material effect on the Consolidated Financial Statements. On January 1, 2015, the Basel III rules became effective and included transition provisions through 2018. In preparation for the expected capital simplification rules, the Basel III implementation phase-in has been halted, as the agencies issued a final rule that will maintain the capital rules' 2017 transition provisions for several regulatory capital deductions and certain other requirements that are subject to multi-year phase-in schedules in the regulatory capital rules.

To be categorized as "well-capitalized," the Company and the Bank must maintain minimum tangible capital, Tier 1 capital, common equity Tier 1, and total capital ratios as set forth in the table below. We, along with the Bank, are considered "well-capitalized" at both September 30, 2018 and December 31, 2017.

The following tables present the regulatory capital ratios as of the dates indicated:

| Flagstar Bancorp | Actual | | For Capital Adequacy Purposes | | Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars in millions) | | | | | |
| September 30, 2018 | | | | | | |
| Tangible capital (to adjusted avg. total assets) | $1,540 | 8.36 % | N/A | N/A | N/A | N/A |
| Tier 1 leverage (to adjusted avg. total assets) | 1,540 | 8.36 % | $ 737 | 4.00 % | $ 921 | 5.00 % |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Common equity Tier 1 capital (to RWA) | 1,300 | 11.01 | % | 532 | 4.50 | % | 768 | 6.50 | % |
| Tier 1 capital (to RWA) | 1,540 | 13.04 | % | 709 | 6.00 | % | 945 | 8.00 | % |
| Total capital (to RWA) | 1,677 | 14.20 | % | 945 | 8.00 | % | 1,181 | 10.00 | % |
| December 31, 2017 | | | | | | | | | |
| Tangible capital (to adjusted avg. total assets) | $1,442 | 8.51 | % | N/A | N/A | | N/A | N/A | |
| Tier 1 leverage (to adjusted avg. total assets) | 1,442 | 8.51 | % | $ 678 | 4.0 | % | $ 848 | 5.0 | % |
| Common equity Tier 1 capital (to RWA) | 1,216 | 11.50 | % | 476 | 4.5 | % | 688 | 6.5 | % |
| Tier 1 capital (to RWA) | 1,442 | 13.63 | % | 635 | 6.0 | % | 846 | 8.0 | % |
| Total capital (to RWA) | 1,576 | 14.90 | % | 846 | 8.0 | % | 1,058 | 10.0 | % |

N/A - Not applicable

57

Table of Contents

| Flagstar Bank | Actual | | For Capital Adequacy Purposes | | Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars in millions) | | | | | |
| September 30, 2018 | | | | | | |
| Tangible capital (to adjusted avg. total assets) | $1,617 | 8.77 % | N/A | N/A | N/A | N/A |
| Tier 1 leverage (to adjusted avg. total assets) | 1,617 | 8.77 % | $ 737 | 4.00 % | $ 922 | 5.00 % |
| Common equity tier 1 capital (to RWA) | 1,617 | 13.68 % | 532 | 4.50 % | 768 | 6.50 % |
| Tier 1 capital (to RWA) | 1,617 | 13.68 % | 709 | 6.00 % | 945 | 8.00 % |
| Total capital (to RWA) | 1,753 | 14.84 % | 945 | 8.00 % | 1,182 | 10.00 % |
| December 31, 2017 | | | | | | |
| Tangible capital (to adjusted avg. total assets) | $1,531 | 9.04 % | N/A | N/A | N/A | N/A |
| Tier 1 leverage (to adjusted avg. total assets) | 1,531 | 9.04 % | $ 677 | 4.0 % | $ 847 | 5.0 % |
| Common equity tier 1 capital (to RWA) | 1,531 | 14.46 % | 476 | 4.5 % | 688 | 6.5 % |
| Tier 1 capital (to RWA) | 1,531 | 14.46 % | 635 | 6.0 % | 847 | 8.0 % |
| Total capital (to RWA) | 1,664 | 15.72 % | 847 | 8.0 % | 1,059 | 10.0 % |

N/A - Not applicable

## Note 16 - Legal Proceedings, Contingencies and Commitments

### Legal Proceedings

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

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

At September 30, 2018, we do not believe that the amount of any reasonably possible losses in excess of any amounts accrued with respect to ongoing proceedings or any other known claims will be material to our financial statements, or that the ultimate outcome of these actions will have a material adverse effect on our financial condition, results of operations or cash flows.

### DOJ litigation settlement

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

In accordance with the Settlement Agreement, we made an initial payment of $15 million and agreed to make future annual payments totaling $118 million in annual increments of up to $25 million upon meeting all conditions, which are evaluated quarterly and include: (a) the reversal of the DTA valuation allowance, which occurred at the end of 2013; (b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred"), which occurred in the third quarter of 2016; and (c) the Bank’s Tier 1 Leverage Capital Ratio equals 11 percent or greater as filed in the Call Report with the OCC.

No payment would be required until six months after the Bank files its Call Report with the OCC first reporting that its Tier 1 Leverage Capital Ratio was 11 percent or greater. If all other conditions were then satisfied, an initial annual payment would be due at that time. The next annual payment is only made if such other conditions continue to be satisfied, otherwise payments are delayed until all such conditions are met. Further, making such a payment must not violate any material banking regulatory requirement, and the OCC must not object in writing.

Table of Contents

Consistent with our business and regulatory requirements, Flagstar shall seek in good faith to fulfill the conditions, and will not undertake any conduct or fail to take any action the purpose of which is to frustrate or delay our ability to fulfill any of the above conditions.

Additionally, if the Bank and Bancorp become party to a business combination in which the Bank or Bancorp represent less than 33.3 percent of the resulting company's assets, annual payments must commence twelve months after the date of that business combination.

The Settlement Agreement meets the definition of a financial instrument for which we elected the fair value option. We consider the assumptions a market participant would make to transfer the liability and evaluate the potential ways we might satisfy the Settlement Agreement and our estimates of the likelihood of these outcomes, which may change over time. The fair value of the liability is subject to significant uncertainty and is impacted by forecasted estimates of the timing of potential payments, which are impacted by estimates of equity, earnings, timing and amount of dividends and growth of the balance sheet and their related impacts on forecasted Tier 1 Leverage Capital Ratio. For further information on the fair value of the liability, see Note 17 - Fair Value Measurements.

