FLAGSTAR BANCORP INC
Form 10-Q
May 10, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

Commission File Number: 001-16577

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

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

(248) 312-2000

(Registrant s telephone number, including area code)

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 ninety days.
Yes þ No o.

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 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 o No o.

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

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

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

As of May 6, 2010, 1,532,890,170 shares of the registrant s common stock, $0.01 par value, were issued and outstanding.

Table of Contents

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of Flagstar Bancorp, Inc. (Flagstar or the Company) and these statements are subject to risk and uncertainty. Forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, include those using words or phrases such as believes, expects, anticipates, plans, trend, objective, continue, remain, pattern or similar expressions or future or conditiona as will, would, should, could, might, can, may or similar expressions.

There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed under the heading Risk Factors in Part I, Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2009 and under Part II, Item 1A of this quarterly report on Form 10-Q, including: (1) our business has been and may continue to be adversely affected by conditions in the global financial markets and economic conditions generally; (2) defaults by another larger financial institution could adversely affect financial markets generally; (3) we may be required to raise capital at terms that are materially adverse to our stockholders; (4) if we cannot effectively manage the impact of the volatility of interest rates our earnings could be adversely affected; (5) if we do not meet the New York Stock Exchange continued listing requirements, our common stock may be delisted; (6) current and further deterioration in the housing market, as well as the number of programs that have been introduced to address the situation by government agencies and government sponsored enterprises, may lead to increased costs to service loans which could affect our margins or impair the value of our mortgage servicing rights; (7) current and further deterioration in the housing and commercial real estate markets may lead to increased loss severities and further increases in delinquencies and non-performing assets in our loan portfolios. Consequently, our allowance for loan losses may not be adequate to cover actual losses, and we may be required to materially increase our reserves; (8) changes in the fair value or ratings downgrades of our securities may reduce our stockholders equity, net earnings, or regulatory capital ratios; (9) certain hedging strategies that we use to manage our investment in mortgage servicing rights may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rates and market liquidity; (10) our ability to borrow funds, maintain or increase deposits or raise capital could be limited, which could adversely affect our liquidity and earnings; (11) our business is highly regulated and subject to change; (12) we are subject to the restrictions and conditions of supervisory agreements with the Office of Thrift Supervision. Failure to comply with the supervisory agreements could result in further enforcement action against us; (13) increases in deposit insurance premiums and special Federal Deposit Insurance Corporation assessments will adversely affect our earnings; (14) we are subject to heightened regulatory scrutiny with respect to bank secrecy and anti-money laundering statutes and regulations; (15) future dividend payments and common stock repurchases may be restricted; (16) we depend on our institutional counterparties to provide services that are critical to our business. If one or more of our institutional counterparties defaults on its obligations to us or becomes insolvent, it could have a material adverse affect on our earnings, liquidity, capital position and financial condition; (17) we use estimates in determining the fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; (18) our home equity lines of credit funding reimbursements have been negatively impacted by loan losses; (19) our secondary market reserve for losses could be insufficient; (20) our home lending profitability could be significantly reduced if we are not able to resell mortgages; (21) our holding company is dependent on Flagstar Bank for funding of obligations and dividends; (22) we may be exposed to other operational and reputational risks; (23) we have many new members of our executive team; (24) the potential loss of key members of senior management or the inability to attract and retain qualified relationship managers in the future could affect our ability to operate effectively; (25) the network and computer systems on which we depend could fail or experience a security breach; (26) our loans are geographically concentrated in only a few states; (27) we are subject to environmental liability risk associated with lending activities; (28) severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business; (29) general business, economic and political conditions may significantly affect our earnings; (30) we are a controlled company that is exempt from certain New York Stock Exchange corporate governance requirements; and (31) our controlling stockholder has significant influence over us, including control over decisions that require the approval of stockholders, whether or not such decisions are in the best interests of other stockholders.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2010
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The consolidated financial statements of the Company are as follows:

Table of Contents

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

	March 31, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and cash items	$ 61,342	$ 73,019
Interest-bearing deposits	909,808	1,009,470
Cash and cash equivalents	971,150	1,082,489
Securities classified as trading	893,318	330,267
Securities classified as available for sale	733,788	605,621
Other investments restricted	4,428	15,601
Loans available for sale ($1,371,476 and $1,937,171 at fair value a March 31, 2010 and December 31, 2009, respectively)	1,873,744	1,970,104
Loans held for investment ($13,671 and $11,287 at fair value at March 31, 2010 and December 31, 2009, respectively)	7,580,679	7,714,308
Less: allowance for loan losses	(538,000)	(524,000)
Loans held for investment, net	7,042,679	7,190,308
Total interest-earning assets	11,457,765	11,121,371
Accrued interest receivable	52,707	44,941
Repossessed assets, net	167,265	176,968
Federal Home Loan Bank stock	373,443	373,443
Premises and equipment, net	237,870	239,318
Mortgage servicing rights at fair value	540,800	649,133
Mortgage servicing rights, net	2,647	3,241
Other assets	1,439,003	1,331,897
Total assets	$ 14,332,842	$ 14,013,331
Liabilities and Stockholders Equity		
Deposits	$ 8,145,679	$ 8,778,469
Federal Home Loan Bank advances	3,900,000	3,900,000
Security repurchase agreements	108,000	108,000
Long term debt	300,182	300,182
Total interest-bearing liabilities	12,453,861	13,086,651
Accrued interest payable	21,726	26,086
Secondary market reserve	76,000	66,000
Other liabilities	676,491	237,870
Total liabilities	13,228,078	13,416,607
Commitments and Contingencies		
Stockholders Equity		
	3	3

Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding at March 31, 2010 and December 31, 2009, respectively		
Common stock $0.01 par value, 3,000,000,000 shares authorized; 1,470,076,137 and 468,770,671 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	14,701	4,688
Additional paid in capital preferred	245,124	243,778
Additional paid in capital common	1,013,100	443,230
Accumulated other comprehensive loss	(39,552)	(48,263)
Retained earnings (accumulated deficit)	(128,612)	(46,712)
Total stockholders equity	1,104,764	596,724
Total liabilities and stockholders equity	$ 14,332,842	$ 14,013,331

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

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

	For the Three Months Ended March 31, 2010	2009
	(Unaudited)	
Interest Income		
Loans	$ 110,195	$ 158,622
Securities classified as available for sale or trading	15,367	25,477
Interest-bearing deposits	643	856
Other	1	23
Total interest income	126,206	184,978
Interest Expense		
Deposits	41,887	67,350
FHLBI advances	41,788	56,809
Security repurchase agreements	1,153	1,153
Other	3,695	2,936
Total interest expense	88,523	128,248
Net interest income	37,683	56,730
Provision for loan losses	63,559	158,214
Net interest expense after provision for loan losses	(25,876)	(101,484)
Non-Interest Income		
Loan fees and charges	16,329	32,922
Deposit fees and charges	8,413	7,233
Loan administration	26,150	(31,801)
(Loss) gain on trading securities	(3,312)	23,747
Loss on residual and transferors interest	(2,682)	(12,535)
Net gain on loan sales	52,566	195,694
Net loss on sales of mortgage servicing rights	(2,213)	(82)
Net gain on securities available for sale	2,166	
Total other-than-temporary impairment gain (loss)	15,688	(126,172)
Gain (loss) recognized in other comprehensive income before taxes	18,974	(108,930)
Net impairment loss recognized in earnings	(3,286)	(17,242)
Other fees and charges	(22,133)	(6,977)
Total non-interest income	71,998	190,959
Non-Interest Expense		
Compensation, commissions and benefits	61,022	91,789

Occupancy and equipment	16,011	18,879
Asset resolution	16,573	24,873
Federal insurance premiums	10,047	1,722
Other taxes	855	1,007
Warrant expense	1,227	11,028
General and administrative	17,607	33,371
Total non-interest expense	123,342	182,669
Loss before federal income taxes	(77,220)	(93,194)
Benefit for federal income taxes		(28,696)
Net Loss	(77,220)	(64,498)
Preferred stock dividend/accretion	(4,680)	(2,919)
Net loss applicable to common stock	$ (81,900)	$ (67,417)
Loss per share		
Basic	$ (0.11)	$ (0.76)
Diluted	$ (0.11)	$ (0.76)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)
(In thousands, except per share data)

	Preferred Stock	Common Stock	Preferred Additional Paid in Capital	Common Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Retained Earnings (Deficit)	Total Stockholders Equity
Balance at January 1, 2009		836		119,024	(81,742)		434,175	472,293
Net loss							(496,678)	(496,678)
Reclassification of gain on sale of securities available for sale					(5,561)			(5,775)
Reclassification of loss on securities available for sale due to other-than-temporary impairment					13,486			13,486
Change in net unrealized loss on securities available for sale					58,468			58,682
Total comprehensive loss								(430,285)
Cumulative effect for adoption of new guidance for other-than-temporary impairments recognition on debt securities debt securities					(32,914)		32,914	
Issuance of preferred stock	6		507,488					507,494
Conversion of preferred stock	(3)	3,750	(268,574)	264,827				
Issuance of common stock		67		5,254				5,321
Reclassification of Treasury Warrants				49,673				49,673
Issuance of common stock for exercise of May Warrants		31		4,345				4,376

Restricted stock issued		1		(46)				(45)
Dividends on preferred stock							(12,259)	(12,259)
Accretion of preferred stock			4,864				(4,864)	
Stock-based compensation		3		619				622
Tax effect from stock-based compensation				(466)				(466)
Balance at December 31, 2009	3	4,688	243,778	443,230	(48,263)		(46,712)	596,724
(Unaudited)								
Net loss							(77,220)	(77,220)
Reclassification of gain on sale of securities available for sale					(1,594)			(1,594)
Reclassification of loss on securities available for sale due to other-than-temporary impairment					3,286			3,286
Change in net unrealized loss on securities available for sale					7,019			7,019
Total comprehensive loss								(68,509)
Issuance of common stock		9,989		567,261				577,250
Restricted stock issued				(12)				(12)
Dividends on preferred stock							(3,334)	(3,334)
Accretion of preferred stock			1,346				(1,346)	
Stock-based compensation		24		2,737				2,761
Tax effect from stock-based compensation				(116)				(116)
Balance at March 31, 2010	$ 3	$ 14,701	$ 245,124	$ 1,013,100	$ (39,552)	$	$ (128,612)	$ 1,104,764

The accompanying notes are an integral part of these consolidated financial statements.

7

Table of Contents

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

	For the Three Months Ended March 31,	
	2010	**2009**
	(Unaudited)	
Operating Activities		
Net loss	$ (77,220)	$ (64,498)
Adjustments to net loss to net cash used in operating activities		
Provision for loan losses	63,559	158,214
Depreciation and amortization	4,648	5,776
Increase in valuation allowance in mortgage servicing rights	176	1,548
Loss on fair value of residential mortgage servicing rights net of hedging gains (losses)	41,471	69,571
Stock-based compensation expense	2,761	255
(Gain) loss on interest rate swap	(221)	(99)
Net loss on the sale of assets	4,480	1,262
Net gain on loan sales	(52,566)	(195,694)
Net loss on sales of mortgage servicing rights	2,213	82
Net gain on sale securities classified as available for sale	(2,166)	
Other than temporary impairment losses on securities classified as available for sale	3,286	17,242
Net loss (gain) on trading securities	3,312	(23,747)
Net loss on residual and transferor interest	2,682	12,535
Proceeds from sales of loans available for sale	5,079,635	6,776,177
Origination and repurchase of mortgage loans available for sale, net of principal repayments	(4,874,084)	(9,379,932)
Purchase of trading securities	(746,589)	(831,552)
Increase in accrued interest receivable	(7,766)	(6,887)
Proceeds from sales of trading securities	178,480	518,793
Increase in other assets	(107,038)	(30,219)
Decrease in accrued interest payable	(4,360)	(6,525)
Net tax effect of stock grants issued	115	453
Decrease (increase) liability for checks issued	(3,930)	1,111
Decrease (increase) in federal income taxes payable	457	(5,637)
Increase in payable for mortgage repurchase option	441,020	
(Decrease) increase in other liabilities	(2,191)	49,250
Net cash used in operating activities	(49,836)	(2,932,521)
Investing Activities		
Net change in other investments	11,173	(2,461)
Proceeds from the sale of investment securities available for sale	54,948	
Net (purchase) repayment of investment securities available for sale	(176,078)	42,717
Proceeds from sales of portfolio loans	(109,496)	16,403
Origination of portfolio loans, net of principal repayments	44,167	13,800
Proceeds from the disposition of repossessed assets	48,943	50,737

Acquisitions of premises and equipment, net of proceeds	(2,949)	(4,787)
Proceeds from the sale of mortgage servicing rights	112,848	1,543
Net cash (used in) provided by investing activities	(16,444)	117,952
Financing Activities		
Net (decrease) increase in deposit accounts	(632,790)	1,944,696
Net receipt of payments of loans serviced for others	14,636	107,915
Net (disbursement) receipt of escrow payments	(705)	15,238
Net tax benefit for stock grants issued	(116)	(453)
Dividends paid to preferred stockholders	(3,334)	
Issuance of preferred stock		544,365
Issuance of common stock	577,250	5,321
Net cash (used in) provided by financing activities	(45,059)	2,617,082
Net decrease in cash and cash equivalents	(111,339)	(197,487)
Beginning cash and cash equivalents	1,082,489	506,905
Ending cash and cash equivalents	$ 971,150	$ 309,418
Loans held for investment transferred to repossessed assets	$ 93,155	$ 117,462
Total interest payments made on deposits and other borrowings	$ 92,883	$ 134,773

Table of Contents

	For the Three Months Ended March 31,	
	2010	**2009**
	(Unaudited)	
Federal income taxes paid	$	$ 590
Reclassification of mortgage loans originated for portfolio to mortgage loans available for sale for sale	$ 109,496	$ 16,403
Mortgage servicing rights resulting from sale or securitization of loans	$ 48,267	$ 82,680

The accompanying notes are an integral part of these consolidated financial statements.

Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements

Note 1 Nature of Business

Flagstar Bancorp, Inc. (Flagstar or the Company), is the holding company for Flagstar Bank, FSB (the Bank), a federally chartered stock savings bank founded in 1987. With $14.3 billion in assets at March 31, 2010, Flagstar is the largest insured depository institution headquartered in Michigan.

The Company s principal business is obtaining funds in the form of deposits and wholesale borrowings and investing those funds in single-family mortgages and other types of loans. Its primary lending activity is the acquisition or origination of single-family mortgage loans. The Company may also originate consumer loans, commercial real estate loans and non-real estate commercial loans. The Company services a significant volume of residential mortgage loans for others.

The Company sells or securitizes most of the mortgage loans that it originates and generally retains the right to service the mortgage loans that it sells. These mortgage servicing rights (MSRs) are occasionally sold by the Company in transactions separate from the sale of the underlying mortgages. The Company may also invest in a significant amount of its loan production to enhance the Company s leverage and to receive the interest spread between earning assets and paying liabilities.

The Bank is a member of the Federal Home Loan Bank System (FHLBI) and is subject to regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC). The Bank s deposits are insured by the FDIC through the Deposit Insurance Fund (DIF).

Note 2 Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of the Company and its consolidated subsidiaries. All significant intercompany balances and transactions have been eliminated. In accordance with current accounting principles, the Company s trust subsidiaries are not consolidated. In addition, certain prior period amounts have been reclassified to conform to the current period presentation.

The unaudited consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (the SEC). Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America (U.S. GAAP) for complete financial statements. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three month period ended March 31, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. We have evaluated the financial statements for subsequent events through the date of the filing of the Form 10-Q. For further information, you should refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, which can be found on the Company s Investor Relations web page, at **www.flagstar.com**, and on the website of the SEC, at **www.sec.gov**.

Table of Contents

Note 3 Recent Developments

Capital Investment

On January 27, 2010, MP Thrift Investments, L.P. (MP Thrift) exercised its rights to purchase 422,535,212 shares of the Company s common stock for approximately $300 million in a rights offering to purchase up to 704,234,180 shares of common stock which expired on February 8, 2010. Pursuant to the rights offering, each stockholder of record as of December 24, 2009 received 1.5023 non-transferable subscription rights for each share of common stock owned on the record date and entitled the holder to purchase one share of common stock at the subscription price of $0.71. During the rights offering, the Company s stockholders (other than MP Thrift) exercised their rights to purchase 806,950 shares of common stock, which means, in the aggregate, the Company issued 423,342,162 shares of common stock in the rights offering for approximately $300.6 million.

On March 31, 2010, the Company completed a registered offering of 575,000,000 shares of common stock, which included 75,000,000 shares issued pursuant to the underwriters over-allotment option, which was exercised in full on March 29, 2010. The Company issued and sold to the Underwriters 575,000,000 shares of the Company s common stock, $0.01 par value per share. The public offering price of the Common Stock was $0.50 per share. MP Thrift participated in this registered offering and purchased 200,000,000 shares at $0.50 per shares. The offering resulted in aggregate net proceeds of approximately $276.1 million, after deducting underwriting fees and offering expenses.

Supervisory Agreements

On January 27, 2010, the Company and the Bank each entered into a supervisory agreement with the OTS (respectively, the Bancorp Supervisory Agreement and the Bank Supervisory Agreement and, collectively, the Supervisory Agreements). The Company and the Bank have taken numerous steps to comply with, and intend to comply in the future with, all of the requirements of the Supervisory Agreements, and do not believe that the Supervisory Agreements will materially constrain management s ability to implement their business plan. The Supervisory Agreements will remain in effect until terminated, modified, or suspended in writing by the OTS, and the failure to comply with the Supervisory Agreements could result in the initiation of further enforcement action by the OTS, including the imposition of further operating restrictions and result in additional enforcement actions against us.

Note 4. Recent Accounting Developments

Accounting Standards Update (ASU) No. 2009-16, Transfers and Servicing (Topic 860) - Accounting for Transfers of Financial Assets. ASU 2009-16 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. ASU 2009-16 eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. ASU 2009-16 also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The provisions of ASU 2009-16 became effective on January 1, 2010 and did not have a significant impact on the Company s consolidated financial position, results of operations or liquidity.

ASU No. 2009-17, Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. ASU 2009-17 amends prior guidance to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. ASU 2009-17 requires additional disclosures about the reporting entity s involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity s financial statements. As further discussed below, ASU No. 2010-10, Consolidations (Topic 810), deferred the effective date of ASU 2009-17 for a reporting entity s interests in investment companies. The provisions of ASU 2009-17 became effective on January 1, 2010 and did not have a significant impact on the Company s consolidated financial position, results of operations or liquidity.

ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures About Fair Value Measurements. ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company s should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required for the Company beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for the Company on January 1, 2010. See Note 5, Fair Value Accounting .

ASU No. 2010-09, Subsequent Events (Topic 855) Amendments to Certain Recognition and Disclosure Requirements. ASU 2010-09 removes the requirement for companies that are subject to the periodic reporting requirements of the Securities Exchange Act of 1934 to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. The FASB also clarified that if the financial statements have been revised, then an entity that is not an SEC filer should disclose both the date that the financial statements were issued or available to be issued and the date the revised financial statements were issued or available to be issued. The FASB believes these amendments remove potential conflicts with the SEC s literature. All of the amendments in the ASU were effective upon issuance, except for the use of the issued date for conduit debt obligors, which will be effective for interim or annual periods ending after June 15, 2010. The adoption of this guidance and is not expected to have a significant impact on the Company s consolidated financial position, results of operations or liquidity.

ASU No. 2010-11, Derivatives and Hedging (Topic 815) Scope Exception Related to Embedded Credit Derivatives. ASU 2010-11 clarifies that the only form of an embedded credit derivative that is exempt from embedded derivative bifurcation requirements are those that relate to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. The provisions of ASU 2010-11 will be effective for the Company for interim reporting periods beginning after June 15, 2010 and are not expected to have a significant impact on the Company s consolidated financial position, results of operations or liquidity.

Note 5 Fair Value Accounting

The Company adheres to guidance related to fair value measurements and additional guidance for financial instruments. This guidance establishes a framework for measuring fair value and prescribes disclosures about fair value measurements. The guidance also establishes a uniform definition of fair value. The definition of fair value under this guidance is market-based as opposed to company-specific and includes the following:

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in either case through an orderly transaction between market participants at a measurement date, and establishes a framework for measuring fair value;

- Establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date;

- Nullifies previous fair value guidance, which required the deferral of profit at inception of a transaction involving a derivative financial instrument in the absence of observable data supporting the valuation technique;

- Eliminates large position discounts for financial instruments quoted in active markets and requires consideration of the company s creditworthiness when valuing liabilities; and

- Expands disclosures about instruments that are measured at fair value.

The accounting guidance for financial instruments provides an option to elect fair value as an alternative measurement for selected financial assets, financial liabilities, unrecognized Company commitments and written loan commitments not previously recorded at fair value. In accordance with the provisions of this guidance, the Company, applies the fair value option for certain non-investment grade residual securities from private-label securitizations. In accordance with this guidance, the Company applies fair value accounting to these residual securities and classified these investments as securities trading to provide consistency in the accounting for the Company s residual interests.

The Company applies the fair value measurement method for residential MSRs under guidance related to servicing assets and liabilities. Management applies the fair value measurement method of accounting for residential MSRs to be consistent with the fair value accounting method required for its risk management strategy to hedge the fair value of these assets. Changes in the fair value of MSRs, as well as changes in fair value of the related derivative instruments, are recognized each period within loan administration income (loss) on the consolidated statement of operations.

Table of Contents

Effective January 1, 2009, the Company elected the fair value option for the majority of its loans available for sale in accordance with the accounting guidance for financial instruments. Only loans available for sale originated subsequent to January 1, 2009 were affected. Prior to the Company s fair value election, loans available for sale were carried at the lower of aggregate cost or estimated fair value; therefore, any increase in fair value to such loans was not realized until such loans were sold. The effect on consolidated operations of this election amounted to recording additional gains on loan sales of $14.1 million for the three month period ended March 31, 2010, respectively, based upon an increase in fair value during the period rather than at a later time when the loans were sold. See Note 7, Loans Available for Sale.

Determination of Fair Value

The Company has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves and option volatilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, creditworthiness, liquidity and unobservable parameters that are applied consistently over time. Any changes to the valuation methodology are reviewed by management to determine appropriateness of the changes. As markets develop and the pricing for certain products becomes more transparent, the Company expects to continue to refine its valuation methodologies.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments at the reporting date.

Valuation Hierarchy

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if Level 2 input is not available. The three levels are defined as follows.

Level 1 Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Company can participate.

Level 2 Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities 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.

Level 3 Fair value is based upon financial models using primarily unobservable inputs.

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 fair value measurement.

The following is a description of the valuation methodologies used by the Company for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Assets

Securities classified as trading. These securities are comprised of U.S. government sponsored agency mortgage-backed securities, United States Department of the Treasury (U.S. Treasury) bonds and non-investment grade residual securities that arose from private-label securitizations of the Company. The U.S. government sponsored agency mortgage-backed securities and U.S. Treasury bonds trade in an active, open market with readily observable prices and are therefore classified within the Level 1 valuation hierarchy. The non-investment grade residual securities do not trade in an active, open market with readily observable prices and are therefore classified within the Level 3 valuation hierarchy. Under Level 3, the fair value of residual securities is determined by discounting estimated net future cash flows using expected prepayment rates and discount rates that approximate current market rates. Estimated net future cash flows include assumptions related to expected credit losses on these securities. The Company maintains a model that evaluates the default rate and severity of loss on the residual securities collateral, considering such factors as loss experience, delinquencies, loan-to-value ratios, borrower credit scores and property type. See Note 10, Private Label Securitization Activity for the key assumptions used in the residual interest valuation process.

Securities classified as available for sale. These securities are comprised of U.S. government sponsored agency mortgage-backed securities and collateralized mortgage obligations (CMOs). Where quoted prices for securities are available in an active market, those securities are classified within Level 1 of the valuation hierarchy. If such quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Due to illiquidity in the markets, the Company determined the fair value of certain non-agency securities using internal valuation models and therefore classified them within the Level 3 valuation hierarchy as these models utilize significant inputs which are unobservable.

Other investments-restricted. Other investments are primarily comprised of various mutual fund holdings. These mutual funds trade in an active market and quoted prices are available. Other investments are classified within Level 1 of the valuation hierarchy.

Loans available for sale. At March 31, 2010, the majority of the Company s loans originated and classified as available for sale were reported at fair value and classified as Level 2. The Company estimates the fair value of mortgage loans based on quoted market prices for securities backed by similar types of loans. Otherwise, the fair value of loans is estimated using discounted cash flows based upon management s best estimate of market interest rates for similar collateral. The Company generally estimated the fair value of mortgage loans based on quoted market prices for securities backed by similar types of loans. Where quoted market prices were available, such market prices were utilized as estimates for fair values. Otherwise, the fair values of loans were estimated by discounting estimated cash flows using management s best estimate of market interest rates, prepayment speeds and loss assumptions for similar collateral. At March 31, 2010, the Company continued to have a relatively small number of loans which were originated prior to the fair value election and accounted for at lower of cost or market. Loans subject to repurchase options of certain securitization transactions and classified as available for sale are accounted for at historical cost, based on current unpaid principal balance.

Loans held for investment. The Company generally does not record these loans at fair value on a recurring basis. However, from time to time a loan is considered impaired and an allowance for loan losses is established. Loans are considered impaired if it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as impaired, the fair value of the impaired loan is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value or discounted cash flows. Impaired loans do not require an allowance if the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2010, substantially all of the total impaired loans were evaluated based on the fair value of the collateral rather than on discounted cash flows. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as a nonrecurring Level 2 valuation.

Repossessed assets. Loans on which the underlying collateral has been repossessed are adjusted to fair value less costs to sell upon transfer to repossessed assets. Subsequently, repossessed assets are carried at the lower of carrying value or fair value, less anticipated marketing and selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the repossessed asset as a nonrecurring Level 2 valuation.

Mortgage Servicing Rights. The Company has obligations to service residential first mortgage loans, and consumer loans (i.e. home equity lines of credit (HELOCs) and second mortgage loans obtained through private-label securitization transactions). Residential MSRs are accounted for at fair value on a recurring basis. Servicing rights associated with consumer loans are carried at amortized cost and are periodically evaluated for impairment.

Residential Mortgage Servicing Rights. The current market for residential mortgage servicing rights is not sufficiently liquid to provide participants with quoted market prices. Therefore, the Company uses an option-adjusted spread valuation approach to determine the fair value of residential MSRs. This approach consists of projecting servicing cash flows under multiple interest rate scenarios and discounting these cash flows using risk-adjusted discount rates. The key assumptions used in the valuation of residential MSRs include mortgage prepayment speeds and discount rates. Management periodically obtains third-party valuations of the residential MSR portfolio to assess the reasonableness of the fair value calculated by its internal valuation model. Due to the nature of the valuation inputs, residential MSRs are classified within Level 3 of the valuation hierarchy. See Note 11, Mortgage Servicing Rights for the key assumptions used in the residential MSR valuation process.

Consumer Loan Servicing Rights. Consumer servicing assets are subject to periodic impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used in the completion of impairment testing. If the valuation model reflects a value less than the carrying value, consumer servicing assets are adjusted to fair value through a valuation allowance as determined by the model. As such, the Company classifies consumer servicing assets subject to nonrecurring fair value adjustments as Level 3 valuations.

Derivative Financial Instruments. Certain classes of derivative contracts are listed on an exchange and are actively traded, and they are therefore classified within Level 1 of the valuation hierarchy. These include U.S. Treasury futures, U.S. Treasury options and interest rate swaps. The Company s forward loan sale commitments may be valued based on quoted prices for similar assets in an active market with inputs that are observable and are classified within Level 2 of the valuation hierarchy. Rate lock commitments are valued using internal models with significant unobservable market parameters and therefore are classified within Level 3 of the valuation hierarchy.

Liabilities

Warrants. Warrant liabilities are valued using a binomial lattice model and are classified within Level 2 of the valuation hierarchy. Significant assumptions include expected volatility, a risk free rate and an expected life.

Assets and liabilities measured at fair value on a recurring basis

The following tables presents the financial instruments carried at fair value as of March 31, 2010 and March 31, 2009, by caption on the Consolidated Statement of Financial Condition and by the valuation hierarchy (as described above):

March 31, 2010	**Level 1**	**Level 2**	**Level 3**	**Total carrying value in the Consolidated Statement of Financial Condition**
		(Dollars in thousands)		
Securities classified as trading:				
Residual interests	$	$	$ 286	$ 286
Mortgage-backed securities	893,032			893,032
Securities classified as available for sale	209,887		523,901	733,788
Loans available for sale		1,371,476		1,371,476
Loans held for investment		13,671		13,671
Residential mortgage servicing rights			540,800	540,800
Other investments-restricted	4,428			4,428
Derivative financial instruments:				
Rate lock commitments			13,085	13,085
Forward loan commitments		7,709		7,709
Agency forwards	(4,713)			(4,713)
Treasury futures	3,028			3,028
Interest rate swaps	(526)			(526)
Warrant liabilities		(6,338)		(6,338)
Total assets and liabilities at fair value	$1,105,136	$1,386,518	$1,078,072	$3,569,726

Table of Contents

March 31, 2009	Level 1	Level 2	Level 3	Total carrying value in the Consolidated Statement of Financial Condition
		(Dollars in thousands)		
Securities classified as trading:				
Residual interests	$	$	$ 18,296	$ 18,296
Mortgage-backed securities	1,674,844			1,674,844
Securities classified as available for sale	234,843		540,969	775,812
Loans available for sale		3,573,997		3,573,997
Residential mortgage servicing rights			515,500	515,500
Other investments-restricted	36,993			36,993
Derivative financial instruments:				
Rate lock commitments			82,645	82,645
Forward agency and loan sales	(58,572)			(58,572)
Agency forwards	33,321			33,321
U.S. Treasury futures	3,911			3,911
Interest rate swaps	(1,349)			(1,349)
Warrant liabilities		(44,901)		(44,901)
Total assets and liabilities at fair value	$1,923,991	$3,529,096	$1,157,410	$6,610,497

Changes in Level 3 fair value measurements

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources). Accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are included within the valuation methodology. Also, the Company manages the risk associated with the observable components of Level 3 financial instruments using securities and derivative positions that are classified within Level 1 or Level 2 of the valuation hierarchy; these Level 1 and Level 2 risk management instruments are not included below, and therefore the gains and losses in the tables do not reflect the effect of the Company s risk management activities related to such Level 3 instruments.

Table of Contents

Fair value measurements using significant unobservable inputs

The tables below include a rollforward of the Consolidated Statement of Financial Condition amounts for the three months ended March 31, 2010 and 2009 (including the change in fair value) for financial instruments classified by the Company within Level 3 of the valuation hierarchy:

For the three months ended March 31, 2010	Fair value, January 1, 2010	Total realized/ unrealized gains/(losses)	Purchases, issuances and settlements, net	Transfers in and/or out of Level 3	Fair value March 31, 2010	Changes in unrealized gains and (losses) related to financial instruments held at March 31, 2010
	(Dollars in thousands)					
Securities classified as trading:						
Residual interests [1]	$ 2,057	$ (1,771)	$	$	$ 286	$
Securities classified as available for sale [2][3]	538,376	7,914	(22,389)		523,901	11,200
Residential mortgage servicing rights	649,133	(156,600)	48,267		540,800	
Derivative financial instruments:						
Rate lock commitments	10,061		3,024		13,085	
Totals	$1,199,627	$(150,457)	$ 28,902	$	$1,078,072	$11,200

Three months ended March 31, 2009	Fair value, January 1, 2009	Total realized/ unrealized gains/losses	Purchases, issuances and settlements, net	Transfers in and/or out of Level 3	Fair value, March 31, 2009	Changes in unrealized gains and (losses) related to financial instruments held at March 31, 2009
	(Dollars in thousands)					
Securities classified as trading:						
Residual interests [1]	$ 24,808	$ (6,512)	$	$	$ 18,296	$

Securities classified as available for Sale (2) (3)	563,083	2,916	(25,030)		540,969	(20,158)
Residential mortgage servicing rights	511,294	(78,474)	82,680		515,500	
Derivative financial Instruments:						
Rate lock commitments	78,613		4,032		82,645	
Totals	$1,177,798	$(82,070)	$ 61,682	$	$1,157,410	$(20,158)

(1) Residual interests are valued using internal inputs supplemented by independent third party inputs.

(2) Realized gains (losses), including unrealized losses deemed other-than-temporary and related to credit issues, are reported in non-interest income. Unrealized gains (losses) are reported in accumulated other comprehensive loss.

(3) U.S. government agency securities classified as available for sale are valued predominantly using quoted broker/dealer prices with adjustments to reflect for any assumptions a willing market participant would include in its valuation. Non-agency securities classified as available for sale are valued using internal valuation models and pricing information from third parties.

Table of Contents

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market and had a fair value below cost at the end of the period as summarized below:

Assets Measured at Fair Value on a Nonrecurring Basis

	Balance at March 31, 2010	**Level 1**	**Level 2**	**Level 3**
		(Dollars in thousands)		
Loans held for investment	$527,788	$	$527,788	$
Repossessed assets	167,265		167,265	
Consumer loan servicing rights	2,647			2,647
Totals	$697,700	$	$695,053	$2,647

	Balance at March 31, 2009	**Level 1**	**Level 2**	**Level 3**
		(Dollars in thousands)		
Loans held for investment	$452,269	$	$452,269	$
Repossessed assets	106,546		106,546	
Consumer servicing rights	7,271			7,271
Totals	$566,086	$	$558,815	$7,271

Table of Contents

Required Financial Disclosures about Fair Value of Financial Instruments

The accounting guidance for financial instruments requires disclosures of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate their fair values. Certain financial instruments and all nonfinancial instruments are excluded from the scope of this guidance. Accordingly, the fair value disclosures required by this guidance are only indicative of the value of individual financial instruments as of the dates indicated and should not be considered an indication of the fair value of the Company.

The following table presents the carrying amount and estimated fair value of certain financial instruments:

	March 31, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(Dollars in thousands)			
Financial Instruments:				
Assets:				
Cash and cash equivalents	$ 971,150	$ 971,150	$ 1,082,489	$ 1,082,489
Securities trading	893,318	893,318	330,267	330,267
Securities available for sale	733,788	733,788	605,621	605,621
Other investments restricted	4,428	4,428	15,601	15,601
Loans available for sale	1,873,744	1,878,061	1,970,104	1,975,819
Loans held for investment, net	7,042,679	6,997,837	7,190,308	7,120,802
FHLBI stock	373,443	373,443	373,443	373,443
Mortgage servicing rights	543,447	543,682	652,374	652,656
Liabilities:				
Retail deposits:				
Demand deposits and savings accounts	(1,791,720)	(1,685,253)	(1,900,855)	(1,799,776)
Certificates of deposit	(3,330,182)	(3,435,776)	(3,546,616)	(3,643,218)
Government accounts	(650,247)	(626,451)	(557,495)	(549,990)
National certificates of deposit	(1,792,743)	(1,828,685)	(2,017,080)	(2,455,684)
Company controlled deposits	(580,787)	(580,787)	(756,423)	(756,423)
FHLBI advances	(3,900,000)	(4,157,788)	(3,900,000)	(4,136,489)
Security repurchase agreements	(108,000)	(110,160)	(108,000)	(110,961)
Long term debt	(300,182)	(115,344)	(300,182)	(284,464)
Warrant liabilities	(6,338)	(6,338)	(5,111)	(5,111)
Derivative Financial Instruments:				
Forward delivery contracts	7,709	7,709	27,764	27,764
Commitments to extend credit	13,085	13,085	10,061	10,061
Interest rate swaps	(526)	(526)	(747)	(747)
U.S. Treasury and agency futures/forwards	(1,685)	(1,685)	(49,228)	(49,228)
Options				

The methods and assumptions that were used to estimate the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The following methods and assumptions were used to estimate the fair value for other financial instruments for which it is practicable to estimate that value:

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

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

FHLB stock. No secondary market exists for FHLB stock. The stock is bought and sold at par by the FHLB. Management believes that the recorded value is the fair value.

Deposit Accounts. The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposits with similar remaining maturities.

FHLB Advances. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

Security Repurchase Agreements. Rates currently available for repurchase agreements with similar terms and maturities are used to estimate fair values for these agreements.

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

Note 6 Investment Securities

As of March 31, 2010 and December 31, 2009, investment securities were comprised of the following:

	Current Maturities	March 31, 2010	December 31, 2009
		(Dollars in thousands)	
Securities trading			
U.S. government treasury bonds	2019-2040	$ 754,184	$
U.S. government sponsored agencies	2038-2039	138,848	328,210
Non-investment grade residual interests		286	2,057
Total securities trading		$ 893,318	$ 330,267
Securities available-for-sale			
Non-agencies	2035-2037	$ 523,901	$ 538,376
U.S. government sponsored agencies	2010-2040	209,887	67,245
Total securities available-for-sale		$ 733,788	$ 605,621
Other investments restricted			
Mutual funds		$ 4,428	$ 15,601

Trading

Securities classified as trading are comprised of AAA-rated U.S. government sponsored agency mortgage-backed securities, U.S. Treasury bonds, and non-investment grade residual interests from private-label securitizations. U.S. government sponsored agency mortgage-backed securities held in trading are distinguished from available-for-sale based upon the intent of the Company to use them as an economic offset against changes in the valuation of the MSR portfolio; however, these securities do not qualify as an accounting hedge as defined in current accounting guidance for derivatives and hedges.

For U.S. Treasury bonds and U.S. government sponsored agency mortgage-backed securities held, we recorded a loss of $3.3 million during the three month period ended March 31, 2010, $3.8 million of which was unrealized loss on securities held at March 31, 2010. For the three month period ended March 31, 2009, we recorded a gain of $23.7 million, $21.4 million of which was unrealized gain on agency mortgage backed securities at March 31, 2009.

The non-investment grade residual interests resulting from the Company s private label securitizations were $0.3 million at March 31, 2010 versus $2.1 million at December 31, 2009. The fair value of non-investment grade residual securities classified as trading decreased as a result of the increase in the actual and expected losses in the second mortgages and HELOCs that underlie these assets.

The fair value of residual interests is determined by discounting estimated net future cash flows using discount rates that approximate current market rates and expected prepayment rates. Estimated net future cash flows include assumptions related to expected credit losses on these securities. The Company maintains a model that evaluates the default rate and severity of loss on the residual interests collateral, considering such factors as loss experience, delinquencies, loan-to-value ratio, borrower credit scores and property type.

Available-for-Sale

At March 31, 2010 and December 31, 2009, the Company had $0.7 billion and $0.6 billion, respectively, in securities classified as available-for-sale which were comprised of U.S. government sponsored agency and non-agency collateralized mortgage obligations. Securities available-for-sale are carried at fair value, with unrealized gains and losses reported as a component of other comprehensive loss to the extent they are temporary in nature or other-than-temporary impairments (OTTI) as to non-credit related issues. If unrealized losses are, at any time, deemed to have arisen from OTTI, the credit related portion is reported as an expense for that period.