Other litigation accruals

At both September 30, 2018 and December 31, 2017, excluding the fair value liability relating to the DOJ litigation settlement, our total accrual for contingent liabilities and settled litigation was $1 million.

Commitments

The following table is a summary of the contractual amount of significant commitments:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in millions) | |
| Commitments to extend credit | | |
| Mortgage loans interest-rate lock commitments | $3,567 | $ 3,667 |
| Warehouse loan commitments | 2,422 | 1,618 |
| Commercial and industrial commitments | 728 | 695 |
| Other commercial commitments | 1,063 | 1,021 |
| HELOC commitments | 395 | 283 |
| Other consumer commitments | 123 | 15 |
| Standby and commercial letters of credit | 66 | 50 |

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

These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the Consolidated Statements of Financial Condition. Our exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. We utilize the same credit policies in making commitments and conditional obligations as we do for balance sheet instruments. The types of credit we extend are as follows:

Mortgage loan interest-rate lock commitments. We enter into mortgage interest-rate lock commitments with our customers. These commitments are considered to be derivative instruments and the fair value of these commitments is recorded in the Consolidated Statements of Financial Condition in other assets. For further information, see Note 8 - Derivative Financial Instruments.

Warehouse loan commitments. Lines of credit provided to mortgage originators to fund loans they originate and then sell. The proceeds of the sale of the loans are used to repay the draw on the line used to fund the loans. See Note 1 - Basis for Presentation, for further information on our mortgage loan warehouse business acquisition.

Table of Contents

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

HELOC commitments. Commitments to extend, originate or purchase credit are primarily lines of credit to consumers and have specified rates and maturity dates. Many of these commitments also have adverse change clauses, which allow us to cancel the commitment due to deterioration in the borrowers' creditworthiness or a decline in the collateral value.

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

Standby and commercial letters of credit. Conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party. Financial standby letters of credit irrevocably obligate the bank to pay a third party beneficiary when a customer fails to repay an outstanding loan or debt instrument.

We maintain a reserve for the estimate of probable credit losses inherent in unfunded commitments to extend credit. Unfunded commitments to extend credit include unfunded loans with available balances, new commitments to lend that are not yet funded, and standby and commercial letters of credit. A reserve balance of $3 million at both September 30, 2018 and December 31, 2017, is reflected in other liabilities on the Consolidated Statements of Financial Condition.

## Note 17 - Fair Value Measurements

We utilize fair value measurements to record or disclose the fair value on certain assets and liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability through an orderly transaction between market participants at the measurement date. The determination of fair values of financial instruments often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation models rely on market-based parameters when available, such as interest rate yield curves or credit spreads. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, our future earnings, interest rates and other relevant inputs. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. For further information see the Fair Value Measurements section of Item 7 of Exhibit 99.1 to our June 1, 2018 Form 8-K Report.

### Valuation Hierarchy

U.S. GAAP establishes a three-level valuation hierarchy for disclosure of fair value measurements. The hierarchy is based on the transparency of the inputs used in the valuation process with the highest priority given to quoted prices available in active markets and the lowest priority to unobservable inputs where no active market exists, as discussed below.

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets in which we can participate as of the measurement date;

Level 2 - Quoted prices for similar instruments in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3 - Unobservable inputs that reflect our own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the overall fair value measurement. Transfers between levels of the fair value hierarchy are recognized at the end of the reporting period.

Table of Contents

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the financial instruments carried at fair value by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy.

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| | (Dollars in millions) | | | |
| Investment securities available-for-sale | | | | |
| Agency - Commercial | $— | $1,094 | $— | $ 1,094 |
| Agency - Residential | — | 674 | — | 674 |
| Municipal obligations | — | 32 | — | 32 |
| Corporate debt obligations | — | 41 | — | 41 |
| Other MBS | — | 16 | — | 16 |
| Loans held-for-sale | | | | |
| Residential first mortgage loans | — | 4,815 | — | 4,815 |
| Loans held-for-investment | | | | |
| Residential first mortgage loans | — | 8 | — | 8 |
| Home equity | — | — | 3 | 3 |
| Mortgage servicing rights | — | — | 313 | 313 |
| Derivative assets | | | | |
| Rate lock commitments (fallout-adjusted) | — | — | 20 | 20 |
| Mortgage-backed securities forwards | — | 19 | — | 19 |
| Interest rate swaps and swaptions | — | 23 | — | 23 |
| Total assets at fair value | $— | $6,722 | $336 | $ 7,058 |
| Derivative liabilities | | | | |
| Rate lock commitments (fallout-adjusted) | $— | $— | $(1) | $ (1) |
| Mortgage backed securities forwards | — | (6) | — | (6) |
| Interest rate swaps | — | (13) | — | (13) |
| DOJ litigation settlement | — | — | (60) | (60) |
| Contingent consideration | — | — | (11) | (11) |
| Total liabilities at fair value | $— | $(19) | $(72) | $ (91) |

Table of Contents

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| | (Dollars in millions) | | | |
| Investment securities available-for-sale | | | | |
| Agency - Commercial | $— | $987 | $— | $987 |
| Agency - Residential | — | 794 | — | 794 |
| Municipal obligations | — | 34 | — | 34 |
| Corporate debt obligations | — | 38 | — | 38 |
| Loans held-for-sale | | | | |
| Residential first mortgage loans | — | 4,300 | — | 4,300 |
| Loans held-for-investment | | | | |
| Residential first mortgage loans | — | 8 | — | 8 |
| Home equity | — | — | 4 | 4 |
| Mortgage servicing rights | — | — | 291 | 291 |
| Derivative assets | | | | |
| Rate lock commitments (fallout-adjusted) | — | — | 24 | 24 |
| Mortgage-backed securities forwards | — | 4 | — | 4 |
| Interest rate swaps and swaptions | — | 11 | — | 11 |
| Total assets at fair value | $— | $6,176 | $319 | $6,495 |
| Derivative liabilities | | | | |
| Interest rate swap on FHLB advances | $— | $(1) | $— | $(1) |
| Mortgage-backed securities forwards | — | (6) | — | (6) |
| Interest rate swaps | — | (4) | — | (4) |
| DOJ litigation settlement | — | — | (60) | (60) |
| Contingent consideration | — | — | (25) | (25) |
| Total liabilities at fair value | $— | $(11) | $(85) | $(96) |

There were no transfers between Level 1 and Level 2 during the nine months ended September 30, 2018.