20

Table of Contents

The following table summarizes the amortized cost and estimated fair value of U.S. government sponsored agency and non-agency collateralized mortgage obligations classified as available-for-sale:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Amortized cost	$ 799,900	$ 679,872
Gross unrealized holding gains	540	2,118
Gross unrealized holding losses	(66,652)	(76,369)
Estimated fair value	$ 733,788	$ 605,621

The following table summarizes by duration the unrealized loss positions, at March 31, 2010, on securities:

	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
Type of Security	Principal	Number of Securities	Current Unrealized Loss	Principal	Number of Securities	Current Unrealized Loss
			(Dollars in thousands)			
U.S. government sponsored agency securities	$		$	$ 200,096	6	$ (1,521)
Collateralized mortgage obligations	626,089	12	(65,131)			
Totals	$ 626,089	12	$ (65,131)	$ 200,096	6	$ (1,521)

The unrealized losses on securities-available-for-sale amounted to $66.7 million on $826.2 million of principal of agency and non-agency CMOs at March 31, 2010. These CMOs consist of interests in investment vehicles backed by mortgage loans.

An investment impairment analysis is triggered when the estimated market value is less than amortized cost for an extended period of time, generally six months. Before an analysis is performed, the Company also reviews the general market conditions for the specific type of underlying collateral for each security; in this case, the mortgage market in general has suffered from significant losses in value. With the assistance of third party experts as deemed necessary, the Company models the expected cash flows of the underlying mortgage assets using historical factors such as default rates, current delinquency rates and estimated factors such as prepayment speed, default speed and severity speed. Next, the cash flows are modeled through the appropriate waterfall for each CMO tranche owned; the level of credit support provided by subordinated tranches is included in the waterfall analysis. The resulting cash flow of principal and interest is then utilized by management to determine the amount of credit losses by security.

The credit losses on the CMO portfolio reflect the economic conditions present in the U.S. over the course of the last two years. This includes high mortgage defaults, declines in collateral values and changes in homeowner behavior, such as intentionally defaulting on a note due to a home value worth less than the outstanding debt on the home.

In the three month period ended March 31, 2010, additional OTTI due to credit losses on six investments with existing other-than-temporary impairment credit losses totaled $3.3 million while no additional OTTI due to credit loss was recognized on securities that did not already have such losses; all OTTI due to credit losses was recognized in current operations. In the three months ended March 31, 2009, additional credit losses on the original three and seven additional CMOs totaled $17.2 million, which was recognized in current operations.

At March 31, 2010, the Company had total other-than-temporary impairment recoveries of $15.7 million on 12 securities in the available-for-sale portfolio with $38.6 million in total credit losses recognized through operations. At December 31, 2009, the Company had total other-than-temporary impairments of $111.6 million on 12 securities in the available-for-sale portfolio with $35.3 million in total credit losses recognized through operations.

The following table shows the activity for OTTI credit loss for the quarter ended March 31, 2010:

	January 1, 2010 Balance	Additions on Securities with No Prior OTTI	Additions on Securities with Previous OTTI Recognized	Reduction for Sold Securities with OTTI	March 31, 2010 Balance
	(Dollars in thousands)				
Collateralized mortgage obligations	$(35,272)		$ (3,286)		$(38,558)

Table of Contents

Gains (losses) on the sale of U.S. government sponsored agency mortgage-backed securities available for sale that are recently created with underlying mortgage products originated by the Company are reported within net gain on loan sale. Securities in this category have typically remained in the portfolio less than 90 days before sale. During the three months ended March 31, 2010, there were no sales of agency securities with underlying mortgage products recently originated by the Bank compared with a $11.1 million gain on $418.7 million of sales during the quarter ended March 31, 2009.

Gain (loss) on sales for all other available for sale securities types are reported in net gain on sale of available for sales securities. During the three months ended March 31, 2010, the Company sold $54.6 million in agency and non-agency securities resulting in a net gain of $2.2 million versus the same period ended March 31, 2009 in which the Company sold no U.S. government sponsored agency and non-agency securities available for sale.

As of March 31, 2010, the aggregate amount of available-for-sale securities from each of the following non-agency issuers was greater than 10% of the Company s stockholders equity.

Name of Issuer	Amortized Cost	Fair Market Value
	(Dollars in thousands)	
Countrywide Home Loans	$ 196,693	$ 177,563
Flagstar Home Equity Loan Trust 2006-1	181,024	163,933
Total	$ 377,717	$ 341,496

Other Investments Restricted

The Company has other investments in its insurance subsidiary which are restricted as to their use. These assets can only be used to pay insurance claims in that subsidiary. These securities had a fair value that approximates their recorded amount for each period presented. During 2009, the Company executed commutation agreements with three of the four mortgage insurance companies it had reinsurance agreements with. Under each commutation agreement, the respective mortgage insurance company took back the ceded risk (thus again assuming the entire insured risk) and receives rights to all future premiums. In addition, the mortgage insurance company received all the cash held in trust, less any amount that is above the amount of total future liability. The Company had securities in its remaining reinsurance subsidiaries of $4.4 million and $15.6 million at March 31, 2010 and December 31, 2009, respectively.

Note 7 Loans Available for Sale

The following table summarizes loans available for sale:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans	$ 1,873,738	$ 1,970,104
Second mortgage loans	6	
Total	$ 1,873,744	$ 1,970,104

Effective January 1, 2009, the Company elected to record new originations of loans available for sale on the fair value method and as such no longer defers loan fees or expenses related to these loans. Because the fair value method was required to be adopted prospectively, only loans originated for sale subsequent to January 1, 2009 are affected. At March 31, 2010 and December 31, 2009, $1.3 billion and $1.9 billion of loans available for sale were recorded at fair value, respectively. The Company estimates the fair value of mortgage loans based on quoted market prices for securities backed by similar types of loans where quoted market prices were available. Otherwise, the fair values of loans were estimated by discounting estimated cash flows using management s best estimate of market interest rates for similar collateral.

In addition, for certain loans sold to Ginnie Mae, the Company as the servicer, has the option to repurchase without Ginnie Mae s prior authorization, any individual loan when certain delinquency criteria are met. Once the Company has the unilateral ability to repurchase the delinquent loan, the Company has effectively regained control over the loan and is required under U.S. GAAP to recognize the loan and a corresponding repurchase liability on its balance sheet regardless of the Company s intention to repurchase the loan. At March 31, 2010, the Company s repurchase option asset and corresponding liability, included in other liabilities, was $441.0 million.

Note 8 Loans Held for Investment

Loans held for investment are summarized as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans	$ 4,803,425	$ 4,990,994
Second mortgage loans	210,208	221,626
Commercial real estate loans	1,555,163	1,600,271
Construction loans	15,544	16,642
Warehouse lending	576,719	448,567
Consumer loans	407,742	423,842
Commercial loans	11,878	12,366
Total	7,580,679	7,714,308
Less allowance for loan losses	(538,000)	(524,000)
Total	$ 7,042,679	$ 7,190,308

For the three month period ended, March 31, 2010, the Company transferred $60.6 million in loans available for sale to loans held for investment. The loans transferred were carried at fair value, and continue to be reported at fair value while classified as held for investment.

Activity in the allowance for loan losses is summarized as follows:

	For the Three Months Ended March 31,	
	2010	2009
	(Dollars in thousands)	
Balance, beginning of period	$ 524,000	$ 376,000
Provision charged to operations	63,559	158,214
Charge-offs	(51,560)	(69,442)
Recoveries	2,001	1,228
Balance, end of period	$ 538,000	$ 466,000

As of March 31, 2010, there were two commercial loans totaling $5.3 million greater than 90 days past due still accruing interest as compared to 18 loans totaling $2.6 million,at March 31, 2009.

For purposes of impairment testing, impaired loans greater than an established threshold ($1.0 million) were individually evaluated for impairment. Loans below those scopes were collectively evaluated as homogeneous pools. Renegotiated loans are evaluated at the present value of expected future cash flows discounted at the loan s effective interest rate. The required valuation allowance is included in the allowance for loan losses in the consolidated statement of financial condition.

Loans on which interest accruals have been discontinued totaled approximately $1.1 billion at March 31, 2010 and $893.8 million at March 31, 2009. Loans are placed on non-accrual status when any portion of principal or interest is 90 days delinquent or earlier when concerns exist as to the ultimate collection of principal or interest. When a loan is placed on non-accrual status, the accrued and unpaid interest is reversed and interest income is recorded as collected. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible. Interest income is recognized on impaired loans using a cost recovery method unless the receipt of principal and interest as they become contractually due is not in doubt, such as in a troubled debt restructuring (TDR). TDRs of impaired loans that continue to perform under the restructured terms will continue on non-accrual status until the borrower has established a willingness and ability to make the restructured payment for at least six months, after which they will begin to accrue interest. Interest that would have been accrued on such loans totaled approximately $8.2 million and $9.8 million during the three months ended March 31, 2010 and 2009, respectively.

The Company may modify certain loans to retain customers or to maximize collection of the loan balance. The Company has maintained several 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. Loan modification programs for borrowers implemented during 2009 have resulted in a significant increase in restructured loans. These loans are classified as troubled debt restructurings (TDRs) and are included in non-accrual loans if the loan was non-accruing prior to the restructuring or if the payment amount increased significantly. These loans will continue on non-accrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months. At March 31, 2010, TDRs totaled $794.6 million of which $334.0 million were non-accruing.

A loan is impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement.

Impaired loans are as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Impaired loans with no allowance for loan losses allocated (1)	$ 135,379	$ 160,188
Impaired loans with allowance for loan losses allocated	921,940	891,022
Total impaired loans	$ 1,057,319	$ 1,051,210
Amount of the allowance allocated to impaired loans	$ 189,907	$ 172,741
Average investment in impaired loans	$ 1,054,264	$ 796,112
Cash-basis interest income recognized during impairment (2)	$ 11,978	$ 26,602

(1) Includes loans for which the principal balance has been charged down to net realizable value.

(2) Includes interest income recognized during the years ended March 31, 2010 and 2009, respectively.

Those impaired loans not requiring an allowance represent loans for which expected discounted cashflows or the fair value of the collateral less estimated selling costs exceeded the recorded investments in such loans. At March 31, 2010, approximately 58.4% of the total impaired loans were evaluated based on the fair value of related collateral.

Note 9 Pledged Assets

The Company has pledged certain securities and loans to collateralize security repurchase agreements, lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the Federal Home Loan Bank of Indianapolis and other potential future obligations. The following table details pledged asset by asset class. The market value of pledged investments and principal amount for pledged loans are presented:

	March 31, 2010 Carrying Value	December 31, 2009 Carrying Value

	(Dollars in thousands)	
Securities trading		
U.S. government treasury bonds	$ 754,184	$
U.S. government sponsored agencies	115,345	328,210
Securities available for sale		
U.S. government sponsored agencies	205,090	47,213
Non-agencies collateralized mortgage obligations	226,248	538,376
Loans		
Mortgage loans	4,545,368	5,526,865
Second mortgage loans	167,487	194,319
HELOCs	280,477	286,602
Commercial loans	708,079	751,472
Totals	$ 7,002,278	$ 7,673,057

Note 10 <u>Private-label Securitization Activity</u>

The Company securitizes fixed and adjustable rate second mortgage loans and home equity line of credit loans. The Company acts as the principal underwriter of the beneficial interests that are sold to investors. The financial assets are derecognized when they are transferred to the securitization trust, which then issues and sells mortgage-backed securities to third party investors. The Company relinquishes control over the loans at the time the financial assets are transferred to the securitization trust. The Company typically recognizes a gain on the sale on the transferred assets.

The Company retains interests in the securitized mortgage loans and trusts, in the form of residual interests, transferor s interests, and servicing assets. The residual interests represent the present value of future cash flows expected to be

Table of Contents

received by the Company. Residual interests are accounted for at fair value and are included as securities classified as trading in the consolidated statement of financial condition. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in the consolidated statement of operations. Transferor s interests represent all of the remaining interest in the assets, which will equal the excess of the loan pool balance over the note principal balance and are comprised of the overcollateralization amount and additional balance increase amount. Transferor s interests are included in loans held for investment in the consolidated statement of financial condition. Servicing assets represent the present value of future servicing cash flows expected to be received by the Company. These servicing assets are accounted for on an amortization method, and are included in mortgage servicing rights in the consolidated statement of financial condition.

The Company recorded $26.1 million in residual interests as of December 31, 2005, as a result of its non-agency securitization of $600 million in home equity line of credit loans (the FSTAR 2005-1 HELOC Securitization). In addition, each month draws on the home equity lines of credit in the trust established in the FSTAR 2005-1 HELOC Securitization are purchased from the Company by the trust, resulting in additional residual interests to the Company. These residual interests are recorded as securities classified as trading and are, therefore, recorded at fair value. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in the consolidated statement of operations.

On April 28, 2006, the Company completed a guaranteed mortgage securitization transaction of approximately $400.0 million of fixed second mortgage loans (the FSTAR 2006-1 Second Mortgage Securitization) that the Company held at the time in its investment portfolio. The transaction was treated as a recharacterization of loans held for investment to mortgage-backed securities held to maturity and, therefore, no gain on sale was recorded.

The Company recorded $11.2 million in residual interests as of December 31, 2006, as a result of its non-agency securitization of $302 million in home equity line of credit loans (the FSTAR 2006-2 HELOC Securitization). In addition, through November 2007, draws on the home equity lines of credit in the trust established in the 2006 HELOC Securitization were purchased from the Company by the trust, resulting in additional residual interests to the Company. These residual interests are recorded as securities classified as trading and are, therefore, recorded at fair value. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in the consolidated statement of operations.

On March 15, 2007, the Company sold $620.9 million in closed-ended, fixed and adjustable rate second mortgage loans (the FSTAR 2007-1 Second Mortgage Securitization) and recorded $22.6 million in residual interests and servicing assets as a result of the non-agency securitization. On June 30, 2007, the Company completed a secondary closing for $98.2 million and recorded an additional $4.2 million in residual interests. The residual interests are categorized as securities classified as trading and are, therefore, recorded at fair value. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in the consolidated statement of operations.

During 2009 and for the three months ended March 31, 2010, the Company did not engage in any private-label securitization activity.

Summary of Securitization Activity

Certain cash flows received from the securitization trusts were as follows:

	For the Three Months Ended March 31,	
	2010	**2009**
	(Dollars in thousands)	
Proceeds from new securitizations	$	$
Proceeds from collections reinvested in securitizations		
Servicing fees received	1,166	1,495
Loan repurchases for representations and warranties		

25

Table of Contents

The following table sets forth certain characteristics of each of the securitizations at their inception and the current characteristics as of and for the three month period ended March 31, 2010:

HELOC Securitizations	2005-1 at inception	2005-1 current levels	2006-2 at inception	2006-2 current levels
	(Dollars in thousands)			
Number of loans	8,155	3,388	4,186	2,857
Aggregate principal balance	$600,000	$167,132	$302,182	$189,960
Average principal balance	$ 55	$ 49	$ 72	$ 66
Weighted average fully indexed interest rate	8.43%	5.93%	9.43%	6.95%
Weighted average original term	120 months	120 months	120 months	120 months
Weighted average remaining term	112 months	64 months	112 months	78 months
Weighted average original credit score	722	721	715	720

Second Mortgage Securitizations	2006-1 at inception	2006-1 current levels	2007-1 at inception	2007-1 current levels
	(Dollars in thousands)			
Number of loans	8,325	4,160	12,416	8,133
Aggregate principal balance	$398,706	$178,006	$622,100	$370,203
Average principal balance	$ 49	$ 43	$ 50	$ 46
Weighted average fully indexed interest rate	7.04%	6.97%	8.22%	8.11%
Weighted average original term	187 months	187 months	196 months	194 months
Weighted average remaining term	179 months	132 months	185 months	149 months
Weighted average original credit score	729	731	726	729

Residual Interests

HELOC Securitizations

FSTAR 2005-1. With respect to this securitization, the Company carried a residual interest of $0.3 million and $2.1 million as of March 31, 2010 and December 31, 2009, respectively. This transaction entered rapid amortization in the second quarter of 2008 as actual cumulative losses exceeded predetermined thresholds.

During the rapid amortization period, the Company will no longer be reimbursed by the trusts for draws on the home equity lines of credit until after the bondholders are paid off and the monoline insurer is reimbursed for amounts it is owed. Upon entering the rapid amortization period, the Company becomes obligated to fund the purchase of those additional balances as they arise in exchange for a beneficial interest in the trust (transferor s interest). The Company must continue to fund the required purchase of additional draws by the trust as long as the securitization remains active.

FSTAR 2006-2. With respect to this securitization, as of March 31, 2010 and December 31, 2009, the residual interests had a fair value of $0. The fair value of the residual interest had been written down to $0 since the third quarter of 2008. This transaction entered rapid amortization in the fourth quarter of 2007.

Second Mortgage Securitizations

FSTAR 2006-1. With respect to this securitization, the residual interests had a fair value of $0 at March 31, 2010 and December 31, 2009, respectively. The fair value of the residual interest had been written down to $0 since the second quarter of 2009.

FSTAR 2007-1. With respect to this securitization, the residual interests had a fair value of $0 at March 31, 2010 and December 31, 2009. The fair value of the residual interest had been written down to $0 since the fourth quarter of 2008.

Table of Contents

At March 31, 2010 and 2009, key assumptions used in determining the value of residual interests resulting from the securitizations were as follows:

	Fair Value at March 31, 2010	Prepayment Speed	Projected Credit Losses	Annual Discount Rate	Weighted-Average Life (in years)
		(Dollars in thousands)			
FSTAR 2005-1 HELOC Securitization	$ 286	6.0%	12.10%	20.0%	4.7
FSTAR 2006-1 Second Mortgage Securitization	$	12.0%	13.12%	20.0%	5.5

	Fair Value at March 31, 2009	Prepayment Speed	Projected Credit Losses	Annual Discount Rate	Weighted-Average Life (in years)
		(Dollars in thousands)			
FSTAR 2005-1 HELOC Securitization	$17,523	12.0%	5.61%	20%	3.9
FSTAR 2006-1 Second Mortgage Securitization	$ 773	16.0%	4.81%	20%	4.3

Transferor s Interests

Under the terms of the HELOC securitizations, the trusts have purchased and were initially obligated to pay for any subsequent additional draws on the lines of credit transferred to the trusts. Upon entering a rapid amortization period, the Company becomes obligated to fund the purchase of those additional balances as they arise in exchange for a beneficial interest in the trust (transferor s interest). The Company must continue to fund the required purchase of additional draws by the trust as long as the securitization remains active. The table below identifies the draw contributions for each of the HELOC securitization trusts as well as the fair value of the transferor s interests.

Summary of Transferor s Interest by Securitization	March 31, 2010 FSTAR 2005-1	March 31, 2010 FSTAR 2006-2	December 31, 2009 FSTAR 2005-1	December 31, 2009 FSTAR 2006-2
Total draw contribution	$31,167	$ 49,150	$30,256	$ 48,105
Additional balance increase amount	$27,186	$ 38,005	$27,183	$ 38,571
Transferor s interest ownership percentage	15.76%	19.29%	15.03%	18.39%
Fair value of transferor s interests	$19,055	$	$19,055	$
Transferor s interest reserve	$	$ 6,241	$	$ 7,287

FSTAR 2005-1. As of March 31, 2010, the Company had a carrying value of $19.1 million in transferor s interest held in the Company s loans held for investment portfolio. The Company determined that a liability in accordance with ASC Topic 450 Contingencies was not warranted because (i) there were only immaterial outstanding claims owed to the note insurer at that time, (ii) the Company continued to receive cash flows on the interest payments associated with the transferor s interest, (iii) increases in transferor s interests gave rise to increases in the cash inflow into the securitization trust that thereby improved the relative credit positions of all parties to the securitization, and (iv) the structure of the securitization provided for losses in the transaction to be shared equally, i.e., pari passu, among the parties rather than being borne solely or primarily by the Company. The securitization continues to have value in its residual and transferor s interests and the note insurer has not been required to perform, in any material respect, under its contract. However, if the performance of the securitization trust deteriorates further, there can be no assurance that the residual interest will continue to have value, that the note insurer will not be required to perform in a material respect under its contract or that the Company will not be required to record a transferor s interest reserve.

FSTAR 2006-2. At March 31, 2010, outstanding claims due to the note insurer were $48.2 million and based on the Company s internal model, the Company believed that because of the claims due to the note insurer and continuing credit losses on the loans underlying the securitization, the carrying amount of the transferor s interest was $0. Also, during the fourth quarter 2009, the Company determined that the transferor s interests had deteriorated to the extent that a SFAS 5 (now codified within ASC Topic 450, Contingencies) liability was required to be recorded. During the period, the Company recorded a liability of $7.6 million to reflect the expected liability arising from losses on future draws associated with this securitization, of which $6.2 million remained at March 31, 2010. In determining this liability, the Company (i) assumed no further draws would be made with respect to those HELOCs as to which further draws were currently prohibited, (ii) the remaining HELOCs would continue to operate in the same manner as their historical draw behavior indicated, as measured on an individual loan basis and on a pool drawdown basis, and (iii) that any draws actually made and therefore recognized as transferor s interests by the Company would have a loss rate of 100%.

There are two distinct components to the assumptions underlying the loss rate on the transferor s interests. First, the structure of the securitization provided for losses in the transaction to be shared *pari passu*, i.e., equally, among the parties rather than being borne solely or primarily by the Company. Second, to the extent that underlying claims to the insurer increased concurrently with credit losses, the reimbursement owed to the insurer from the waterfall also increased. During the fourth quarter 2009, the excess spread, the difference between the coupon rate of the underlying loans less the note rate paid to the bondholders and the transferor s interests were insufficient to support the repayment of the insurer s claims, and the assumed loss rate increased to 100%, giving rise to our recording of the related liability at that time.

In order to estimate losses on future draws and the timing of such losses, a forecast for the draw reserve was established. The forecast was used as the basis for recording the liability. Historical observations and draw behavior formed the basis for establishing the key assumptions and forecasted draw reserve.

First, the forecast assumed a 100% loss on all future draws. Second, the forecast projected future obligations on a monthly basis using a three-month rolling average of the actual draws as a percentage of the unfunded balance. For example, for the period ended March 31, 2010, the three- month rolling average draw rate was 2.47% of the unfunded commitments (still active). This percentage was computed by dividing (i) the actual draw rate over the three month period ending on that date, by (ii) the balance of the unfunded commitments still active on that date. The draw rate was then used to project monthly draws through the remaining expected life of the securitization. In doing so, the 2.47% draw rate (as noted above) was applied against the expected declining level of unfunded commitments in future months caused by payoffs, credit terminations and line cancellations. This rate of decline was based on historical experience within the securitization pool of loans.

These calculations of future monthly draws comprise, in the aggregate, the total dollar amount of expected future draws from the securitization pool. Despite a significant reduction in the unfunded commitments, the Company has not observed a similar reduction in the actual draw rate. Even with a constant draw rate, such total dollar amount declines to the extent the level of unfunded commitments that are still active declines, as is the case in our forecast. Because the expected loss on future draws in March 2010 was 100%, the expected future draws equaled the potential future draw liability at that date.

As indicated above, the forecast uses a constant draw rate as a percentage of the current unfunded commitment that is based on historical observations and draw behavior. The forecast does not contemplate current inactive accounts becoming active and thereby becoming eligible for draw because the nature of the loans that do not currently generate transferor s interests have characteristics that suggest an extremely low likelihood of doing so in the future. Such loans are those in which the draw feature has been discontinued pursuant to the terms of the underlying loan agreement due to a credit-related deficiency of the borrower or due to a decline in the value of the related residential property serving as collateral.

The forecast also reflects the low or zero draw rates of certain of the unfunded commitments that are still active (i.e., $20.4 million for FSTAR 2005-1 and $13.8 million for FSTAR 2006-2 at March 31, 2010). For instance, some loans are still active but have never been drawn upon, suggesting that the loan may have been acquired at the time of a related first mortgage origination solely for contingency purposes but without any actual intent to draw. Similarly, another group of active loans was fully drawn upon at the time of the related first mortgage origination and have been paid down over time, suggesting that the borrower intended the HELOC to serve more as a second mortgage rather than as a revolving line of credit.

The following table outlines the Company s expected losses on future draws on loans in FSTAR 2006-2 at March 31, 2010.

Unfunded Commitments (1)	Expected Future Draws as % of Unfunded Commitments (2)	Expected Future Draws (3)	Expected Loss (4)	Potential Future Liability (5)

(Dollars in thousands)

$13,770	45.3%	$6,241	100.00%	$6,241

(1) Unfunded commitments represent the amounts currently fundable at the dates indicated because the underlying borrowers lines of credit are still active.

(2) Expected future draws on unfunded commitments represents the historical draw rate within the securitization.

(3) Expected future draws reflects unfunded commitments multiplied by expected future draws percentage.

(4) Expected losses represents an estimated reduction in carrying value of future draws.

(5) Potential future liability reflects expected future draws multiplied by expected losses.

Table of Contents

Unfunded Commitments

The table below identifies separately for each HELOC trust: (i) the notional amount of the unfunded commitment under the Company s contractual arrangements, (ii) unfunded commitments that have been frozen or suspended because the borrowers do not currently meet the contractual requirements under their home equity line of credit with the Company, and (iii) the amount currently fundable because the underlying borrowers lines of credit are still active:

	At March 31, 2010		
	FSTAR 2005-1	FSTAR 2006-2	Total
	(Dollars in thousands)		
Notional amount of unfunded commitments (1)	$43,119	$ 39,270	$82,389
Frozen or suspended unfunded commitments	$22,736	$ 25,500	$48,236
Unfunded commitments still active	$20,383	$ 13,770	$34,153

(1) The Company s total potential funding obligation is dependent on both (a) borrower behavior (e.g., the amount of additional draws requested) and (b) the contractual draw period (remaining term) available to the borrowers. Because borrowers can make principal payments and restore the amounts available for draws and then borrow additional amounts as long as their lines of credit remain active, the funding obligation has no specific

limitation and it is not possible to define the maximum funding obligation. However, we expect that the call provision of this securitization pool will be reached in 2015 and our exposure will be substantially mitigated at that time, based on prepayment speeds and losses in our cash flow forecast.

Credit Risk on Securitization

With respect to the issuance of private-label securitizations, the Company retains certain limited credit exposure in that it retains non-investment grade residual securities in addition to customary representations and warranties. The Company does not have credit exposure associated with non-performing loans in securitizations beyond its investment in retained interests in non-investment grade residuals and draws (transferor s interests) on HELOCs that it funds and which are not reimbursed by the respective trust. The value of the Company s transferor s interests reflects the Company s credit loss assumptions as to the underlying collateral pool. To the extent that actual credit losses exceed the assumptions, the value of the Company s non-investment grade residual securities and unreimbursed draws will be diminished.

The following table summarizes the Company s consumer servicing portfolio and the balance of retained assets with credit exposure, which includes residential interests that are included as trading securities and unreimbursed HELOC draws that are included in loans held for investment at March 31:

	2010		2009	
	Total Loans Serviced	**Balance of Retained Assets with Credit Exposure**	**Total Loans Serviced**	**Balance of Retained Assets with Credit Exposure**
	(Dollars in thousands)			
Private-label securitizations	$ 905,301	$ 19,341	$ 1,141,270	$ 70,546
Total	$ 905,301	$ 19,341	$ 1,141,270	$ 70,546

Mortgage loans that have been securitized in private-label securitizations at March 31, 2010 and 2009 that are sixty days or more past due and the credit losses incurred in the securitization trusts are presented below:

	Total Principal Amount of Loans Outstanding March 31,		**Principal Amount Of Loans 60 Days Or More Past Due March 31,**		**Credit Losses (Net of Recoveries) For the Three Months Ended March 31,**	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
	(Dollars in thousands)					
Securitized mortgage loans	$905,301	$1,141,270	$63,083	$74,415	$25,332	$30,125

29

Note 11 Mortgage Servicing Rights

The Company has obligations to service residential first mortgage loans and consumer loans (HELOC and second mortgage loans resulting from private-label securitization transactions). A description of these classes of servicing assets follows.

Residential Mortgage Servicing Rights. Servicing of residential first mortgage loans is a significant business activity of the Company. The Company recognizes MSR assets on residential first mortgage loans when it retains the obligation to service these loans upon sale. MSRs are subject to changes in value from, among other things, changes in interest rates, prepayments of the underlying loans and changes in credit quality of the underlying portfolio. Historically, the Company has treated this risk as a counterbalance to the increased production and gain on loan sale margins that tend to occur in an environment with increased prepayments. The Company specifically hedges the risk of fair value changes of MSRs with derivative instruments that are intended to change in value inversely to part or all of the changes in the fair value of MSRs.

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

	For the Three Months Ended March 31,	
	2010	2009
	(Dollars in thousands)	
Balance at beginning of period	$ 649,133	$ 511,294
Cumulative effect of change in accounting		
Additions from loans sold with servicing retained	48,267	82,680
Reductions from bulk sales	(115,128)	
Changes in fair value due to:		
Payoffs(1)	(15,271)	(36,303)
All other changes in valuation inputs or assumptions (2)	(26,201)	(42,171)
Fair value of MSRs at end of period	$ 540,800	$ 515,500
Unpaid principal balance of residential mortgage loans serviced for others	$ 47,359,431	$ 57,714,858

(1) Represents decrease in MSR value associated with loans that paid off during the period.

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

The fair value of residential MSRs is estimated using a valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. The Company periodically obtains third-party valuations of its residential MSRs to assess the reasonableness of the fair value calculated by the valuation model.

The key economic assumptions used in determining the fair value of MSRs capitalized during the three month period ended March 31, 2010 and 2009 periods were as follows:

	For the Three Months Ended March 31,	
	2010	**2009**
Weighted-average life (in years)	5.9	5.5
Weighted-average constant prepayment rate	20.0%	24.4%
Weighted-average discount rate	8.4%	8.6%

The key economic assumptions used in determining the fair value of MSRs at period end were as follows:

	March 31,	
	2010	**2009**
Weighted-average life (in years)	5.7	4.3
Weighted-average constant prepayment rate	11.3%	23.8%
Weighted-average discount rate	8.7%	7.8%

Table of Contents

Consumer Servicing Assets. Consumer servicing assets represent servicing rights related to HELOC and second mortgage loans that were created in the Company s private-label securitizations. These servicing assets are initially measured at fair value and subsequently accounted for using the amortization method. Under this method, the assets are amortized in proportion to and over the period of estimated servicing income and are evaluated for impairment on a periodic basis. When the carrying value exceeds the fair value, a valuation allowance is established by a charge to loan administration income in the consolidated statement of operations.

The fair value of consumer servicing assets is estimated by using an internal valuation model. This method is based on calculating the present value of estimated future net servicing cash flows, taking into consideration discount rates, actual and expected loan prepayment rates, servicing costs and other economic factors.

Changes in the carrying value of the consumer servicing assets and the associated valuation allowance follow:

	For the Three Months Ended March 31,	
	2010	**2009**
	(Dollars in thousands)	
Consumer servicing assets		
Balance at beginning of period	$ 7,049	$ 9,469
Addition from loans securitized with servicing retained		
Amortization	(418)	(650)
Carrying value before valuation allowance at end of period	6,631	8,819
Valuation allowance		
Balance at beginning of period	(3,808)	
Impairment recoveries (charges)	(176)	(1,548)
Balance at end of period	(3,984)	(1,548)
Net carrying value of servicing assets at end of period	$ 2,647	$ 7,271
Unpaid principal balance of consumer loans serviced for others	$ 905,301	$ 1,141,270
Fair value of servicing assets:		
Beginning of period	$ 3,523	$ 12,284
End of period	$ 2,881	$ 9,278

The key economic assumptions used to estimate the fair value of these servicing assets were as follows:

	March 31,	
	2010	**2009**
Weighted-average life (in years)	2.8	3.8
Weighted-average discount rate	11.4%	11.7%

Contractual Servicing Fees. Contractual servicing fees, including late fees and ancillary income, for each type of loan serviced are presented below. Contractual servicing fees are included within loan administration income on the consolidated statements of operations.

For the Three Months Ended

	March 31,	
	2010	2009
	(Dollars in thousands)	
Residential real estate	$ 37,369	$ 38,486
Consumer	1,174	1,482
Total	$ 38,543	$ 39,968

Table of Contents

Note 12 Other Assets

Other assets are comprised of the following:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Repurchased assets with government insurance [1]	$ 867,660	$ 826,349
Repurchased assets without government insurance	50,735	45,697
Derivative assets, including margin accounts	157,633	202,436
Escrow advances	108,699	102,372
Tax assets, net	78,351	77,442
Servicing sales	90,947	
Other	84,978	77,601
Total other assets	$ 1,439,003	$ 1,331,897

(1) Excludes $441.0 million of Ginnie Mae loans as to which we have the unilateral right to repurchase and which are included in loans available for sale, see Footnote 7.

Note 13 Income Taxes

Federal

Total federal income tax provision (benefit) is allocated as follows:

	For the Three Months Ended March 31, 2010	2009
	(Dollars in thousands)	
Provision (benefit) from operations	$	$ (28,696)
Stockholders equity, for the tax effect of other comprehensive loss		(12,539)
Stockholders equity, for the tax effect of stock-based compensation		453
	$	$ (40,782)

Components of the benefit for federal income taxes from operations consist of the following:

For the Three Months Ended

	March 31, 2010	March 31, 2009
	(Dollars in thousands)	
Current (benefit) provision	$ 116	$ 3
Deferred (benefit) provision	(116)	(28,699)
	$	$ (28,696)

The Company s effective tax rate differs from the statutory federal tax rate. The following is a summary of such differences:

	For the Three Months Ended March 31, 2010	For the Three Months Ended March 31, 2009
	(Dollars in thousands)	
Benefit at statutory federal income tax rate (35%)	$ (27,027)	$ (32,618)
Increases resulting from:		
Valuation allowance	26,122	
Warrant expense	429	3,860
Other	476	62
Provision (benefit) at effective federal income tax rate	$	$ (28,696)

Table of Contents

Deferred income tax assets and liabilities at March 31, 2010 and December 31, 2009 reflect the effect of temporary differences between assets, liabilities and equity for financial reporting purposes and the bases of such assets, liabilities and equity as measured by tax laws, as well as tax loss and tax credit carryforwards.

Temporary differences and carryforwards that give rise to deferred tax assets and liabilities are comprised of the following:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for loan and other losses	$ 273,397	$ 270,779
Tax loss carry forwards	119,407	149,452
Non-accrual interest revenue	28,559	20,814
Premises and equipment	6,141	6,226
Alternative minimum tax credit carry forwards (indefinite carryforward period)	5,211	5,211
Accrued vacation pay	1,950	2,125
Mark-to-market adjustments		
Other	8,880	8,065
	443,545	462,672
Valuation allowance	(227,157)	(201,035)
	216,388	261,637
Deferred tax liabilities:		
Mortgage loan servicing rights	(171,857)	(208,702)
Loan securitizations	(27,703)	(23,655)
Mark-to-market adjustments	(8,864)	(21,477)
Federal Home Loan Bank stock dividends	(6,624)	(6,624)
State income taxes	(1,309)	(1,151)
Other	(31)	(28)
	(216,388)	(261,637)
Net deferred tax asset	$	$

The Company incurred federal net operating loss carry forwards of $206.5 million and $220.5 million in calendar years 2008 and 2009, respectfully. These carry forwards, if unused, expire in calendar years 2028 and 2029.

The Company has not provided deferred income taxes for the Bank s pre-1988 tax bad debt reserve of approximately $4.0 million because it is not anticipated that this temporary difference will reverse in the foreseeable future. Such reserves would only be taken into taxable income if the Bank, or a successor institution, liquidates, redeems shares, pays dividends in excess of earnings and profits, or ceases to qualify as a bank for tax purposes.

The Company regularly reviews the carrying amount of its deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of the Company s deferred tax assets will not be realized in future periods, a deferred tax valuation allowance would be established. Consideration is given to all positive and negative evidence related to the realization of the deferred tax assets.

In evaluating this available evidence, management considers, among other things, historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earning trends and the timing of reversals of temporary differences. The Company s evaluation is based on current tax laws as well as management s expectations of future performance. Furthermore, on January 30, 2009, the Company incurred a change in control within the meaning of Section 382 of the Internal Revenue Code. As a result, federal tax law places an annual limitation of approximately $15.2 million on approximately $224.8 million of the Company s net operating loss carryforwards.

In particular, additional scrutiny should be given to deferred tax assets of an entity that has incurred pre-tax losses during the three most recent years because it is significant negative evidence that is objective and verifiable and therefore difficult to overcome. The Company had pre-tax losses for 2007, 2008, and 2009, and the Company s management considered this factor in its analysis of deferred tax assets. As a result of the Company s analysis, at December 31, 2009 a $201.0 million valuation allowance against its net deferred tax assets with the resulting charge to earnings amounting to $196.9 million was recorded. The remaining $4.1 million is the federal tax effect of the charge to other taxes for the state valuation allowance, discussed below. This effect did not impact earnings. For the quarter ending March 31, 2010, the valuation allowance was increased to $227.2 million, as a result of an increase of $26.1 million in the net deferred tax assets.

The details of the net tax asset recorded as of March 31, 2010 and December 31, 2009 are as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Current tax loss carryback claims	$ 76,603	$ 76,603
Other current, net	(247)	(703)
Current tax asset	76,356	75,900
Net deferred tax asset		
Net tax asset	$ 76,356	$ 75,900

The Company s income tax returns are subject to review and examination by federal, state and local government authorities. On an ongoing basis, numerous federal, state and local examinations are in progress and cover multiple tax years. As of March 31, 2010, the Internal Revenue Service had completed its examination of the Company through the taxable year ended December 31, 2005 and was in process of examining taxable years ending December 31, 2006, 2007, and 2008. The years open to examination by state and local government authorities vary by jurisdiction.

The following table provides a reconciliation of the total amounts of unrecognized tax benefits (dollars in thousands):

	For the three months ended March 31, 2010
Balance at January 1, 2010	$ 1,493
Additions to tax positions recorded during the current year	35
Additions to tax positions recorded during prior years	
Reductions to tax positions recorded during prior years	(46)
Settlements	
Reductions in tax positions due to lapse of statutory limitations	
Balance at March 31, 2010	$ 1,482

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense and/or franchise tax expense. For the three month period ended March 31, 2010, the Company recognized interest expense of approximately $35,000 in its statement of operations and statement of financial condition, respectively. The Company expects the above tax positions to reverse during the next 12 months, principally this amount relates to state tax controversies expected to be settled on resolution of a state tax audits.

State

The Company accrues and pays state taxes in numerous states in which it does business. State tax provisions (benefits) are included in the consolidated statement of operations under non-interest expense-other taxes.

State tax benefits are as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
State tax benefits	$ (2,982)	$ (15,065)
Valuation allowance	2,656	25,700
Net expense (benefits)	$ (326)	$ 10,635

Table of Contents

State deferred tax assets are as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Tax loss carryforwards (expiration dates through 2029)	$ 25,715	$ 27,456
Temporary differences, net	11,974	7,577
	37,689	35,033
Valuation allowance	(37,689)	(35,033)
Net deferred state tax assets	$	$

For reasons discussed above in the Federal income tax portion of this footnote, the Company has recorded a valuation allowance against its state deferred tax assets of $37.7 million as of March 31, 2010 and $35.0 million as of December 31, 2009.

Note 14 Warrant Liabilities

In full satisfaction of the Company s obligations under anti-dilution provisions applicable to certain investors (the May Investors) in the Company s May 2008 private placement capital raise, the Company granted warrants (the May Investor Warrants) to the May Investors on January 30, 2009 for the purchase of 14,259,794 of the Company s common stock at $0.50 per share. The holders of such warrants are entitled to acquire the Company s common shares for a period of ten years. During the three month period ended March 31, 2010, no shares of the Company s common stock were issued upon exercise of May Investor Warrants. As a result of the Company s registered offering of 575 million shares of common stock a price per share of $0.50, the number of shares of the Company s common stock issuable to the May Investors under the May Investor Warrants was increased by 2,666,736 and the exercise price was decreased to $0.50 pursuant to the anti- dilution provisions of the May Investors Warrants. Therefore, at March 31, 2010, the May Investors held warrants to purchase 13,778,137 shares.