Table of Contents

Fair Value Measurements Using Significant Unobservable Inputs

The following tables include a roll forward of the Consolidated Statements of Financial Condition amounts (including the change in fair value) for financial instruments classified by us within Level 3 of the valuation hierarchy:

| | Balance at Beginning of Period | Total Gains (Losses) Recorded in Earnings (1) | Purchases / Originations | Sales | Settlements | Transfers In (Out) | Balance at End of Period |
|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | |
| Three Months Ended September 30, 2018 | | | | | | | |
| Assets | | | | | | | |
| Loans held-for-investment | | | | | | | |
| Home equity | $3 | $ — | $ — | $— | $ — | $ — | $ 3 |
| Mortgage servicing rights (2) | 257 | 7 | 100 | (51 ) | — | — | 313 |
| Rate lock commitments (net) (2)(3) | 32 | (5 ) | 60 | — | — | (68 ) | 19 |
| Totals | $292 | $ 2 | $ 160 | $(51) | $ — | $ (68 ) | $ 335 |
| Liabilities | | | | | | | |
| DOJ litigation settlement | $(60 ) | $ — | $ — | $— | $ — | $ — | $ (60 ) |
| Contingent consideration | (18 ) | 3 | — | — | 4 | — | (11 ) |
| Totals | $(78 ) | $ 3 | $ — | $— | $ 4 | $ — | $ (71 ) |
| Three Months Ended September 30, 2017 | | | | | | | |
| Assets | | | | | | | |
| Loans held-for-investment | | | | | | | |
| Home equity | $5 | $ — | $ — | $— | $ (1 ) | $ — | $ 4 |
| Mortgage servicing rights (2) | 184 | (9 ) | 75 | (4 ) | — | — | 246 |
| Rate lock commitments (net) (2)(3) | 26 | 21 | 82 | — | — | (97 ) | 32 |
| Totals | $215 | $ 12 | $ 157 | $(4 ) | $ (1 ) | $ (97 ) | $ 282 |
| Liabilities | | | | | | | |
| DOJ litigation settlement | $(60 ) | $ — | $ — | $— | $ — | $ — | $ (60 ) |
| Contingent consideration | (23 ) | (1 ) | (2 ) | — | — | — | (26 ) |
| Totals | $(83 ) | $ (1 ) | $ (2 ) | $— | $ — | $ — | $ (86 ) |

(1) There were no unrealized gains (losses) recorded in OCI during the three months ended September 30, 2018 and 2017.

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

(3) Rate lock commitments are reported on a fallout adjusted basis. Transfers out of Level 3 represent the settlement value of the commitments that are transferred to LHFS, which are classified as Level 2 assets.

Table of Contents

| | Balance at Beginning of Period | Total Gains (Losses) Recorded in Earnings (1) | Purchases / Originations | Sales | Settlements | Transfers In (Out) | Balance at End of Period |
|---|---|---|---|---|---|---|---|
| | (Dollars in millions) | | | | | | |
| Nine Months Ended September 30, 2018 | | | | | | | |
| Assets | | | | | | | |
| Loans held-for-investment | | | | | | | |
| Home equity | $4 | $ — | $ — | $— | $ (1 ) | $ — | $ 3 |
| Mortgage servicing rights (2) | 291 | 12 | 283 | (273 ) | — | — | 313 |
| Rate lock commitments (net) (2)(3) | 24 | (37 ) | 191 | — | — | (159 ) | 19 |
| Totals | $319 | $ (25 ) | $ 474 | $(273) | $ (1 ) | $ (159 ) | $ 335 |
| Liabilities | | | | | | | |
| DOJ litigation settlement | $(60 ) | $ — | $ — | $— | $ — | $ — | $ (60 ) |
| Contingent consideration | (25 ) | 8 | — | — | 6 | — | (11 ) |
| Totals | $(85 ) | $ 8 | $ — | $— | $ 6 | $ — | $ (71 ) |
| | | | | | | | |
| Nine Months Ended September 30, 2017 | | | | | | | |
| Assets | | | | | | | |
| Loans held-for-sale | | | | | | | |
| Home equity | $— | $ 1 | $ — | $(52 ) | $ (1 ) | $ 52 | $ — |
| Loans held-for-investment | | | | | | | |
| Home equity | 65 | 1 | — | — | (7 ) | (55 ) | 4 |
| Mortgage servicing rights (2) | 335 | (7 ) | 178 | (260 ) | — | — | 246 |
| Rate lock commitments (net) (2)(3) | 18 | 55 | 199 | — | — | (240 ) | 32 |
| Totals | $418 | $ 50 | $ 377 | $(312) | $ (8 ) | $ (243 ) | $ 282 |
| Liabilities | | | | | | | |
| DOJ litigation settlement | $(60 ) | $ — | $ — | $— | $ — | $ — | $ (60 ) |
| Contingent consideration | — | (1 ) | (25 ) | — | — | — | (26 ) |
| Totals | $(60 ) | $ (1 ) | $ (25 ) | $— | $ — | $ — | $ (86 ) |

(1) There were no unrealized gains (losses) recorded in OCI during the nine months ended September 30, 2018 and 2017.

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

(3) Rate lock commitments are reported on a fallout adjusted basis. Transfers out of Level 3 represent the settlement value of the commitments that are transferred to LHFS, which are classified as Level 2 assets.

Table of Contents

The following tables present the quantitative information about recurring Level 3 fair value financial instruments and the fair value measurements as of:

| | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| September 30, 2018 | | | | |
| Assets | | | | |
| Loans held-for-investment | | | | |
| Home equity | $3 | Discounted cash flows | Discount rate<br>Constant prepayment rate<br>Constant default rate | 7.2% - 10.8% (9.0%)<br>15.3% - 22.9% (19.1%)<br>3.0% - 4.5% (3.6%) |
| Mortgage servicing rights | $313 | Discounted cash flows | Option adjusted spread<br>Constant prepayment rate<br>Weighted average cost to service per loan | 2.1% -25.3% (5.0%)<br>0% - 10.6% (9.0%)<br>$67 - $95 ($81) |
| Rate lock commitments (net) | $19 | Consensus pricing | Origination pull-through rate | 79.8% - 87.2% (81.3%) |
| Liabilities | | | | |
| DOJ litigation settlement | $(60 ) | Discounted cash flows | Discount rate<br>Asset growth rate | 7.2% - 10.8% (9.0%)<br>4.2% - 17.5% (6.3%) |
| Contingent consideration | $(11 ) | Discounted cash flows | Beta<br>Equity volatility | 0.6 - 1.6 (1.1)<br>26.6% - 58.9% (40.0%) |

| | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| December 31, 2017 | | | | |
| Assets | | | | |
| Loans held-for-investment | | | | |
| Home equity | $4 | Discounted cash flows | Discount rate<br>Constant prepayment rate<br>Constant default rate | 7.2% - 10.8% (9.0%)<br>5.1% - 7.7% (6.4%)<br>3.0% - 4.5% (3.6%) |
| Mortgage servicing rights | $291 | Discounted cash flows | Option adjusted spread<br>Constant prepayment rate<br>Weighted average cost to service per loan | 5.0% - 7.5% (6.3%)<br>8.0% - 11.8% (9.9%)<br>$58 - $87 ($73) |
| Rate lock commitments (net) | $24 | Consensus pricing | Origination pull-through rate | 64.7% - 97.1% (82.0%) |
| Liabilities | | | | |
| DOJ litigation settlement | $(60 ) | Discounted cash flows | Discount rate<br>Asset growth rate | 7.8% - 11.7% (9.7%)<br>5.6% - 17.4% (6.3%) |
| Contingent consideration | $(25 ) | Discounted cash flows | Beta<br>Equity volatility | 0.6 - 1.6 (1.1)<br>26.6% - 58.9% (40.0%) |

Recurring Significant Unobservable Inputs

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

MSRs. The significant unobservable inputs used in the fair value measurement of the MSRs are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation would result in a significantly lower (higher) fair value measurement. Weighted average life (in years) is used to determine the change in fair value of MSRs. For September 30, 2018 and December 31, 2017 the weighted average life (in years) for the entire MSR portfolio was 6.1 and 6.0, respectively.

DOJ litigation settlement. The significant unobservable input used in the fair value measurement of the DOJ litigation settlement are the discount rate and asset growth rate, in addition to those assumptions discussed in Note 16 - Legal Proceedings, Contingencies and Commitments. Significant increases (decreases) in the discount rate or asset growth rate in isolation may result in a marginally lower (higher) fair value measurement. For further information on the fair value inputs related to the DOJ litigation settlement, see Note 16 - Legal Proceedings, Contingencies, and Commitments.

Table of Contents

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

Contingent consideration. The significant unobservable input used in the fair value of the contingent consideration is future forecasted target production volumes and profitability of the division. An increase or decrease to these inputs results in an increase or decrease of the liability. Other unobservable inputs include Beta and volatility which drive the risk adjusted discount rate utilized in a Monte Carlo simulation. Increases (decreases) in these inputs results in a lower (higher) to the liability.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We also have assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis.

The following table presents assets measured at fair value on a nonrecurring basis:

| | Total (1) | Level 2 | Level 3 | Gains (Losses) |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| September 30, 2018 | | | | |
| Loans held-for-sale (2) | $6 | $ 6 | $ — | $ (1 ) |
| Impaired loans held-for-investment (2) | | | | |
| Residential first mortgage loans | 12 | — | 12 | (5 ) |
| Repossessed assets (3) | 7 | — | 7 | (3 ) |
| Totals | $25 | $ 6 | $ 19 | $ (9 ) |
| December 31, 2017 | | | | |
| Loans held-for-sale (2) | $6 | $ 6 | $ — | $ (1 ) |
| Impaired loans held-for-investment (2) | | | | |
| Residential first mortgage loans | 21 | — | 21 | (10 ) |
| Repossessed assets (3) | 8 | — | 8 | (4 ) |
| Totals | $35 | $ 6 | $ 29 | $ (15 ) |

(1) The fair values are determined at various dates during the three months ended September 30, 2018 and the year ended December 31, 2017, respectively.
(2) Gains (losses) reflect fair value adjustments on assets for which we did not elect the fair value option.
(3) Gains (losses) reflect write downs of repossessed assets based on the estimated fair value of the specific assets.

The following tables present the quantitative information about nonrecurring Level 3 fair value financial instruments and the fair value measurements:

| | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| September 30, 2018 | | | | |
| Impaired loans held-for-investment | | | | |
| Loans held-for-investment | $12 | Fair value of collateral | Loss severity discount | 25% - 30% (28.3%) |
| Repossessed assets | $7 | Fair value of collateral | Loss severity discount | 0% - 100% (26.4%) |
| December 31, 2017 | | | | |
| Impaired loans held-for-investment | | | | |

| | | | | |
|---|---|---|---|---|
| Loans held-for-investment | $21 | Fair value of collateral | Loss severity discount | 25% - 30% (27.9%) |
| Repossessed assets | $8 | Fair value of collateral | Loss severity discount | 0% - 100% (70.9%) |

Nonrecurring Significant Unobservable Inputs

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

Table of Contents

Fair Value of Financial Instruments

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

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| | Carrying Value | Total | Level 1 | Level 2 | Level 3 |
| | (Dollars in millions) | | | | |
| Assets | | | | | |
| Cash and cash equivalents | $264 | $264 | $264 | $— | $ — |
| Investment securities available-for-sale | 1,857 | 1,857 | — | 1,857 | — |
| Investment securities held-to-maturity | 724 | 690 | — | 690 | — |
| Loans held-for-sale | 4,835 | 4,836 | — | 4,836 | — |
| Loans held-for-investment | 8,966 | 8,839 | — | 8 | 8,831 |
| Loans with government guarantees | 305 | 274 | — | 274 | — |
| Mortgage servicing rights | 313 | 313 | — | — | 313 |
| Federal Home Loan Bank stock | 303 | 303 | — | 303 | — |
| Bank owned life insurance | 338 | 338 | — | 338 | — |
| Repossessed assets | 7 | 7 | — | — | 7 |
| Other assets, foreclosure claims | 58 | 58 | — | 58 | — |
| Derivative financial instruments, assets | 62 | 62 | — | 42 | 20 |
| Liabilities | | | | | |
| Retail deposits | | | | | |
| Demand deposits and savings accounts | $(5,469) | $(4,891) | $— | $(4,891) | $ — |
| Certificates of deposit | (2,208) | (2,199) | — | (2,199) | — |
| Wholesale deposits | (653) | (651) | — | (651) | — |
| Government deposits | (1,466) | (1,421) | — | (1,421) | — |
| Custodial deposits | (1,793) | (1,709) | — | (1,709) | — |
| Federal Home Loan Bank advances | (4,479) | (4,463) | — | (4,463) | — |
| Long-term debt | (495) | (459) | — | (459) | — |
| DOJ litigation settlement | (60) | (60) | — | — | (60) |
| Contingent consideration | (11) | (11) | — | — | (11) |
| Derivative financial instruments, liabilities | (20) | (20) | — | (19) | (1) |