Based on management s analysis, the May Investor Warrants do not meet the definition of a contract that is indexed to the Company s own stock under U.S. GAAP. Therefore, the May Investor Warrants are classified as liabilities and are measured at fair value, with changes in fair value recognized through operations.

On January 30, 2009, in conjunction with the capital investments, the Company recorded the May Investor Warrants at their fair value of $6.1 million. Since the issuance of the May Investor Warrants on January 30, 2009 through March 31, 2010, the Company marked these warrants to market which resulted in an increase in the liability of $2.6 million. This increase was recorded as warrant expense and included in non-interest expense under general and administrative. The Company will mark the May Investor Warrants to market quarterly until exercised.

At March 31, 2010, the Company s liability to warrant holders amounted to $6.3 million. This amount relates to the liability for the May Investor Warrants. The warrant liabilities are included within other liabilities in the Company s consolidated statement of financial condition.

On January 30, 2009, the Company sold to the U. S. Treasury, 266,657 shares of the Company s fixed rate cumulative non-convertible perpetual preferred stock for $266.7 million, and a warrant (the Treasury Warrant) to purchase up to approximately 64.5 million shares of the Company s common stock at an exercise price of $0.62 per share, subject to certain anti-dilution and other adjustments. The issuance and the sale of the preferred stock and Treasury Warrant were exempt from the registration requirements of the Securities Act. The preferred stock qualifies as Tier 1 capital and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Treasury Warrant became exercisable upon receipt of stockholder approval on May 26, 2009 and has a 10 year term.

During the first quarter 2009, the Company recorded a Treasury Warrant liability that arose in conjunction with the Company s participation in the Troubled Asset Relief Program (TARP) because the Company did not have available an adequate number of authorized and unissued common shares. As described in Note 15, Stockholders Equity, the Company initially recorded the Treasury Warrant on January 30, 2009 at its fair value of $27.7 million. The warrant was marked to market on March 31, 2009 resulting in an increase to the warrant liability of $9.1 million. Upon stockholder approval on May 26, 2009 to increase the number of authorized common shares, the Company marked the liability to market at that date and reclassified the Treasury Warrant liability to additional paid in capital. The mark to market on May 26, 2009 resulted in an increase to the warrant liability of $12.9 million during the second quarter 2009. This increase was recorded as warrant expense and included in non-interest expense under general and administrative.

Table of Contents

Note 15 Stockholder s Equity

Preferred stock with a par value of $0.01 and a liquidation value of $1,000 and additional paid in capital attributable to preferred shares at March 31, 2010 is summarized as follows:

	Rate	Earliest Redemption Date	Shares Outstanding	Preferred Shares	Additional Paid in Capital
			(Dollars in thousands)		
Series C, TARP Capital Purchase Program	5%	January 31, 2012	266,657	$ 3	$ 245,124
				$ 3	$ 245,124

On January 27, 2010, MP Thrift exercised its rights to purchase 422,535,212 shares of the Company common stock for approximately $300 million in a rights offering to purchase up to 704,234,180 shares of common stock which expired on February 8, 2010. Pursuant to the rights offering, each stockholder of record as of December 24, 2009 received 1.5023 non-transferable subscription rights for each share of common stock owned on the record date and entitled the holder to purchase one share of common stock at the subscription price of $0.71. During the rights offering, the Company stockholders (other than MP Thrift) exercised their rights to purchase 806,950 shares of common stock, which means, in the aggregate, the Company issued 423,342,162 shares of common stock in the rights offering for approximately $300.6 million.

On March 31, 2010, the Company completed a registered offering of 575,000,000 shares of common stock, which included 75,000,000 shares issued pursuant to the underwriters over-allotment option, which was exercised in full on March 29, 2010. The Company issued and sold to the Underwriters 575,000,000 shares of the Company s common stock, $0.01 par value per share. The public offering price of the common stock was $0.50 per share. MP Thrift participated in this registered offering and purchased 200,000,000 shares at $0.50 per shares. The offering resulted in aggregate net proceeds of approximately $276.1 million, after deducting underwriting fees and offering expenses.

Accumulated Other Comprehensive Loss

The following table sets forth the ending balance in accumulated other comprehensive loss for each component:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Net unrealized loss on securities available for sale	$ (39,552)	$ (48,263)
Ending balance	$ (39,552)	$ (48,263)

The following table sets forth the changes to other comprehensive (loss) income and the related tax effect for each component:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Gain (reclassified to earnings) on sales of securities available for sale	$ (2,166)	$ (8556)
Related tax expense	572	2,995
		(50,638)

Loss (reclassified from retained earnings) for adoption of new accounting guidance for investments debt and equity securities other-than- temporary impairments		
Related tax benefit		17,724
Loss (reclassified to earnings) for other-than-temporary impairment of securities available for sale	3,286	20,747
Related tax benefit		(7,261)
Unrealized gain (loss) on securities available for sale	7,019	89,953
Related tax (benefit) expense		(31,485)
Change	$ 8,711	$ 33,479

Table of Contents

Note 16 Derivative Financial Instruments

The Company follows the provisions of derivatives and hedging accounting guidance, which require it to recognize all derivative instruments on the consolidated statements of financial condition at fair value. The following derivative financial instruments were identified and recorded at fair value as of March 31, 2010 and December 31, 2009:

Fannie Mae, Freddie Mac, Ginnie Mae and other forward loan sale contracts;

Rate lock commitments;

Interest rate swap agreements; and

U.S. Treasury futures and options.

The Company hedges the risk of overall changes in fair value of loans held for sale and rate lock commitments generally by selling forward contracts on securities of Fannie Mae, Freddie Mac and Ginnie Mae. The forward contracts used to economically hedge the loan commitments are accounted for as non-designated hedges and naturally offset rate lock commitment mark-to-market gains and losses recognized as a component of gain on loan sale. The Bank recognized loss of $17.0 million versus a gain of $6.7 million for the three months ended March 31, 2010 and 2009 respectively, on its hedging activity relating to loan commitments and loans held for sale. Additionally, the Company hedges the risk of overall changes in fair value of MSRs through the use of various derivatives including purchases forward contracts on securities of Fannie Mae and Freddie Mac and the purchase/sale of U.S. Treasury futures contracts and options on U.S. Treasury futures contracts. These derivatives are accounted for as non-designated hedges against changes in the fair value of MSRs. The Company recognized $29.7 million and $7.1 million for the three months ended March 31, 2010 and 2009, respectively, on MSR fair value hedging activities.

The Company occasionally uses interest rate swap agreements to reduce its exposure to interest rate risk inherent in a portion of the current and anticipated borrowings and advances. A swap agreement is a contract between two parties to exchange cash flows based on specified underlying notional amounts and indices. Under U.S. GAAP, the swap agreements used to hedge the Company s anticipated borrowings and advances qualify as cash flow hedges. Derivative gains and losses reclassed from accumulated other comprehensive (loss) income to current period operations are included in the line item in which the hedge cash flows are recorded. On January 1, 2008, the Company derecognized all cash flow hedges.

The Company had the following derivative financial instruments:

	March 31, 2010		
	Notional Amounts	Fair Value	Expiration Dates
	(Dollars in thousands)		
Mortgage banking derivatives:			
Rate lock commitments	$1,849,934	$13,085	2010
Forward agency and loan sales	2,830,863	7,709	2010
Mortgage servicing rights:			
U.S. Treasury and agency futures	2,495,000	(1,685)	2010
Borrowings and advances hedges:			
Interest rate swaps (LIBOR)	25,000	(526)	2010

	December 31, 2009		
	Notional Amounts	Fair Value	Expiration Dates
	(Dollars in thousands)		
Mortgage Banking Derivatives:			
Rate lock commitments	$1,418,730	$ 10,061	2010

Forward agency and loan sales	3,007,252	27,764	2010
Mortgage servicing rights:			
U.S. Treasury and agency futures	4,900,000	(49,228)	2010
Borrowings and advances hedges:			
Interest rate swaps (LIBOR)	25,000	(747)	2010

Table of Contents

Counterparty Credit Risk

The Bank is exposed to credit loss in the event of non-performance by the counterparties to its various derivative financial instruments. The Company manages this risk by selecting only well-established, financially strong counterparties, spreading the credit risk among such counterparties, and by placing contractual limits on the amount of unsecured credit risk from any single counterparty.

Note 17 Segment Information

The Company s operations are broken down into two business segments: banking and home lending. Each business operates under the same banking charter but is reported on a segmented basis for this report. Each of the business lines is complementary to each other. The banking operation includes the gathering of deposits and investing those deposits in duration-matched assets primarily originated by the home lending operation. The banking group holds these loans in the investment portfolio in order to earn income based on the difference or spread between the interest earned on loans and the interest paid for deposits and other borrowed funds. The home lending operation involves the origination, packaging, and sale of loans in order to receive transaction income. The lending operation also services mortgage loans for others and sells MSRs into the secondary market. Funding for the lending operation is provided by deposits and borrowings garnered by the banking group. All of the non-bank consolidated subsidiaries are included in the banking segment. No such subsidiary is material to the Company s overall operations.

Following is a presentation of financial information by business segment for the period indicated:

	For the Three Months Ended March 31, 2010			
2010:	**Bank Operations**	**Home Lending Operations**	**Elimination**	**Combined**
	(Dollars in thousands)			
Net interest income	$ 48,527	$ (10,844)	$	$ 37,683
(Loss) gain on sale revenue	2,166	47,041		49,207
Other income (loss)	9,821	12,970		22,791
Total net interest income and non-interest income	60,514	49,167		109,681
(Loss) earnings before federal income taxes	(62,018)	(15,202)		(77,220)
Depreciation and amortization	2,041	3,607		4,648
Capital expenditures	39	2,783		2,822
Identifiable assets	12,570,739	4,512,103	(2,750,000)	14,332,842
Inter-segment income (expense)	20,625	(20,625)		

	For the Three Months Ended March 31, 2009			
2009:	**Bank Operations**	**Home Lending Operations**	**Elimination**	**Combined**
	(Dollars in thousands)			
Net interest income	$ 49,273	$ 7,457	$	$ 56,730
(Loss) gain on sale revenue	(17,242)	206,824		189,582
Other income (loss)	31,026	(29,649)		1,377
Total net interest income and non-interest income	63,057	184,632		247,689
(Loss) earnings before federal income taxes	(145,334)	52,140		(93,194)
Depreciation and amortization	2,563	3,213		5,776
Capital expenditures	1,085	3,702		4,787

Identifiable assets	15,193,765	6,471,052	(4,855,000)	16,809,817
Inter-segment income (expense)	36,413	(36,413)		

Revenues are comprised of net interest income (before the provision for loan losses) and non-interest income. Non-interest expenses are fully allocated to each business segment. The intersegment income (expense) consists of interest expense incurred for intersegment borrowing.

Table of Contents

Note 18 Stock-Based Compensation

For the three months ended March 31, 2010 and 2009, the Company recorded stock-based compensation expense of $3.8 million and $0.3 million, respectively.

Stock Options

The following tables summarize the activity that occurred for the three month period ended:

	Number of Shares March 31, 2010
Options outstanding, beginning of year	964,316
Options granted	13,259,786
Options exercised	
Options canceled, forfeited and expired	(143,712)
Options outstanding, at March 31, 2010	14,080,390
Options exercisable, at March 31, 2010	945,290

The total intrinsic value of options exercised during the three month period ended March 31, 2010 was zero.

	Weighted Average Exercise Price March 31, 2010
Options outstanding, beginning of year	$ 14.13
Options granted	0.80
Options exercised	
Options canceled, forfeited and expired	3.03
Options outstanding, at March 31, 2010	$ 1.69
Options exercisable, at March 31, 2010	$ 14.06

The following information pertains to the stock options issued pursuant to the Company s 1997 Employees and Directors Stock Option Plan, 2000 Stock Incentive Plan and 1997 Incentive Compensation Plan, which were consolidated, amended and restated into the 2006 Equity Incentive Plan (the 2006 Plan), but not exercised at March 31, 2010:

	Options Outstanding			Options Exercisable	
Range of Grant Price	Number of Options Outstanding at March 31, 2010	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at March 31, 2010	Weighted Average Exercise Price
$ 0.80 - 1.96	13,253,719	9.73	$ 0.81	118,619	$ 1.78
5.01	40,552	1.14	5.01	40,552	5.01

11.80 - 12.27	463,383	2.44	11.94	463,383	11.94
15.23	4,500	2.33	15.23	4,500	15.23
19.35	11,429	5.15	19.35	11,429	19.35
20.06 - 20.73	85,348	4.77	20.67	85,348	20.67
22.68 - 24.72	221,459	3.51	23.87	221,459	23.87
	14,080,390			945,290	

At March 31, 2010, options available for future grants were 14,894,540. Shares issued under the 2006 Plan may consist, in whole or in part, of authorized and unissued shares or treasury shares. The Company does not expect a material cash outlay relating to obtaining shares expected to be issued under the 2006 Plan during 2010.

Cash-settled Stock Appreciation Rights

The Company issues cash-settled stock appreciation rights (SARs) to officers and key employees in connection with year-end compensation. Cash-settled SARs generally vest at the rate of 25% of the grant on each of the first four annual anniversaries of the grant date. The standard term of a SAR is seven years beginning on the grant date. Grants of SARs may be settled only in cash and once made, may not be later amended or modified to be settled in common stock or a combination of common stock and cash.

The Company used the following weighted average assumptions in applying the Black-Scholes model to determine the fair value of the SARs it issued during the three months ended March 31, 2010: dividend yield of zero; expected volatility range of 109.3% to 137.8%; a risk-free rate range of 0.8% to 1.8%; and an expected life range of 1.7 years to 3.3 years.

The following table presents the status and changes in cash-settled stock appreciation rights issued under the 2006 Plan:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
Stock Appreciation Rights Awarded:			
Non-vested balance at December 31, 2009	386,615	$ 9.86	$ 0.12
Granted			
Vested	(156,206)	10.98	0.11
Forfeited	(7,630)	9.17	0.13
Non-vested balance at March 31, 2010	222,779	9.10	0.13

The Company recognized expense of $3,000 and $67,000 with respect to SARs during the three months ended March 31, 2010 and 2009, respectively. At March 31, 2010, the non-vested SARs have a total compensation cost of approximately $29,000 expected to be recognized over the weighted average remaining vesting period of approximately two years.

Restricted Stock Units

The Company issues restricted stock units to officers, directors and key employees in connection with year-end compensation. Restricted stock generally will vest in 33% increments on each annual anniversary of the date of grant beginning with the first anniversary. At March 31, 2010, the maximum number of shares of common stock that may be issued under the 2006 Plan as the result of any grants is 41,485,460 shares. The Company incurred expenses of approximately $0.4 million and $0.2 million with respect to restricted stock units during the three months ended March 31, 2010, and 2009, respectively. As of March 31, 2010, restricted stock units had a market value of $5.0 million.

	Shares	Weighted -Average Grant-Date Fair Value per Share
Restricted Stock:		
Nonvested at December 31, 2009	52,262	$ 6.86
Granted	8,385,845	0.63
Vested	(51,612)	6.86
Canceled and forfeited	(650)	6.86

Nonvested at March 31, 2010	8,385,845	0.63

On September 29, 2009, the Company offered a share purchase plan to one of its key executives. The plan requires the executive to purchase 1,987,500 shares of common stock at a purchase price of $1.05 per share (the closing price of the common stock on September 28, 2009). As of March 31, 2010, 525,000 shares have been purchased through this plan.

Incentive Compensation Plan

The Incentive Compensation Plan (Incentive Plan) is administered by the compensation committee of the board of directors. Each year the committee decides which employees of the Company will be eligible to participate in the Incentive Plan and the size of the bonus pool. The Company incurred expenses of $75,000 for the three month period ended March 31, 2010.

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

Where we say we, us, or our, we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to we, us, or our will include our wholly-owned subsidiary Flagstar Bank, FSB, and Flagstar Capital Markets Corporation (FCMC), its wholly-owned subsidiary, which we collectively refer to as the Bank.

General

We are a Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, Flagstar Bank, FSB, a federally chartered stock savings bank. At March 31, 2010, our total assets were $14.3 billion, making us the largest publicly held savings bank in the Midwest and one of the top 15 largest savings banks in the United States. We are considered a controlled company for New York Stock Exchange (NYSE) purposes because MP Thrift Investments, L.P. (MP Thrift) held approximately 80% of our voting common stock as of December 31, 2009 and approximately 67.9% as of March 31, 2010. On April 1, 2010, following the conversion of trust preferred securities to our common stock, MP Thrift held 69.2% of our voting common stock.

As a savings and loan holding company, we are subject to regulation, examination and supervision by the Office of Thrift Supervision (OTS) of the United States Department of the Treasury (Treasury). The Bank is a member of the Federal Home Loan Bank of Indianapolis (FHLBI) and is subject to regulation, examination and supervision by the OTS and the Federal Deposit Insurance Corporation (FDIC). The Bank s deposits are insured by the FDIC through the Deposit Insurance Fund (DIF).

We operate 162 banking centers (of which 27 are located in retail stores), including 113 located in Michigan, 22 located in Indiana and 27 located in Georgia. Through our banking centers, we gather deposits and offer a line of consumer and commercial financial products and services to individuals and to small and middle market businesses. We also gather deposits on a nationwide basis through our website, FlagstarDirect.com, and provide deposit and cash management services to governmental units on a relationship basis throughout our markets. We leverage our banking centers and internet banking to cross sell other products to existing customers and increase our customer base. At March 31, 2010, we had a total of $8.2 billion in deposits, including $5.1 billion in retail deposits, $0.7 billion in government funds, $1.8 billion in wholesale deposits and $0.6 billion in company-controlled deposits.

We also operated 23 stand-alone home loan centers located in 14 states, which originate one-to-four family residential mortgage loans as part of our retail home lending business. These offices employ approximately 162 loan officers. We also originate retail loans through referrals from our 162 retail banking centers, consumer direct call center and our website, flagstar.com. Additionally, we have wholesale relationships with approximately 3,300 mortgage brokers and nearly 1,200 correspondents, which are located in all 50 states and serviced by 152 account executives. The combination of our retail, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our first mortgage loan products. Our servicing activities primarily include collecting cash for principal, interest and escrow payments from borrowers, and accounting for and remitting principal and interest payments to investors and escrow payments to third parties. With over $32.3 billion in mortgage originations in 2009, we are ranked by industry sources as the 12^{th} largest mortgage originator in the nation with a 1.6% market share.

Our earnings include net interest income from our retail banking activities, fee-based income from services we provide our customers, and non-interest income from sales of residential mortgage loans to the secondary market, the servicing of loans for others, and the sale of servicing rights related to mortgage loans serviced for others. Approximately 99.8% of our total loan production during the three months ended March 31, 2010 represented mortgage loans that were collateralized by first or second mortgages on single-family residences and were eligible for sale through U.S. government-sponsored entities, or GSEs (a term generally used to refer collectively or singularly to Fannie Mae, Freddie Mac and Ginnie Mae).

At March 31, 2010, we had 3,241 full-time equivalent salaried employees of which 314 were account executives and loan officers.

Operating Segments

Our business is comprised of two operating segments banking and home lending. Our banking operation currently offers a line of consumer and commercial financial products and services to individuals and to small and middle market businesses. Our strategy provides that we will significantly expand the offering of many of these products within our retail footprint, including consumer loans, business loans and deposits, and cash management services. This expansion is expected to occur through our network of bank branches and on-line services, as well as through teams of business and middle market bankers. Our home lending operation originates, acquires, sells and services mortgage loans on one-to-four family residences. Each operating segment supports and complements the operations of the other, with funding for the home lending operation primarily provided by deposits and borrowings obtained through the banking operation. Financial information regarding our two operating segments is set forth in Note 17 of the Notes to Consolidated Financial Statements, in Item 1. Financial Statements and Supplementary Data. A discussion of our two operating segments is set forth below.

Banking Operation. Our banking operation is composed of three delivery channels: Branch Banking, Internet Banking and Government Banking.

Branch Banking consists of 162 banking centers located throughout the State of Michigan and also in Indiana (principally in the Indianapolis Metropolitan Area) and Georgia (principally in the north Atlanta suburbs).

Internet Banking is engaged in deposit gathering (principally money market deposit accounts and certificates of deposits) on a nationwide basis, delivered primarily through FlagstarDirect.com.

Government Banking is engaged in providing deposit and cash management services to governmental units on a relationship basis throughout key markets, including Michigan and Indiana and, to a lesser degree, in Georgia.

In addition to deposits, we may borrow funds by obtaining advances from the FHLBI or other federally backed institutions or by entering into repurchase agreements with correspondent banks using as collateral our mortgage-backed securities that we hold as investments. The banking operation may invest these funds in a variety of consumer and commercial loan products.

Home Lending Operation. Our home lending operation originates, acquires, sells and services one-to-four family residential mortgage loans. The origination or acquisition of residential mortgage loans constitutes our most significant lending activity. At March 31, 2010, we held approximately 58.3% of our interest-earning assets in first mortgage loans on single-family residences.

During 2009 and continuing into 2010, we were one of the country s leading mortgage loan originators. We utilize three production channels to originate or acquire mortgage loans Retail, Broker and Correspondent. Each production channel produces similar mortgage loan products and applies, in most instances, the same underwriting standards. We expect to continue to leverage our technology to streamline the mortgage origination process and bring service and convenience to our brokers and correspondents. We maintain eight sales support offices that assist our brokers and correspondents nationwide. We also continue to make increasing use of the Internet as a tool to facilitate the mortgage loan origination process through our production channels. Our brokers, correspondents and home loan centers are able to register and lock loans, check the status of in-process inventory, deliver documents in electronic format, generate closing documents, and request funds through the Internet. Virtually all mortgage loans that closed in 2010 used the Internet in the completion of the mortgage origination or acquisition process.

Retail. In a retail transaction, we originate the loan through our nationwide network of stand-alone home loan centers, as well as referrals from our 162 banking centers located in Michigan, Indiana and Georgia and our national call center located in Troy, Michigan. When we originate loans on a retail basis, we complete the origination documentation inclusive of customer disclosures and other aspects of the lending process and fund the transaction internally. At March 31, 2010, we maintain 23 stand-alone home loan centers. In 2010, we expect to allocate additional, dedicated home lending resources towards developing lending capabilities in our 162 banking centers and our consumer direct channel. At the same time, we centralized our loan processing to gain efficiencies and allow our lending staff to focus on originations. For the three months ended March 31, 2010 we closed $413.7 million of loans utilizing this origination channel, which equaled 9.6% of total originations as compared to $1.2 billion or 12.2% of total originations for the same period in 2009.

Broker. In a broker transaction, an unaffiliated mortgage brokerage company completes the loan paperwork, but the loans are underwritten on a loan-level basis to our underwriting standards and we supply the funding for the loan at closing (also known as table funding) thereby becoming the lender of record. At closing, the broker may receive an origination fee from the borrower and we may also pay the broker a premium to acquire the loan. We currently have active broker relationships with over 3,300 mortgage brokerage companies located in all 50 states. For the three months ended March 31, 2010, we closed $1.7 billion utilizing this origination channel, which equaled 38.4% of total originations, as compared to $4.0 billion or 42.7% for the same period in 2009.

Correspondent. In a correspondent transaction, an unaffiliated mortgage company completes the loan paperwork and also supplies the funding for the loan at closing. We acquire the loan after the mortgage company has funded the transaction, usually paying the mortgage company a market price for the loan. Unlike several of our competitors, we do not generally acquire loans in bulk amounts from correspondents but rather, we acquire each loan on a loan-level basis and require that each loan be originated to our underwriting guidelines. We have active correspondent relationships with over 1,200 companies, including banks and mortgage companies, located in all 50 states. Over the years, we have developed what we believe to be a competitive advantage as a warehouse lender, wherein we provide lines of credit to mortgage companies to fund their loans. Warehouse lending is not only a profitable, stand-alone business for us, but also provides valuable synergies with our correspondent channel. In today s marketplace, there is high demand for warehouse lending, but we believe that there are only a limited number of experienced providers. We believe that offering warehouse lines has provided us a competitive advantage in the small to midsize correspondent channel and has helped us grow and build out our correspondent business in a profitable manner. For example, in

2010, our warehouse lines funded over 79.0% of the loans in our correspondent channel. We plan to continue to leverage our warehouse lending for customer retention throughout the remainder of 2010. For the three months ended March 31, 2010, we closed $2.2 billion utilizing the correspondent origination channel, which equaled 52.0% of total originations versus $4.3 billion or 45.1% originated for the same period in 2009.

Underwriting. In past years, we originated a wide variety of residential mortgage loans, both for sale and for our own portfolio, including fixed rate first and second lien mortgage loans, adjustable rate mortgages (ARMs), interest only mortgage loans both ARM and fixed, and to a far lesser extent, potential negative amortization payment option ARMs (option power ARMs), subprime loans, and home equity lines of credit (HELOCs). We also originated commercial real estate loans for our own portfolio.

As a result of our increasing concerns about nationwide economic conditions, in 2007, we began to reduce the number and types of loans that we originated for our own portfolio in favor of sale into the secondary market. In 2008, we halted originations of virtually all types of loans for our held-for-investment portfolio and focused on the origination of residential mortgage loans for sale.

During the three months ended March 31, 2010, we primarily originated residential mortgage loans for sale that conformed to the respective underwriting guidelines established by the U.S. government sponsored agencies. Loans placed in the held-for-investment portfolio in the three months ended March 31, 2010 would comprise either loans that were repurchased or, on a very limited basis, loans that were originated to assist with the sale of our real estate owned (REO). During 2010, we will continue with the same mortgage origination offerings and will have the same limited level of loans placed into the held-for-investment portfolio.

First Mortgage Loans

At March 31, 2010, most of our held-for-investment mortgage loans were originated in prior years with underwriting criteria that varied by product and with the standards in place at the time of origination.

Set forth below is a table describing the characteristics of the first mortgage loans in our held-for-investment portfolio at March 31, 2010, by year of origination.

Year of Origination	**2007 and Prior**	**2008**	**2009**	**2010**	**Total**
			(Dollars in thousands)		
Unpaid principal balance [(1)]	$4,606,702	$115,680	$37,318	$1,871	$4,761,571
Average note rate	5.47%	6.09%	5.43%	5.17%	5.48%
Average original FICO score	716	680	688	675	715
Average original loan-to-value ratio	74.8%	84.1%	88.7%	75.9%	75.1%
Average original combined loan-to- value ratio	78.3%	85.2%	91.0%	80.1%	78.5%
Underwritten with low or stated income documentation	41.0%	17.0%	3.0%	%	40.0%

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

First mortgage loans are underwritten on a loan-by-loan basis rather than on a pool basis. Generally, mortgage loans produced through our production channels are reviewed by one of our in-house loan underwriters or by a contract underwriter employed by a mortgage insurance company. However, a limited number of our correspondents have been delegated underwriting authority but this has not comprised more than 12% of the loans originated in any year. In all cases, loans must be underwritten to our underwriting standards. Any loan not underwritten by our employees must be warranted by the underwriter s employer, which may be a mortgage insurance company or a correspondent mortgage company with delegated underwriting authority. For further information, please refer to our annual report on form 10-K for the year ended December 31, 2009.

The following table identifies, at March 31, 2010, our held-for-investment mortgages by major category and describes the current portfolio with unpaid principal balance, average note rate, average original FICO score, average original combined loan-to-value ratio (CLTV), the weighted average maturity and the related housing price index. The housing price index (HPI) loan-to-value (LTV) is updated from the original LTV based on Metropolitan Statistical Area-level Office of Federal Housing Enterprise Oversight data. Within the first lien residential mortgage loan portfolio, high LTV loan originations, defined as loans with a 95% LTV or greater at origination, comprised only 2.7% of our held-for-investment loan portfolio. Our risk of loss on these loans is mitigated because private mortgage insurance was required on the vast majority of loans with LTVs exceeding 80% at the time of origination.

Table of Contents

	Unpaid Principal Balance (1)	Average Note Rate	Average Original FICO Score	Average Original Combined Loan-to-Value Ratio	Weighted Average Maturity	Housing Price Index LTV
	(Dollars in thousands)					
First mortgage loans:						
Amortizing:						
3/1 ARM	235,546	4.74%	684	83.5%	280	85.1%
5/1 ARM	581,340	4.97%	713	77.0%	295	76.7%
7/1 ARM	72,991	5.67%	726	76.1%	302	85.6%
Other ARM	110,000	4.59%	671	84.5%	268	82.9%
Other amortizing	927,213	6.19%	709	76.4%	283	84.9%
Interest only:						
3/1 ARM	368,680	4.98%	722	81.8%	268	87.7%
5/1 ARM	1,537,916	5.27%	721	79.0%	295	87.2%
7/1 ARM	128,195	6.08%	727	75.4%	303	93.3%
Other ARM	78,907	4.97%	720	83.1%	302	92.8%
Other interest only	454,815	6.18%	723	77.7%	311	98.2%
Option ARMs	259,833	5.71%	720	76.8%	320	103.5%
Subprime						
3/1 ARM	1,839	7.71%	646	97.8%	295	118.5%
Other ARM	2,094	6.95%	600	85.2%	235	107.4%
Other subprime	2,203	6.85%	580	81.2%	276	96.6%
Total first mortgage loans	4,761,572	5.48%	715	78.5%	293	87.5%
Second mortgages	209,654	8.34%	733	89.5%(2)	150	22.9%(3)
HELOCs	288,761	5.32%	740	80.1%(2)	71	26.4%(3)

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

(2) Reflects LTV because these are second liens.

(3) Does not reflect any first mortgages that may be outstanding. Instead,

incorporates current loan balance as a portion of current HPI value.

The following table sets forth characteristics of those loans in our held-for-investment mortgage portfolio, which includes first mortgages, second mortgages and HELOCs, as of March 31, 2010 that were originated with less documentation than is currently required. Loans as to which underwriting information was accepted from a borrower without validating that particular item of information is referred to as low doc or stated. Substantially all of those loans were underwritten with verification of employment but with the related job income or personal assets, or both, stated by the borrower without verification of actual amount. Those loans may have additional elements of risk because information provided by the borrower in connection with the loan was limited. Loans as to which underwriting information was supported by third party documentation or procedures is referred to as full doc and the information therein is referred to as verified. Also set forth are different types of loans that may have a higher risk of non-collection than other loans.

	Low Doc	
	% of Held-for-Investment Portfolio	Unpaid Principal Balance (1)
	(Dollars in thousands)	
Characteristics:		
SISA (stated income, stated asset)	17.17%	$ 1,296,991
SIVA (stated income, verified assets)	2.58%	$ 194,806
High LTV (i.e., at or above 95%)	0.26%	$ 19,706
Second lien products (HELOCs, Second mortgages)	1.88%	$ 142,184
Loan types:		
Option ARM loans	2.42%	$ 182,473
Interest-only loans	14.70%	$ 1,110,561
Subprime (2)	0.04%	$ 3,075

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

(2) Includes loans with a FICO score of less than 620.

ARMs

ARM loans held for investment were originated using Fannie Mae and Freddie Mac guidelines as a base framework, and the debt-to-income ratio guidelines and documentation typically followed the AUS guidelines. Our underwriting guidelines were designed with an intent to minimize layered risk. The maximum ratios allowable for purposes of both the LTV ratio and the CLTV ratio, which includes second mortgages on the same collateral, was 100%, but subordinate (i.e., second mortgage) financing was not allowed over a 90% LTV ratio. At a 100% LTV ratio with private mortgage insurance, the minimum acceptable FICO score, or the floor, was 700, and at lower LTV ratio levels, the FICO floor was 620. All occupancy and specific-purpose loan types were allowed at lower LTVs. At times ARMs were underwritten at an initial rate, also known as the start rate, that was lower than the fully indexed rate but only for loans with lower LTV ratios and higher FICO scores. Other ARMs were either underwritten at the note rate if the initial fixed term was two years or greater, or at the note rate plus two percentage points if the initial fixed rate term was six months to one year.

Adjustable rate loans were not consistently underwritten to the fully indexed rate until the Interagency Guidance on Nontraditional Mortgage Products issued by the federal banking regulatory agencies was released in 2006. Teaser rates (i.e., in which the initial rate on the loan was discounted from the otherwise applicable fully indexed rate) were only offered for the first three months of the loan term, and then only on a portion of ARMs that had the negative amortization payment option available and HELOCs. Due to the seasoning of our portfolio, all borrowers have adjusted out of their teaser rates at this time.

Option power ARMs, which comprised 5.5% of the first mortgage portfolio as of March 31, 2010, are adjustable rate mortgage loans that permit a borrower to select one of three monthly payment options when the loan is first originated: (i) a principal and interest payment that would fully repay the loan over its stated term, (ii) an interest-only payment that would require the borrower to pay only the interest due each month but would have a period (usually 10 years) after which the entire amount of the loan would need to be repaid (i.e., a balloon payment) or refinanced, and (iii) a minimum payment amount selected by the borrower and which might exclude principal and some interest, with the unpaid interest added to the balance of the loan (i.e., a process known as negative amortization).

Option power ARMS were originated with maximum LTV and CLTV ratios of 95%; however, subordinate financing was only allowed for LTVs of 80% or less. At higher LTV/CLTV ratios, the FICO floor was 680, and at lower LTV levels the FICO floor was 620. All occupancy and purpose types were allowed at lower LTVs. The negative amortization cap, i.e., the sum of a loan s initial principal balance plus any deferred interest payments, divided by the original principal balance of the loan, was generally 115%, except that the cap in New York was 110%. In addition, for the first five years, when the new monthly payment due is calculated every twelve months, the monthly payment amount could not increase more than 7.5% from year to year. By 2007, option power ARMs were underwritten at the fully indexed rate rather than at a start rate. At March 31,

Table of Contents

2010, we had $259.8 million of option power ARM loans in our held-for-investment loan portfolio, and the amount of negative amortization reflected in the loan balances at March 31, 2010 was $16.0 million. The maximum balance that all option power ARMs could reach cumulatively is $282.5 million.

Set forth below is a table describing the characteristics of our ARM loans in our held-for-investment mortgage portfolio at March 31, 2010, by year of origination.

Year of Origination	**2007 and Prior**	**2008**	**2009**	**2010**	**Total**
	(Dollars in thousands)				
Unpaid principal balance (1)	$ 3,314,969	$ 47,194	$ 13,308	$ 1,871	$ 3,377,342
Average note rate	5.19%	5.78%	5.15%	5.17%	5.20%
Average original FICO score	716	716	687	675	716
Average original loan-to-value ratio	75.2%	80.7%	84.1%	75.9%	75.3%
Average original combined loan-to-value ratio	79. 1%	84.2%	91.4%	81.0%	79.2%
Underwritten with low or stated income documentation	41.0%	22.0%	10.0%	%	40.0%

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

Set forth below is a table describing specific characteristics of option power ARMs in our held-for-investment mortgage portfolio at March 31, 2010, by year of origination:

Year of Origination	**2007 and Prior**	**2008**	**2009**	**2010**	**Total**
		(Dollars in thousands)			
Unpaid principal balance (1)	$259,833	$	$	$	$259,833
Average note rate	5.71%				5.71%
Average original FICO score	720				720
Average original loan-to-value ratio	72.6%				72.6%
Average original combined loan-to- value ratio	76.8%				76.8%
Underwritten with low or stated income documentation	$182,473	$	$	$	$182,473
Total principal balance with any accumulated negative amortization ($)	$245,660	$	$	$	$245,660
Percentage of total ARMS with any accumulated negative amortization	7.0%				7.0%
Amount of negative amortization (i.e., deferred interest) accumulated as interest income as of 3/31/10	$ 16,046	$	$	$	$ 16,046

(1) Unpaid principal balance does not include

premiums or discounts.

Set forth below are the accumulated amounts of interest income arising from the net negative amortization portion of loans at March 31:

	Unpaid Principal Balance of Loans in Negative Amortization at Period End (1)	**Amount of Net Negative Amortization Accumulated as Interest Income During Period**
	(Dollars in thousands)	
2010	$259,833	$ 16,046
2009	$301,370	$ 15,369
2008	$105,805	$ 4,987

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

Table of Contents

Set forth below are the frequencies at which the ARM loans outstanding at March 31, 2010, will reprice:

Reset frequency	# of Loans	Balance	% of the Total
		(Dollars in thousands)	
Monthly	317	$ 88,161	2.9%
Semi-annually	6,160	2,165,226	70.5%
Annually	4,661	816,157	26.6%
Total	11,138	$ 3,069,544	100. 0%

Set forth below as of March 31, 2010, are the amounts of the ARM loans in our held-for-investment loan portfolio with interest rate reset dates in the periods noted. As noted in the above table, loans may reset more than once over a three-year period. Accordingly, the table below may include the same loans in more than one period:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
	(Dollars in thousands)			
2010	$ 401,724 (2)	$ 726,975	$ 899,383	$ 948,143
2011	$ 933,266	$ 999,622	$ 949,452	$1,036,482
2012	$1,043,456	$1,239,808	$1,221,727	$1,233,930
Later years (1)	$1,232,529	$1,267,919	$1,264,222	$1,283,978

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

(2) Reflects loans that have reset through March 31, 2010.

The ARM loans were originated with interest rates that are intended to adjust (i.e., reset or reprice) within a range of an upper limit, or cap, and a lower limit, or floor.

Generally, the higher the cap, the more likely a borrower s monthly payment could undergo a sudden and significant increase due to an increase in the interest rate when a loan reprices. Such increases could result in the loan becoming delinquent if the borrower was not financially prepared at that time to meet the higher payment obligation. In the current lower interest rate environment, ARM loans have generally repriced downward, providing the borrower with a lower monthly payment rather than a higher one. As such, these loans would not have a material change in their likelihood of default due to repricing.

Interest Only Mortgages

Both adjustable and fixed term loans were offered with a 10-year interest only option. These loans were originated using Fannie Mae and Freddie Mac guidelines as a base framework. We generally applied the debt-to-income ratio guidelines and documentation using the AUS Approve/Accept response requirements. The LTV and CLTV maximum ratios allowable were 95% and each 100%, respectively, but subordinate financing was not allowed over a 90% LTV ratio. At a 95% LTV ratio with private mortgage insurance, the FICO floor was 660, and at lower LTV levels, the FICO floor was 620. All occupancy and purpose types were allowed at lower LTVs. Lower LTV and high FICO ARMs were underwritten at the start rate, while other ARMs were either underwritten at the note rate if the initial fixed term was two years or greater, and the note rate plus two percentage points if the initial fixed rate term was six months to one year.

Set forth below is a table describing the characteristics of the interest-only mortgage loans at the dates indicated in our held-for-investment mortgage portfolio at March 31, 2010, by year of origination.

Year of Origination	**2007 and Prior**	**2008**	**2009**	**2010**	**Total**
		(Dollars in thousands)			
Unpaid principal balance [1]	$ 2,546,989	$ 20,691	$ 832	$	$ 2,568,512
Average note rate	5.42%	6.27%	3.66%		5.42%
Average original FICO score	722	747	617		722
Average original loan-to-value ratio	74.7%	79.1%	78.0%		74.7%
Average original combined loan-to-value ratio	79.1%	79.6%	78.0%		79.1%
Underwritten with low or stated Income documentation	43.0%	22.0%			43.0%

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

Table of Contents

Second Mortgages

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

Set forth below is a table describing the characteristics of the second mortgage loans in our held-for-investment portfolio at March 31, 2010, by year of origination.