Table of Contents

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| | Carrying Value | Total | Level 1 | Level 2 | Level 3 |
| | (Dollars in millions) | | | | |
| Assets | | | | | |
| Cash and cash equivalents | $204 | $204 | $204 | $— | $ — |
| Investment securities available-for-sale | 1,853 | 1,853 | — | 1,853 | — |
| Investment securities held-to-maturity | 939 | 924 | — | 924 | — |
| Loans held-for-sale | 4,321 | 4,322 | — | 4,322 | — |
| Loans held-for-investment | 7,713 | 7,667 | — | 8 | 7,659 |
| Loans with government guarantees | 271 | 261 | — | 261 | — |
| Mortgage servicing rights | 291 | 291 | — | — | 291 |
| Federal Home Loan Bank stock | 303 | 303 | — | 303 | — |
| Bank owned life insurance | 330 | 330 | — | 330 | — |
| Repossessed assets | 8 | 8 | — | — | 8 |
| Other assets, foreclosure claims | 84 | 84 | — | 84 | — |
| Derivative financial instruments, assets | 39 | 39 | — | 15 | 24 |
| Liabilities | | | | | |
| Retail deposits | | | | | |
| Demand deposits and savings accounts | $(5,003) | $(4,557) | $— | $(4,557) | $ — |
| Certificates of deposit | (1,494) | (1,498) | — | (1,498) | — |
| Wholesale deposits | (43) | (43) | — | (43) | — |
| Government deposits | (1,073) | (1,048) | — | (1,048) | — |
| Custodial deposits | (1,321) | (1,311) | — | (1,311) | — |
| Federal Home Loan Bank advances | (5,665) | (5,662) | — | (5,662) | — |
| Long-term debt | (494) | (417) | — | (417) | — |
| DOJ litigation settlement | (60) | (60) | — | — | (60) |
| Contingent consideration | (25) | (25) | — | — | (25) |
| Derivative financial instruments, liabilities | (11) | (11) | — | (11) | — |

Fair Value Option

We elected the fair value option for certain items as discussed throughout the Notes to the Consolidated Financial Statements to more closely align the accounting method with the underlying economic exposure. Interest income on LHFS is accrued on the principal outstanding primarily using the "simple-interest" method.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Dollars in millions) | | | |
| Assets | | | | |
| Loans held-for-sale | | | | |
| Net gain on loan sales | $7 | $ 92 | $(61) | $260 |

| | | | | |
|---|---|---|---|---|
| Loans held-for-investment | | | | |
| Other noninterest income | $— | $ — | $— | $ 1 |

68

Table of Contents

The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding for assets and liabilities for which the fair value option has been elected:

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Unpaid Principal Balance | Fair Value | Fair Value Over / (Under) Unpaid Principal Balance | Unpaid Principal Balance | Fair Value | Fair Value Over / (Under) Unpaid Principal Balance |
| | (Dollars in millions) | | | | | |
| Assets | | | | | | |
| Nonaccrual loans | | | | | | |
| Loans held-for-sale | $7 | $7 | $ — | $6 | $5 | $ (1 ) |
| Loans held-for-investment | 5 | 4 | (1 ) | 5 | 4 | (1 ) |
| Total nonaccrual loans | $12 | $11 | $ (1 ) | $11 | $9 | $ (2 ) |
| Other performing loans | | | | | | |
| Loans held-for-sale | $4,692 | $4,808 | $ 116 | $4,167 | $4,295 | $ 128 |
| Loans held-for-investment | 8 | 7 | (1 ) | 10 | 8 | (2 ) |
| Total other performing loans | $4,700 | $4,815 | $ 115 | $4,177 | $4,303 | $ 126 |
| Total loans | | | | | | |
| Loans held-for-sale | $4,699 | $4,815 | $ 116 | $4,173 | $4,300 | $ 127 |
| Loans held-for-investment | 13 | 11 | (2 ) | 15 | 12 | (3 ) |
| Total loans | $4,712 | $4,826 | $ 114 | $4,188 | $4,312 | $ 124 |
| Liabilities | | | | | | |
| Litigation settlement (1) | $(118 ) | $(60 ) | $ 58 | $(118 ) | $(60 ) | $ 58 |

(1) We are obligated to pay $118 million in installment payments upon meeting certain performance conditions, as described in Note 16 - Legal Proceedings, Contingencies and Commitments.

Note 18 - Segment Information

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

Effective January 1, 2018, the following changes were made with offsetting adjustments included in the Other segment to reconcile to the Consolidated Statements of Operations: 1) operating leases in Community Banking are reflected as loans by reclassifying rental income and depreciation expense to net interest income, and 2) the interest expense on custodial deposits on third party sub-servicing contracts, recognized in the Mortgage Servicing segment as loan administration income, is now reflected as a component of net interest income. Prior period segment financial information, related to these changes, has been recast to conform to the current presentation.

The Community Banking segment originates loans, provides deposits and fee based services to consumer, business, and mortgage lending customers through its Branch Banking, Business Banking and Commercial Banking, Government Banking, Warehouse Lending and LHFI Portfolio groups. Products offered through these groups include checking accounts, savings accounts, money market accounts, certificates of deposit, consumer loans, commercial loans, commercial real estate loans, equipment finance and leasing, home builder finance loans and warehouse lines of credit. Other financial services available include consumer and corporate card services, customized treasury management solutions, merchant services and capital markets services such as loan syndications, and wealth management products and services.

The Mortgage Originations segment originates and acquires one-to-four family residential mortgage loans to sell or hold on our balance sheet. Loans originated-to-sell, comprise the majority of the lending activity. These loans are originated through mortgage branches, call centers, the Internet and third party counterparties. The resulting gains from sales associated

Table of Contents

with these loans are recognized in the Mortgage Originations segment whereas the interest income on LHFI is recognized in the Community Banking segment.