Year of Origination	**Prior to 2008**	**2008**	**2009**	**2010**	**Total**
			(Dollars in thousands)		
Unpaid principal balance (1)	$192,071	$15,584	$1,792	$ 206	$209,653
Average note rate	8.38%	8.08%	6.98%	6.96%	8.34%
Average original FICO score	732	751	715	731	733
Average original loan-to-value ratio	20.1%	19.0%	17.2%	18.9%	20.0%
Average original combined loan-to-value ratio	90.2%	79.7%	94.1%	98.9%	89.5%

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

HELOCs

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

Set forth below is a table describing the characteristics of the HELOCs in our held-for-investment portfolio at March 31, 2010, by year of origination.

Year of Origination	**2007 and Prior**	**2008**	**2009**	**2010**	**Total**
			(Dollars in thousands)		
Unpaid principal balance (1)	$265,210	$22,986	$ 527	$ 38	$288,761
Average note rate (2)	5.42%	4.13%	6.18%	5.51%	5.32%
Average original FICO score	737	755	N/A	N/A	740

Average original loan-to-value ratio	24.9%	27.5%	18.9%	9.0%	25.1%
Average original combined loan-to-value ratio	82.0%	74.4%	73.7%	71.1%	81.0%

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

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

Commercial Loans

Our commercial loan portfolio is primarily comprised of seasoned commercial real estate loans that are collateralized by real estate properties intended to be income-producing in the normal course of business. During 2006 and 2007, we placed an increased emphasis on commercial real estate lending and on the expansion of our commercial lending business as a diversification from our national residential mortgage lending platform. During 2008 and 2009, as a result of continued economic and regulatory concerns, we funded commercial loans that had previously been underwritten and approved but otherwise halted new commercial lending activity.

The primary factors considered in past commercial credit approvals were the financial strength of the borrower, assessment of the borrower s management capabilities, industry sector trends, type of exposure, transaction structure, and the general economic outlook. Commercial loans were made on a secured, or in limited cases, on an unsecured basis, with a vast majority also being enhanced by personal guarantees of the principals of the borrowing business. Assets used as collateral for secured commercial loans required an appraised value sufficient to satisfy our loan-to-value ratio requirements. We also generally required a minimum debt-service-coverage ratio, other than for development loans, and considered the enforceability and collectability of any relevant guarantees and the quality of the collateral.

As a result of the steep decline in originations, in early 2009, the commercial lending division completed its transformation from a production orientation into one in which the focus is on working out troubled loans, reducing classified assets and taking pro-active steps to prevent deterioration in performing loans. Toward that end, commercial loan officers were largely replaced by experienced workout officers and relationship managers. A comprehensive review, including customized workout plans, were prepared for all classified loans, and risk assessments were prepared on a loan level basis for the entire commercial real estate portfolio.

At March 31, 2010, our commercial real estate loan portfolio totaled $1.6 billion, or 14.1% of our investment loan portfolio, and our non-real estate commercial loan portfolio was $11.8 million, or 0.1% of our investment loan portfolio. At March 31, 2009, our commercial real estate loan portfolio totaled $1.8 billion, or 12.0% of our investment loan portfolio, and our non-real estate commercial loan portfolio was $25.3 million, or .0.2% of our investment loan portfolio. During 2010, we only originated $0.8 million of new commercial loans versus $23.4 million for the same period in 2009.

At March 31, 2010, our commercial real estate loans were geographically concentrated in a few states, with approximately $872.6 million (55.6%) of all commercial loans located in Michigan, $237.7 million (15.2%) located in Georgia and $88.0 million (5.6%) located in Indiana.

The average loan balance in our commercial real estate portfolio was approximately $1.8 million, with the largest loan being $42.0 million. There are approximately 24 loans with more than $10.0 million of exposure, and those loans comprise approximately 25.0% of the portfolio.

In commercial lending, ongoing credit management is dependent upon the type and nature of the loan. We monitor all significant exposures on a regular basis. Internal risk ratings are assigned at the time of each loan approval and are assessed and updated with each monitoring event. The frequency of the monitoring event is dependent upon the size and complexity of the individual credit, but in no case less frequently than every 12 months. Current commercial collateral values are updated more frequently if deemed necessary as a result of impairments of specific loan or other credit or borrower specific issues. We continually review and adjust our risk rating criteria and rating determination process based on actual experience. This review and analysis process also contributes to the determination of an appropriate allowance for loan loss amount for our commercial loan portfolio.

We also continue to offer warehouse lines of credit to other mortgage lenders. These commercial lines allow the lender to fund the closing of residential mortgage loans. Each extension or drawdown on the line is collateralized by the residential mortgage loan being funded, and in many cases, we subsequently acquire that loan. Underlying mortgage loans must be originated based on our underwriting standards. These lines of credit are, in most cases, personally guaranteed by one or more qualified principal officers of the borrower. The aggregate amount of warehouse lines of credit granted to other mortgage lenders at March 31, 2010, was $1.4 billion, of which $576.7 million was outstanding, as compared to, $1.2 billion granted at March 31, 2009, of which $601.6 million was outstanding.

Table of Contents

The following table identifies our commercial loan portfolio by major category and selected criteria at March 31, 2010:

	Unpaid Principal Balance (1)	Average Note Rate	Commercial Loans on Non-accrual Status
	(Dollars in thousands)		
Commercial real estate loans:			
Fixed rate	$ 1,210,692	6.6%	$ 186,625
Adjustable rate	357,563	6.2%	188,569
Total commercial real estate	$ 1,568,255	6.5%	$ 375,194
Commercial non-real estate loans:			
Fixed rate	$ 7,690	7.6%	$ 1,947
Adjustable rate	4,104	8.2%	2,536
Total commercial non-real estate	$ 11,794	7.8%	$ 4,483
Warehouse lines of credit:			
Adjustable rate	$ 591,122	5.4%	$
Total warehouse lines of credit	$ 591,122	5.4%	$

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

Critical Accounting Policies

Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, we have identified three policies that, due to the judgment, estimates and assumptions inherent in those policies, are critical to an understanding of our consolidated financial statements. These policies relate to: (a) fair value measurements; (b) the determination of our allowance for loan losses; and (c) the determination of our secondary market reserve. We believe that the judgment, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate given the factual circumstances at the time. However, given the sensitivity of our consolidated financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition. For further information on our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2009, which is available on our website, **www.flagstar.com**, under the Investor Relations section, or on the website of the SEC, at **www.sec.gov**.

Table of Contents

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

	For the Three Months Ended March 31, 2010	For the Three Months Ended March 31, 2009
Return on average assets	(2.38)%	(1.68)%
Return on average equity	(41.02)%	(33.64)%
Efficiency ratio	112.5%	73.8%
Equity/assets ratio (average for the period)	5.80%	5.00%
Mortgage loans originated or purchased	$4,330,388	$9,499,744
Other loans originated or purchased	$ 6,823	$ 20,027
Mortgage loans sold and securitized	$5,014,748	$7,699,063
Interest rate spread bank only[1]	1.45%	1.63%
Net interest margin bank only[2]	1.42%	1.67%
Interest rate spread consolidated[1]	1.40%	1.59%
Net interest margin consolidated[2]	1.29%	1.59%
Dividend payout ratio	N/A	N/A
Average common shares outstanding	776,986	88,210(4)
Average fully diluted shares outstanding	776,986	88,210(4)
Charge-offs to average investment loans (annualized)	2.65%	3.00%

	March 31, 2010	December 31, 2009	March 31, 2009
Equity-to-assets ratio	7.71%	4.26%	5.54%
Core capital ratio[3]	9.39%	5.81%	7.22%
Total risk-based capital ratio [3]	17.98%	11.27%	13.58%
Book value per common share	$ 0.57	$ 0.70	$ 4.03(4)
Number of common shares outstanding	1,470,076	468,771	90,379
Mortgage loans serviced for others	$48,264,731	$56,521,902	$58,856,128
Capitalized value of mortgage servicing rights	1.12%	1.15%	0.88%
Ratio of allowance to non-performing loans	47.4%	48.9%	52.1%
Ratio of allowance to loans held for investment	7.10%	6.79%	5.21%
Ratio of non-performing assets to total assets	9.45%	9.25%	6.06%
Number of banking centers	162	165	177
Number of home lending centers	23	23	61
Number of salaried employees	2,927	3,075	3,285
Number of commissioned employees	314	336	519

(1) Interest rate spread is the difference between the annualized average yield earned on average interest-earning assets for the period and the

annualized average rate of interest paid on average interest-bearing liabilities for the period.

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

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

(4) Does not reflect the 300,000 shares of Series B convertible participating voting preferred stock that upon stockholder approval converted to 375,000,000 shares of common stock, the Treasury

warrant to purchase 64.5 million shares of common stock, or the May Investor warrant to purchase 14.3 million shares of common stock.

Table of Contents

Results of Operations

Net Loss

Net loss applicable to common stockholders for the three months ended March 31, 2010 was $81.9 million, $(0.11) per share-diluted, a $14.5 million increase from the loss of $67.4 million, $(0.76) per share-diluted, reported in the comparable 2009 period. The overall increase resulted from a $59.4 million decrease in non-interest expense and a $75.6 million increase in net interest income after provision for loan losses, $119.0 million decrease in non-interest income and a $28.7 million decrease in federal income tax benefit and an increase of $1.8 million preferred stock dividends.

Net Interest Income

We recognized $37.7 million in net interest income for the three months ended March 31, 2010, which represented a decrease of 33.6% compared to the $56.7 million reported for the same period in 2009. Net interest income represented 34.4% of our total revenue in 2010 as compared to 22.9% in 2009. Net interest income is primarily the dollar value of the average yield we earn on the average balances of our interest-earning assets, less the dollar value of the average cost of funds we incur on the average balances of our interest-bearing liabilities. For the three months ended March 31, 2010, we had an average balance of $11.4 billion of interest-earning assets, of which $9.0 billion were loans receivable. Interest income recorded on these loans is reduced by the amortization of net premiums and net deferred loan origination costs. Interest income for the three months ended March 31, 2010 was $126.2 million, a decrease of 31.8% from the $184.9 million recorded 2009. Offsetting the decrease in interest income was a decrease in our cost of funds. Our interest income also includes the amount of negative amortization (i.e., capitalized interest) arising from our option power ARM loans. The amount of net negative amortization included in our interest income during the three month period ended March 31, 2010 and 2009 was $0.9 million and $1.7 million, respectively. The average cost of interest-bearing liabilities decreased 65 basis points (17.6%), from 3.70% during 2009 to 3.05% in 2010, while the average yield on interest-earning assets decreased 84 basis points (15.8%), from 5.29% during 2009 to 4.45% in 2010. As a result, our interest rate spread was 1.40% at March 31, 2010. The compression of our interest rate spread during the period, together with an increase in nonperforming loans of $0.3 billion, from $0.8 billion at March 31, 2009 as compared to $1.1 billion at March 31, 2010 negatively impacted our consolidated net interest margin, resulting in a decrease for 2010 to 1.29% from 1.59% at March 31, 2009. The Bank recorded a net interest margin of 1.42% at March 31, 2010, as compared to 1.67% at March 31, 2009.

The following table presents interest income from average earning assets, expressed in dollars and yields, and interest expense on average interest-bearing liabilities, expressed in dollars and rates. Interest income from earning assets was reduced by $0.9 million and $1.7 million of amortization of net premiums and net deferred loan origination costs for the three month period ended March 31, 2010 and 2009, respectively. Non-accruing loans were included in the average loans outstanding. Our interest income also includes the amount of negative amortization (i.e., capitalized interest) arising from our option ARM loans. The amount of net negative amortization included in our interest income during the three month period ended March 31, 2010 and 2009 was $0.9 million and $1.7 million, respectively.

	For the Three Months Ended March 31,					
	2010			2009		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
	(Dollars in thousands)					
Interest-Earning Assets:						
Loans available for sale	$ 1,521,640	$ 18,928	4.98%	$ 2,852,951	$ 36,199	5.08%
Loans held for investment						
Mortgage Loans	5,115,419	61,293	4.79%	6,203,307	84,530	5.45%
Commercial Loans	1,956,926	23,852	4.89%	2,351,025	30,929	5.28%
Consumer Loans	415,930	6,122	5.97%	536,229	6,964	5.27%
Loans held for investment	7,488,275	91,267	4.88%	9,090,561	122,423	5.41%
Securities classified as available for sale or trading	1,137,521	15,367	5.43%	1,822,084	25,477	5.63%
Interest-bearing deposits	1,208,667	643	0.22%	225,940	856	1.54%
Other	8,141	1	0.03%	35,410	23	0.26%
Total interest-earning assets	11,364,244	$ 126,206	4.45%	14,026,946	$ 184,978	5.29%
Other assets	2,397,983			2,000,834		
Total assets	$ 13,762,227			$ 16,027,780		
Interest-Bearing Liabilities:						
Demand deposits	$ 370,016	$ 512	0.56%	$ 271,270	$ 388	0.58%
Savings deposits	688,978	1,420	0.84%	424,262	1,989	1.90%
Money market deposits	581,848	1,271	0.89%	615,220	3,422	2.26%
Certificates of deposits	3,390,755	24,779	2.96%	3,963,030	37,941	3.88%
Total retail deposits	5,031,597	27,982	2.26%	5,273,782	43,740	3.36%
Demand deposits	291,901	273	0.38%	20,102	55	1.10%
Savings deposits	77,233	92	0.48%	80,251	223	1.12%
Certificates of deposits	273,685	513	0.76%	1,003,747	6,237	2.52%
	642,819	878	0.55%	1,104,100	6,515	2.39%

Total government deposits						
Wholesale deposits	1,790,434	13,027	2.95%	2,052,276	17,095	3.44%
Deposits	7,464,850	41,887	2.28%	8,430,158	67,350	3.24%
FHLB advances	3,900,000	41,788	4.35%	5,270,548	56,809	4.37%
Security repurchase agreements	108,000	1,153	4.33%	108,000	1,153	4.33%
Other	300,182	3,695	4.99%	248,660	2,936	4.79%
Total interest-bearing liabilities	11,773,032	88,523	3.05%	14,057,366	128,248	3.70%
Other liabilities	1,190,566			1,168,880		
Stockholders equity	798,629			801,534		
Total liabilities and stockholders equity	$ 13,762,227			$ 16,027,780		
Net interest-earning assets	$ (408,788)			$ (30,420)		

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

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

Table of Contents

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities that are presented in the preceding table. The table below distinguishes between the changes related to average outstanding balances (changes in volume while holding the initial rate constant) and the changes related to average interest rates (changes in average rates while holding the initial balance constant). Changes attributable to both a change in volume and a change in rates were included as changes in rate.

	For the Three Months Ended March 31, 2010 Versus 2009 Increase (Decrease) due to:		
	Rate	Volume	Total
	(Dollars in millions)		
Interest-earning assets:			
Loans available for sale	$ (0.4)	$ (16.9)	$ (17.3)
Loans held for investment			
Mortgage loans	(8.4)	(14.8)	(23.2)
Commercial loans	(1.9)	(5.2)	(7.1)
Consumer loans	0.7	(1.6)	(0.9)
Loans held for investment	(9.6)	(21.6)	(31.2)
Securities available for sale or trading	(0.5)	(9.6)	(10.1)
Interest bearing deposits	(4.0)	3.8	(0.2)
Total interest-earning assets	(14.5)	(44.3)	(58.8)
Other assets			
Interest-bearing liabilities:			
Demand deposits		0.1	0.1
Savings deposits	(1.8)	1.3	(0.5)
Money market deposits	(2.0)	(0.2)	(2.2)
Certificates of deposits	(7.6)	(5.6)	(13.2)
Total retail deposits	(11.4)	(4.4)	(15.8)
Demand deposits	(0.5)	0.7	0.2
Savings deposits	(0.1)		(0.1)
Certificates of deposits	(1.1)	(4.6)	(5.7)
Total government deposits	(1.7)	(3.9)	(5.6)
Wholesale deposits	(1.8)	(2.3)	(4.1)
Deposits	(14.9)	(10.6)	(25.5)
FHLB advances		(15.0)	(15.0)
Other	0.1	0.6	0.7
Total interest-bearing liabilities	(14.8)	(25.0)	(39.8)
Change in net interest income	$ 0.3	$ (19.3)	$ (19.0)

Provision for Loan Losses

During the three months ended March 31, 2010, we recorded a provision for loan losses of $63.6 million as compared to $158.2 million recorded during the same period in 2009. The provisions reflect our estimates to maintain the allowance for loan losses at a level to cover probable losses inherent in the portfolio for each of the respective periods.

The increase in the provision during 2010, which increased the allowance for loan losses to $538.0 million at March 31, 2010 from $524.0 million at December 31, 2009, reflects the increase in overall loan delinquencies and severity of loss (i.e., loans at least 30 days past due) in 2010. Net charge-offs for the three month period ended March 31, 2010 totaled $49.6 million as compared to $68.2 million for the same period in 2009, resulting primarily from decreased charge-offs of commercial real estate and second mortgages. As a percentage of the average loans held for investment, net charge-offs for the three months ended March 31, 2010 decreased to 2.65% from 3.00% for the same period in 2009. At the same time, overall loan delinquencies increased to 18.6% of total loans held for investment at March 31, 2010 from 16.89% at December 31, 2009. Loan delinquencies include all loans that were delinquent for at least 30 days under the OTS Method. Total delinquent loans increased to $1.4 billion at March 31, 2010, of which $1.1 billion were over 90 days delinquent and non-accruing, as compared to $1.3 billion at December 31, 2009, of which $1.1 billion were over 90 days delinquent and non-accruing.

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

Non-Interest Income

Our non-interest income consists of (i) loan fees and charges, (ii) deposit fees and charges, (iii) loan administration, (iv) net gain on loan sales, (v) net (loss) gain on sales of MSRs, (vi) net loss on securities available for sale, (vii) loss on trading securities, and (viii) other fees and charges. Our total non-interest income equaled $72.0 million during the three months ended March 31, 2010, which was a 62.3% decrease from the $191.0 million of non-interest income that we earned in the comparable 2009 period. The primary reason for the change was the decrease in 2010 of net gain on loan sales and securitizations.

Loan Fees and Charges. Both our home lending operation and banking operation earn loan origination fees and collect other charges in connection with originating residential mortgages and other types of loans. For the three month period ended March 31, 2010, we recorded gross loan fees and charges of $16.3 million, a decrease of $16.6 million from the $32.9 million recorded for the comparable 2009 period. The decreases in loan fees and charges resulted from decreases in the volume of loans originated during 2010, compared to 2009. In accordance with U.S. generally accepted accounting principle (U.S. GAAP), loan origination fees are capitalized and added as an adjustment to the basis of the individual loans originated. These fees are accreted into income as an adjustment to the loan yield over the life of the loan or when the loan is sold. Effective January 1, 2009, we elected to account for substantially all of our mortgage originations as available-for-sale using the fair value method and therefore no longer applied deferral of non-refundable fees and costs to those loans. During three month period ended March 31, 2010, we had an adjustment of $7,000 to fee revenue in accordance with this guidance for loans not accounted for under fair value, compared to $35,000 in deferred fee revenue for the comparable 2009 period.

Deposit Fees and Charges. Our banking operation collects deposit fees and other charges such as fees for non-sufficient funds checks, cashier check fees, ATM fees, overdraft protection, and other account fees for services we provide to our banking customers. The amount of these fees tend to fluctuate as a function of the increases or decreases in our deposit base. Total deposit fees and charges increased 16.3% during the three month period ended March 31, 2010 to $8.4 million as compared to $7.2 million during comparable 2009 period. A significant portion of this increase in deposit fees and charges was the result of a 21.8% increase in debit card transaction volume during the first quarter 2010. Our debit card fee income was $1.4 million and $1.1 million during the first three months of 2010 and 2009 respectively. Total number of customer checking accounts increased from approximately 110,800 at March 31, 2009 to approximately 117,000 at March 31, 2010.