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

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

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

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

| | Three Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Mortgage Originations | Mortgage Servicing | Other (1) | Total |
| | (Dollars in millions) | | | | |
| Summary of Operations | | | | | |
| Net interest income | $81 | $ 36 | $ 2 | $5 | $124 |
| Net gain (loss) on loan sales | (3 ) | 46 | — | — | 43 |
| Other noninterest income | 10 | 30 | 24 | — | 64 |
| Total net interest income and noninterest income | 88 | 112 | 26 | 5 | 231 |
| (Provision) benefit for loan losses | (1 ) | — | — | 3 | 2 |
| Compensation and benefits | (17 ) | (26 ) | (4 ) | (29 ) | (76 ) |
| Other noninterest expense and directly allocated overhead | (27 ) | (41 ) | (18 ) | (11 ) | (97 ) |
| Total noninterest expense | (44 ) | (67 ) | (22 ) | (40 ) | (173 ) |
| Income (loss) before indirect overhead allocations and income taxes | 43 | 45 | 4 | (32 ) | 60 |
| Provision (benefit) for income taxes | 7 | 6 | — | (1 ) | 12 |
| Overhead allocations | (9 ) | (16 ) | (5 ) | 30 | — |
| Net income (loss) | $27 | $ 23 | $ (1 ) | $(1 ) | $48 |
| Intersegment (expense) revenue | $1 | $ 4 | $ 5 | $(10) | $— |
| | | | | | |
| Average balances | | | | | |
| Loans held-for-sale | $10 | $ 4,383 | $ — | $— | $4,393 |
| Loans with government guarantees | — | 292 | — | — | 292 |
| Loans held-for-investment (2) | 8,868 | 11 | — | 29 | 8,908 |
| Total assets | 9,028 | 5,676 | 29 | 3,878 | 18,611 |
| Deposits | 9,170 | — | 2,072 | 94 | 11,336 |

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

Table of Contents

| | Three Months Ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Mortgage Originations | Mortgage Servicing | Other (1) | Total |
| | (Dollars in millions) | | | | |
| Summary of Operations | | | | | |
| Net interest income | $63 | $ 34 | $ 4 | $ 2 | $103 |
| Net gain (loss) on loan sales | (4 ) | 79 | — | — | 75 |
| Other noninterest income | 8 | 27 | 14 | 6 | 55 |
| Total net interest income and noninterest income | 67 | 140 | 18 | 8 | 233 |
| (Provision) benefit for loan losses | (1 ) | (1 ) | — | — | (2 ) |
| Compensation and benefits | (15 ) | (28 ) | (4 ) | (29 ) | (76 ) |
| Other noninterest expense and directly allocated overhead | (25 ) | (49 ) | (13 ) | (8 ) | (95 ) |
| Total noninterest expense | (40 ) | (77 ) | (17 ) | (37 ) | (171 ) |
| Income (loss) before indirect overhead allocations and income taxes | 26 | 62 | 1 | (29 ) | 60 |
| Provision (benefit) for income taxes | 6 | 16 | (1 ) | (1 ) | 20 |
| Overhead allocations | (10 ) | (15 ) | (6 ) | 31 | — |
| Net income (loss) | $10 | $ 31 | $ (4 ) | $ 3 | $40 |
| Intersegment (expense) revenue | $(4 ) | $ 2 | $ 5 | $ (3 ) | $— |
| | | | | | |
| Average balances | | | | | |
| Loans held-for-sale | $14 | $ 4,462 | $ — | $— | $4,476 |
| Loans with government guarantees | — | 264 | — | — | 264 |
| Loans held-for-investment (2) | 6,789 | 10 | — | 29 | 6,828 |
| Total assets | 6,843 | 5,743 | 30 | 3,823 | 16,439 |
| Deposits | 7,498 | — | 1,507 | — | 9,005 |

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

| | Nine Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Mortgage Originations | Mortgage Servicing | Other (1) | Total |
| | (Dollars in millions) | | | | |
| Summary of Operations | | | | | |
| Net interest income | $231 | $ 100 | $ 5 | $9 | $345 |
| Net gain (loss) on loan sales | (10 ) | 176 | — | — | 166 |
| Other noninterest income | 27 | 76 | 65 | 7 | 175 |
| Total net interest income and noninterest income | 248 | 352 | 70 | 16 | 686 |
| (Provision) benefit for loan losses | (2 ) | (1 ) | — | 6 | 3 |
| Compensation and benefits | (51 ) | (83 ) | (13 ) | (89 ) | (236 ) |
| Other noninterest expense and directly allocated overhead | (81 ) | (129 ) | (49 ) | (28 ) | (287 ) |
| Total noninterest expense | (132 ) | (212 ) | (62 ) | (117 ) | (523 ) |
| Income (loss) before indirect overhead allocations and income taxes | 114 | 139 | 8 | (95 ) | 166 |
| Provision (benefit) for income taxes | 18 | 18 | (2 ) | (1 ) | 33 |
| Overhead allocations | (29 ) | (51 ) | (15 ) | 95 | — |
| Net income (loss) | $67 | $ 70 | $ (5 ) | $1 | $133 |
| Intersegment (expense) revenue | $(1 ) | $ 6 | $ 14 | $(19 ) | $— |
| | | | | | |
| Average balances | | | | | |
| Loans held-for-sale | $11 | $ 4,254 | $ — | $— | $4,265 |

| | | | | | |
|---|---|---|---|---|---|
| Loans with government guarantees | — | 288 | — | — | 288 |
| Loans held-for-investment (2) | 8,250 | 9 | — | 29 | 8,288 |
| Total assets | 8,425 | 5,477 | 30 | 3,902 | 17,834 |
| Deposits | 8,581 | — | 1,800 | — | 10,381 |

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

Table of Contents

| | Nine Months Ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Mortgage Originations | Mortgage Servicing | Other (1) | Total |
| | (Dollars in millions) | | | | |
| Summary of Operations | | | | | |
| Net interest income | $171 | $ 96 | $ 9 | $7 | $283 |
| Net gain (loss) on loan sales | (7 ) | 196 | — | — | 189 |
| Other noninterest income | 22 | 77 | 47 | 11 | 157 |
| Total net interest income and noninterest income | 186 | 369 | 56 | 18 | 629 |
| (Provision) benefit for loan losses | (3 ) | (3 ) | — | 2 | (4 ) |
| Compensation and benefits | (46 ) | (72 ) | (12 ) | (89 ) | (219 ) |
| Other noninterest expense and directly allocated overhead | (67 ) | (114 ) | (45 ) | (20 ) | (246 ) |
| Total noninterest expense | (113 ) | (186 ) | (57 ) | (109 ) | (465 ) |
| Income (loss) before indirect overhead allocations and income taxes | 70 | 180 | (1 ) | (89 ) | 160 |
| Provision (benefit) for income taxes | 14 | 47 | (6 ) | (3 ) | 52 |
| Overhead allocations | (30 ) | (46 ) | (17 ) | 93 | — |
| Net income (loss) | $26 | $ 87 | $ (12 ) | $7 | $108 |
| Intersegment (expense) revenue | $(5 ) | $ 3 | $ 14 | $(12) | $— |
| | | | | | |
| Average balances | | | | | |
| Loans held-for-sale | $16 | $ 3,998 | $ — | $— | $4,014 |
| Loans with government guarantees | — | 300 | — | — | 300 |
| Loans held-for-investment (2) | 6,201 | 7 | — | 29 | 6,237 |
| Total assets | 6,262 | 5,307 | 36 | 3,801 | 15,406 |
| Deposits | 7,438 | — | 1,409 | — | 8,847 |

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.
(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

Note 19 - Recently Issued Accounting Pronouncements

Adoption of New Accounting Standards

We adopted the following accounting standard updates (ASU) during 2018, none of which had a material impact to our financial statements:

| Standard | Description | Effective Date |
|---|---|---|
| ASU 2018-03 | Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Update to 2016-01 | January 1, 2018 |
| ASU 2018-02 | Income Statement-Reporting Comprehensive Income (Topic 220); Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income | January 1, 2019 |
| ASU 2017-09 | Update 2017-09—Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting | January 1, 2018 |
| ASU 2017-05 | Other Income - Gains and Losses from the De-recognition of Non-financial Assets (Subtopic 610-20): Clarifying the Scope of Asset De-recognition Guidance and Accounting for Partial Sales of Non-financial Assets | January 1, 2018 |
| ASU 2017-01 | Business Combinations (Topic 805): Clarifying the Definition of a Business | January 1, 2018 |
| | Statement of Cash Flows (Topic 230): Restricted Cash | |

| | | |
|---|---|---|
| ASU 2016-18 | | January 1, 2018 |
| ASU 2016-16 | Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory | January 1, 2018 |
| ASU 2016-15 | Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments | January 1, 2018 |
| ASU 2016-01 | Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities | January 1, 2018 |

Table of Contents

Accounting Standards Adopted which had a Material Impact

The following ASUs have been adopted which impact our significant accounting policies and/or have a significant financial impact:

Revenue from Contracts with Customers - In May 2014, FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under the amended guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration in exchange for those goods or services.

Effective January 1, 2018, we have adopted the requirements of ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and all related amendments. We have implemented the guidance utilizing the modified retrospective approach which did not have a material impact on the Company's financial position or results of operations. As lease contracts and financial instruments, which include loans and securities, are excluded from the scope of this standard, the majority our revenue falls outside of the scope of Topic 606.

The adoption of this guidance does not result in changes to how revenue is recognized or the timing of recognition from our method prior to adoption. Revenue is recognized when obligations, under the terms of a contract with our customer, are satisfied, which generally occurs when services are performed. Revenue is measured as the amount of consideration we expect to receive in exchange for providing services.

The disaggregation of our revenue from contracts with customers is provided below.

| | Location of Revenue (1) | Three Months Ended September 30, 2018 | 2017 | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|---|
| | | (Dollars in millions) | | | |
| Deposit account and other banking income | Deposit fees and charges | $4 | $ 4 | $ 12 | $ 11 |
| Interchange fees | Deposit fees and charges | 1 | 1 | 3 | 3 |
| Interchange fees | Other noninterest income | — | 1 | 1 | 1 |
| Wealth management | Other noninterest income | 3 | 2 | 7 | 5 |
| Total | | $8 | $ 8 | $ 23 | $ 20 |

(1) Recognized within the Community Banking segment.

Deposit account and other banking income - We charge depositors various deposit account service fees including those for outgoing wires, overdrafts, stop payments, and ATM fees. These fees are generated from a depositor’s option to purchase services offered under the contract and are only considered a contract when the depositor exercises their option to purchase these account services. Therefore we deem the term of our contracts with depositors to be day-to-day and do not extend beyond the services already provided. Deposit account and other banking fees are recorded at the point in time we perform the requested service.

Interchange income - We collect interchange fee income when debit cards that we have issued to our customers, are used in merchant transactions. Our performance obligation is satisfied and revenue is recognized at the point we initiate the payment of funds from a customer’s account to a merchant account.

Merchant fee income - We receive a percentage of merchant fees based upon card transactions processed through point of sale terminals at referred merchant locations. Our performance obligation is satisfied when our referral of a merchant to a payment processing vendor results in an executed agreement between the merchant and the vendor. Merchant fee revenue is recognized as received. Merchant fee income was less than $1 million for the three and nine months ended September 30, 2018 and September 30, 2017.

Wealth management revenue - We earn commission income through a revenue share program based on a tiered percentage of total gross commissions generated from the sales of investment and insurance services to Flagstar customers. Commissions are earned and our performance obligation has been satisfied at the point of sale or trade execution. Our portion of earned commissions is calculated, paid and recognized as revenue on a monthly basis.

We also receive revenue from portfolio management services. We receive payment for portfolio management services in advance at beginning of each quarter for services to be performed over the quarter which results an insignificant revenue liability. We recognize this revenue over the quarter on a straight-line basis, as we believe this is the most appropriate method to measure progress towards satisfaction of the performance obligation.

Table of Contents

Derivatives and Hedging - In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendments were designed to more closely align hedge accounting requirements with users' risk management strategies. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018 and early adoption is permitted. The Company has early adopted this ASU during the first quarter of 2018. The guidance provides a broader range of hedge accounting opportunities and simplifies documentation requirements for our existing cash flow hedge relationships. In conjunction with adoption of this ASU, the Company elected to transfer $144 million of investment securities from HTM to AFS during the first quarter of 2018, as permitted by the standard, which resulted in a de minimis impact to AOCI.

Accounting Standards Issued But Not Yet Adopted

The following ASUs have been issued and are expected to result in a significant change to our significant accounting policies and/or have a significant financial impact:

Credit Losses - In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The ASU alters the current method for recognizing credit losses within the reserve account. Currently, we use the incurred loss method, whereas the new guidance requires financial assets to be presented at the net amount expected to be collected (i.e., net of expected credit losses). The measurement of expected credit losses should be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019.

Our cross-functional implementation team has developed a project plan that results in running a CECL parallel production in the second half of 2019 and the adoption of the standard in the first quarter of 2020. We are currently evaluating the impact the adoption of the guidance will have on our Consolidated Financial Statements, and highlight that any impact will be contingent upon the underlying characteristics of the affected portfolio and macroeconomic and internal forecasts at adoption date. We do not expect any material allowance on held to maturity securities since the majority of this portfolio consists of agency-backed securities that inherently have an immaterial risk of loss.

Leases - In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) which supersedes Topic 840. The guidance requires lessees to recognize substantially all leases on their balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Classification will be based on criteria that are largely similar to those applied in current lease accounting. ASU 2016-02 is effective retrospectively for fiscal years beginning after December 15, 2018 and early adoption is permitted. Additional guidance per ASU 2018-11 provides the practical expedient of forgoing the restatement of comparative periods and we intend on exercising this option. Upon adoption and implementation, we expect to gross up assets and liabilities due to the recognition of lease liabilities and right-of-use assets associated with the underlying lease contracts. We do not expect the adoption of the guidance to have a material impact on our Consolidated Statements of Operations given our current inventory of leases.

The following ASUs have been issued and are not expected to have a material impact on our Consolidated Financial Statements and/or significant accounting policies:

| Standard | Description | Effective Date |
|---|---|---|
| ASU 2018-15 | Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force) | January 1, 2020 |
| ASU 2018-13 | Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement | January 1, 2020 |

| | | |
|---|---|---|
| ASU 2018-11 | Leases (Topic 842): Targeted Improvements | January 1, 2019 |
| ASU 2018-10 | Codification Improvements to Topic 842, Leases | January 1, 2019 |
| ASU 2018-07 | Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting | January 1, 2019 |
| ASU 2017-11 | Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Non-controlling Interests with a Scope. | January 1, 2019 |
| ASU 2017-08 | Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities | January 1, 2019 |
| ASU 2017-06 | Plan Accounting - Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting | January 1, 2019 |
| ASU 2017-04 | Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment | January 1, 2020 |

Table of Contents

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

## Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. As of September 30, 2018, pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), an evaluation was performed by the Company's management, including our principal executive and financial officers, regarding the design and effectiveness of our disclosure controls and procedures. Based upon that evaluation, the principal executive and financial officers have concluded that our current disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms as of September 30, 2018.

(b) Changes in Internal Controls. There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(d) of the Exchange Act) during the three months ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

## PART II
### Item 1. Legal Proceedings

From time to time, the Company is party to legal proceedings incidental to its business. For further information, see Note 16 - Legal Proceedings, Contingencies and Commitments.

### Item 1A. Risk Factors

The Company believes that there have been no material changes to the risk factors previously disclosed in response to Item 1A. to Part I, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, with the exception of the following:

Our recently announced branch acquisition may fail to achieve the benefits currently anticipated.

We recently announced Flagstar Bank's agreement to acquire 52 branches from Wells Fargo Bank, which we expect will close at the beginning of December 2018. We may fail to realize all or any of the anticipated benefits of the acquisition, or those benefits may take longer to realize than expected. We may experience challenges related to the integration of the operations of the branches, including transition of data, integration of product offerings and the standardization of business practices. Complications associated with the acquisition could result in additional costs, loss of customers, damage to our reputation or other operational risks.

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

Sale of Unregistered Securities

The Company made no sales of unregistered securities during the quarter ended September 30, 2018.

Issuer Purchases of Equity Securities

The Company made no purchases of its equity securities during the quarter ended September 30, 2018.

### Item 3. Defaults upon Senior Securities

The Company had no defaults on senior securities.

### Item 4. Mine Safety Disclosures

None.

### Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

| Exhibit No. | Description |
|---|---|
| 2.1 | Purchase and Assumption Agreement between Wells Fargo Bank, N.A., and Flagstar Bank, FSB (previously filed as Exhibit 2.1 to the Company's Quarterly Report on Form 10-Q, for the period ended June 30, 2018, and incorporated herein by reference). |
| 3.1 | Second Amended and Restated Articles of Incorporation of Flagstar Bancorp, Inc. (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, for the period ended June 30, 2017, and incorporated herein by reference). |
| 3.2 | Sixth Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q, for the period ended September 30, 2016, and incorporated herein by reference). |
| 4.1 | Indenture, dated July 11, 2016, between Flagstar Bancorp, Inc. as Issuers and Wilmington Trust, National Association, as Trustee and Collateral Agent, including the form of 6.125% senior secured note due 2021 (previously filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, dated July 11, 2016, and incorporated herein by reference). |
| 4.2 | Registration Rights Agreement, dated as of July 11, 2016, among Flagstar Bancorp, Inc., J.P.Morgan Securities LLC and Sandler O'Neill & Partners, L.P. as representatives of the initial purchasers (previously filed as Exhibit 4.3 to the Company's Current Report on Form 8-K, dated July 11, 2016, and incorporated herein by reference). |
| 4.3 | Form of 6.125% Global Note due 2021 (previously filed as Exhibit 4.3 to the Company's Registration Statement on Form S-4, dated October 7, 2016, and incorporated herein by reference). |
| 31.1 | Section 302 Certification of Chief Executive Officer |
| 31.2 | Section 302 Certification of Chief Financial Officer |
| 32.1 | Section 906 Certification, as furnished by the Chief Executive Officer |
| 32.2 | Section 906 Certification, as furnished by the Chief Financial Officer |
| 101 | Financial statements from Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2018, formatted in XBRL: (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements. |

Table of Contents

SIGNATURES

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

| | | |
|---|---|---|
| | | FLAGSTAR BANCORP, INC.<br>Registrant |
| Date: | November 5, 2018 | /s/ Alessandro DiNello<br>Alessandro DiNello<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| | | /s/ James K. Ciroli<br>James K. Ciroli<br>Executive Vice President and Chief Financial Officer<br>(Principal Financial Officer) |

Table of Contents

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