Loan Administration. When our home lending operation sells mortgage loans in the secondary market it usually retains the right to continue to service these loans and earn a servicing fee, also referred to herein as loan administration income. The majority of our MSRs are accounted for on the fair value method. See Note 11 of the Notes to Consolidated Financial Statements, in Item 1. Financial Statements herein.

The following table summarizes net loan administration income (loss):

	For the Three Months Ended March 31, 2010	2009
	(Dollars in thousands)	
Servicing income (loss) on consumer mortgage servicing:		
Servicing fees, ancillary income and charges	$ 1,174	$ 1,482
Amortization expense consumer	(418)	(650)
Impairment (loss) consumer	(176)	(1,548)
Total net loan administration income (loss), consumer	580	(716)
Servicing income (loss) on residential mortgage servicing:		
Servicing fees, ancillary income and charges	$ 37,369	38,486

Fair value adjustments		29,672	7,060
(Loss) on hedging activity		(41,471)	(76,631)
Total net loan administration income (loss) residential		25,570	(31,085)
Total loan administration income (loss)	$	26,150	(31,801)

(1) Loan administration income does not include the impact of mortgage-backed securities deployed as economic hedges of the MSR assets. These positions, recorded as securities-trading, provided $3.3 million in losses and $23.7 million in gains and contributed an estimated $2.1 million and $10.6 million of net interest income for the three month period ended March 31, 2010 and 2009, respectively.

Loan administration income increased to $26.2 million for the three month period ended March 31, 2010 from a loss of $31.8 million for the comparable 2009 period. Servicing fees, ancillary income, and charges on our residential mortgage servicing decreased during 2010 compared to 2009, primarily as a result of decreases in the average balance of our loans serviced for others portfolio. This decrease reflects the sale of servicing rights related to $10.8 billion of loans serviced for others on a bulk basis and $0.5 billion on a servicing released basis during the three month period ending March 31, 2010. The total unpaid principal balance of loans serviced for others was $48.3 billion at March 31, 2010, versus $58.9 billion at March 31, 2009.

For consumer mortgage servicing, the decrease in the servicing fees, ancillary income and charges for the three month period ended March 31, 2010 versus 2009 was due to the decrease in consumer loans serviced for others. At March 31, 2010, the total unpaid principal balance of consumer loans serviced for others was $0.9 billion versus $1.1 billion serviced at March 31, 2009. The decrease in impairment of $1.4 million was primarily the result of changes in delinquency assumptions.

***(Loss) Gain on Trading Securities*.** Securities classified as trading are comprised of U.S. government sponsored agency mortgage-backed securities, U.S. Treasury bonds and residual interests from private-label securitizations; losses from residual interests are classified separately in Loss on Residual and Transferor Interests. U.S. government sponsored agency mortgage-backed securities held in trading are distinguished from available-for-sale based upon the intent of management to use them as an economic hedge against changes in the valuation of the MSR portfolio; however, these do not qualify as an accounting hedge as defined in current accounting guidance for derivatives and hedges.

For U.S. government sponsored agency mortgage-backed securities held, we recorded a loss of $3.3 million for the three month period ended March 31, 2010, of which $3.8 million related to an unrealized loss on agency mortgage backed securities held at March 31, 2010. For the same period in 2009, we recorded a gain of $23.7 million of which $21.4 million related to an unrealized gain on agency mortgage backed securities held at March 31, 2009.

***Loss on Residual Interests and Transferor Interests*.** Losses on residual interests classified as trading and transferor s interest are a result of a reduction in the estimated fair value of our beneficial interests resulting from private securitizations. The losses in 2010 and 2009 are primarily due to continued increases in expected credit losses on the assets underlying the securitizations.

We recognized a loss of $2.7 million for the three month period ended March 31, 2010. In 2010, $1.8 million was related to a reduction in the residual valuation and $0.9 million was related to a reduction in the transferor s interest carried within consumer loans on the HELOC securitizations. Additionally, during the fourth quarter 2009, we wrote down the remaining amount of transferor interest on one of our HELOC securitizations and recorded a liability of $7.6 million to reflect the expected liability arising from future transferor s interest. At March 31, 2010, our expected liability was $6.2 million.

Net Gain on Loan Sales. Our home lending operation records the transaction fee income it generates from the origination, securitization and sale of mortgage loans in the secondary market. The amount of net gain on loan sales recognized is a function of the volume of mortgage loans originated for sale and the fair value of these loans, net of related selling expenses. Net gain on loan sales is increased or decreased by any mark to market pricing adjustments on loan commitments and forward sales commitments, increases to the secondary market reserve related to loans sold during the period, and related administrative expenses. The volatility in the gain on sale spread is attributable to market pricing, which changes with demand and the general level of interest rates. Generally, we are able to sell loans into the secondary market at a higher margin during periods of low or decreasing interest rates. Typically, as the volume of acquirable loans increases in a lower or falling interest rate environment, we are able to pay less to acquire loans and are then able to achieve higher spreads on the eventual sale of the acquired loans. In contrast, when interest rates rise, the volume of acquirable loans decreases and therefore we may need to pay more in the acquisition phase, thus decreasing our net gain achievable. During 2008 and into 2009, our net gain was also affected by increasing spreads available from securities we sell that are guaranteed by Fannie Mae and Freddie Mac and by a combination of a significant decline in residential mortgage lenders and a significant shift in loan demand to Fannie Mae and Freddie Mac conforming residential mortgage loans and Federal Housing Administration insured loans, which have provided us with more favorable loan pricing opportunities for conventional residential mortgage products.

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

	For the Three Months Ended March 31,	
	2010	2009
	(Dollars in thousands)	
Net gain on loan sales	$ 52,566	$ 195,694
Loans sold and securitized	$ 5,014,748	$ 7,699,063
Spread achieved	1.05%	2.54%

For the three month period ended March 31, 2010, net gain on loan sales decreased $143.1 million to $52.6 million from $195.7 million in the comparable 2009 period. The 2010 period reflects the sale of $5.0 billion in loans versus $7.7 billion sold in the 2009 period. Management believes changes in market conditions during the 2009 period which has continued into 2010 resulted in a decreased mortgage loan origination volume ($4.3 billion in the 2010 period versus $9.5 billion in the 2009 period) and an overall decrease on sale spread (105 basis points in the 2010 versus 254 basis points in the 2009 period).

Our calculation of net gain on loan sales reflects our adoption of fair value accounting for the majority of our mortgage loans available for sale beginning January 1, 2009. The effect of the application of fair value accounting on the current year s operations amounted to $14.1 million of additional gain on loan sales. This amount represents the recording of the mortgage loans available for sale that remained on our consolidated statement of financial condition at March 31, 2010 at their estimated fair value. The change of method was made on a prospective basis; therefore, only mortgage loans available for sale that were originated during 2009 have been affected. In addition, we also had changes in amounts related to derivatives, lower of cost or market adjustments on loans transferred to held for investment and provisions to our secondary market reserve. Changes in amounts related to loan commitments and forward sales commitments amounted to $17.0 million and $(6.7) million for the three month period ended March 31, 2010 and 2009, respectively. Lower of cost or market adjustments amounted to $88.0 million and $256.8 million for the three month period ended March 31, 2010 and 2009, respectively. Provisions to our secondary market reserve amounted to $7.1 million and $3.8 million, for the three month period ended March 31, 2010 and 2009 respectively. Also included in our net gain on loan sales is the capitalized value of our MSRs, which totaled $48.3 million and $86.5 million for the three month period ended March 31, 2010 and 2009 respectively.

Net (Loss) Gain on Sales of Mortgage Servicing Rights. As part of our business model, our home lending operation occasionally sells MSRs in transactions separate from the sale of the underlying loans. Because we carry most of our MSRs at fair value we would not expect to realize significant gains or losses at the time of the sale. Instead, our income or loss on changes in the valuation of MSRs would be recorded through our loan administration income.

For the three month period ended March 31, 2010, we recorded a loss on sales of MSRs of $2.2 million, which represented the estimated costs of the transaction, compared to a $0.1 million loss recorded for the same period in 2009. For the first three months in 2010, we sold servicing rights related to $10.8 billion of loans serviced for others on a bulk basis and $0.5 billion on a servicing released basis.

Net Gain (Loss) on Securities Available for Sale. Securities classified as available for sale are comprised of U.S. government sponsored agency mortgage-backed securities and collateralized mortgage obligations (CMOs).

Gains on the sale of U.S. government sponsored agency mortgage-backed securities available for sale that are recently created with underlying mortgage products originated by the Bank are reported within net gain on loan sales. Securities in this category have typically remained in the portfolio less than 90 days before sale. For the three month period ended March 31, 2010, there were no sales of U.S. government sponsored agency securities with underlying mortgage products recently originated by the Bank compared with a $11.1 million gain on $418.7 million of sales during the quarter ended March 31, 2009.

Gain on sales for all other available for sale securities types are reported in net gain on sale of available for sale securities. During the three month period ended March 31, 2010, we sold $54.6 million in purchased U.S. government sponsored agency and non-U.S. government sponsored agency securities available for sale generating a net gain on sale of available for sale securities of $2.2 million.

Net Impairment Losses Recognized Through Earnings. As required by current accounting guidance for investments-debt and equity securities with other-than-temporary impairments, we may also incur losses on securities available for sale as a result of a reduction in the estimated fair value of the security when that decline has been deemed to be an other-than-temporary. Prior to the first quarter of 2009, if an other-than-temporary impairment was identified, the difference between the amortized cost and the fair value was recorded as a loss through operations. Beginning the first quarter of 2009, accounting guidance changed to only recognize other-than-temporary impairment related to credit losses through operations with any remainder recognized through other comprehensive income. Further, upon adoption, the guidance required a cumulative adjustment increasing retained earnings and other comprehensive loss by the non-credit portion of other-than-temporary impairment, related to securities available for sale, that we had recorded prior to January 1, 2009.

Generally, an investment impairment analysis is performed when the estimated fair value is less than amortized cost for an extended period of time, generally six months. Before an analysis is performed, we also review the general market conditions for the specific type of underlying collateral for each security; in this case, the mortgage market in general has suffered from significant losses in value. With the assistance of third party experts, as deemed necessary, we model the expected cash flows of the underlying mortgage assets using historical factors such as default rates and current delinquency and estimated factors such as prepayment speed, default speed and severity speed. Next, the cash flows are modeled through the appropriate waterfall for each CMO tranche owned; the level of credit support provided by subordinated tranches is included in the waterfall analysis. The resulting cash flow of principal and interest is then utilized by management to determine the amount of credit losses by security.

The credit losses on the CMO portfolio have been created by the economic conditions present in the U.S. over the course of the last two years. This includes high mortgage defaults, low collateral values and changes in homeowner behavior, such as strategic default by borrowers on a note due to a home value worth less than the outstanding debt on the home.

In the three month period ended March 31, 2010, additional other-than-temporary impairment (OTTI) due to credit losses on investments with existing other-than-temporary impairment credit losses totaled $3.3 million while no additional OTTI due to credit loss was recognized on securities that did not already have such losses; all OTTI due to credit losses were recognized in current operations. In the three months ended March 31, 2009, additional credit losses on the CMOs totaled $17.2 million, which was recognized in current operations. At March 31, 2010, the cumulative amount of other-than-temporary impairment due to credit losses totaled $38.6 million.

Other Fees and Charges. Other fees and charges include certain miscellaneous fees, including dividends received on FHLBI stock and income generated by our subsidiaries Flagstar Reinsurance Company (formerly Flagstar Credit, Inc.) and Douglas Insurance Agency, Inc.

For the three month period ended March 31, 2010, we recognized an increase of $2.7 million in dividends on an average outstanding balance of FHLBI stock of $373.4 million. During 2010, Flagstar Reinsurance Company earned fees of $0.5 million versus $2.4 million in 2009. The amount of fees earned by Flagstar Reinsurance Company varies with the volume of loans that were insured during the respective periods. However, also during the three month period ended March 31, 2010, we recorded an expense of $26.8 million for the increase in our secondary market reserve due to our change in estimate of expected losses from loans sold in prior periods, which increased from the $10.8 million recorded in the comparable 2009 period.

Non-Interest Expense

The following table sets forth the components of our non-interest expense, along with the allocation of expenses related to loan originations that are deferred pursuant to accounting guidance for receivables, non-refundable fees and other costs. Mortgage loan fees and direct origination costs (principally compensation and benefits) are capitalized as an adjustment to the basis of the loans originated during the period and amortized to expense over the lives of the respective loans rather than immediately expensed. Other expenses associated with loan production, however, are not required or allowed to be capitalized and are, therefore, expensed when incurred. Effective January 1, 2009, we elected to account for substantially all of our mortgage loans available for sale using the fair value method and, therefore, immediately began recognizing loan origination fees and direct origination costs in the period incurred;

Non-Interest Expenses

	For the Three Months Ended March 31,	
	2010	**2009**
	(Dollars in thousands)	
Compensation and benefits	$ 53,931	$ 58,654
Commissions	7,150	33,415
Occupancy and equipment	16,011	18,879
Advertising	2,159	2,494
Federal insurance premiums	10,047	4,236
Communication	1,212	1,725
Other taxes	856	1,007
Asset resolution	16,573	24,873
Warrant expense	1,227	11,028
Other	14,238	26,641

Total	$123,404	$182,952
Less: capitalized direct costs of loan closings, in accordance with ASC 310	(62)	(283)
Total, net	$123,342	$182,669
Efficiency ratio [1]	112.5%	73.8%

(1) Total operating and administrative expenses divided by the sum of net interest income and non-interest income.

Table of Contents

Non-interest expenses, before the capitalization of direct costs of loan closings, totaled $123.4 million during the three month period ended March 31, 2010 compared to $183.0 million in the comparable 2009 period. The 32.5% decrease in non-interest expense was largely due to a decline in commissions, a decrease in warrant expense, and an overall reduction in expenses resulting from cost-saving measures. Moreover, for the first three months in 2010, we closed three banking centers, bringing our banking center network total for the quarter to 162.

Our gross compensation and benefit expense totaled $53.9 million for the three month period ended March 31, 2010, compared to $58.7 million in the comparable 2009 period. The 8.1% decrease in gross compensation and benefits expense is primarily attributable to a reduction in our salaried workers. Our full-time equivalent (FTE) salaried employees decreased by 358 from March 31, 2009 to 2,927 at March 31, 2010, which largely reflects a reduction in bank employees due to branch closings. Commission expense, which is a variable cost associated with loan production, totaled $7.2 million, equal to 17 basis points (0.17%) of total loan production in 2010 as compared to $33.4 million, equal to 35 basis points (0.35%) of total loan production in the comparable 2009 period. The decline in commission is due to a revised compensation structure across our various distribution channels. Occupancy and equipment totaled $16.0 million for the three months ended March 31, 2010, a decrease of $2.9 million from the comparable 2009 period, which reflects the closing of various non-profitable home loan centers. Advertising expense, totaled $2.2 million for the three months ended March 31, 2010 a decrease of $0.3 million, or 13.4%, from March 31, 2009. Our FDIC insurance premiums were $10.0 million for the three months ended March 31, 2010 as compared to $4.2 million at 2009. We recorded $1.2 million in communication expense for the three months ended March 31, 2010 as compared to $1.7 million for the comparable 2009 period. These expenses typically include telephone, fax and other types of electronic communication. The decrease in communication expenses is reflective of a decrease in our banking centers as well as expense reductions resulting from our vendor management initiatives. We pay taxes in the various states and local communities in which we are located and/or do business. For the three month period ended March 31, 2010, our state and local taxes totaled a tax expense of $0.9 million, compared to a tax expense of $1.0 million in comparable 2009 period. Asset resolution expenses consists of foreclosure and other disposition and carry costs, loss provisions and gains and losses on the sale of REO properties that we have obtained through foreclosure or other proceedings. Asset resolution expense decreased $8.3 million to $16.6 million primarily due to a decrease in our provision for REO loss. Provision for REO loss decreased from $17.4 million to $7.5 million, a decrease of $5.1 million net of any gain on REO and recovery of related debt. Warrant expense consisted of the recording of a $1.2 million valuation for the warrants issued to certain investors in our May 2008 private placement in full satisfaction of our obligations under anti-dilution provisions applicable to such investors. Warrant expense decreased from $11.0 million during the three month period ended March 31, 2009 to $1.2 million for the three months ended March 31, 2010. The $9.8 million decrease was primarily due to the discontinuation of recording the valuation for Treasury warrants that were valued in the comparable 2009 period at $9.0 million. Other expenses totaled $14.2 million for the three month period ended March 31, 2010 compared to $26.6 million in the comparable 2009 period. The $12.4 million decrease was primarily due to a $10.0 million decrease in net reinsurance expense.

Provision (Benefit) for Federal Income Taxes

For the three month period ended March 31, 2010, our provision for federal income taxes as a percentage of pretax loss was 0% compared to benefits on pretax losses of 30.8% for the comparable 2009 period. For each period, the (benefit) provision for federal income taxes varies from statutory rates primarily because of certain non-deductible corporate expenses.

We account for income taxes in accordance with FASB ASC Topic 740, Income Taxes. Under this pronouncement, deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates that will apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

We periodically review the carrying amount of our deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of our deferred tax assets will not be realized in future periods, a deferred tax valuation allowance would be established.

Consideration is given to all positive and negative evidence related to the realization of the deferred tax assets.

In evaluating this available evidence, we consider historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earning trends and the timing of reversals of temporary differences. Our evaluation is based on current tax laws as well as our expectations of future performance.

FASB ASC Topic 740 suggests that additional scrutiny should be given to deferred tax assets of an entity with cumulative pre-tax losses during the three most recent years. This is widely considered to be significant negative evidence that is objective and verifiable; and therefore, difficult to overcome. We had cumulative pre-tax losses in 2007, 2008 and 2009 and we considered this factor in our analysis of deferred tax assets. Additionally, based on the continued economic uncertainty that persists at this time, we believed that it was probable that we would not generate significant pre-tax income in the near term. As a result of these two significant facts, we recorded a $227.2 million valuation allowance against deferred tax assets as of March 31, 2010. See Note 13 of Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Analysis of Items on Statement of Financial Condition

Securities Classified as Trading. Securities classified as trading are comprised of U.S. government sponsored agency mortgage-backed securities, Treasury bonds, and non-investment grade residual interests from our private-label securitizations. Changes to the fair value of trading securities are recorded in the consolidated statement of operations. At March 31, 2010 there were $893.0 million in Treasury bonds and agency mortgage-backed securities in trading as compared to $328.2 million at December 31, 2009. U.S. government sponsored agency mortgage-backed securities held in trading are distinguished from those classified as available-for-sale based upon the intent of management to use them as an offset against changes in the valuation of the MSR portfolio, however, these do not qualify as an accounting hedge as defined in U.S. GAAP. The non-investment grade residual interests resulting from our private label securitizations were $0.3 million at March 31, 2010 versus $2.1 million at December 31, 2009. Non-investment grade residual securities classified as trading decreased as a result of the increase in actual and expected losses in the second mortgages and HELOC s that underlie these assets. See Note 6 the Notes to Consolidated Financial Statements, in Item 1. Financial Statements herein.

Securities Classified as Available-for-Sale. Securities classified as available-for-sale, which are comprised of U.S. government sponsored agency mortgage-backed securities and CMOs, increased to $0.7 billion at March 31, 2010, from $0.6 billion at December 31, 2009. See Note 5 of the Notes to Consolidated Financial Statements, in Item 1. Financial Statements herein.

Other Investments Restricted. Our investment portfolio decreased from $15.6 million at December 31, 2009 to $4.4 million at March 31, 2010. We have other investments in our insurance subsidiary which are restricted as to their use. These assets can only be used to pay insurance claims in that subsidiary. These securities had a fair value that approximates their recorded amount for each period presented.

Loans Available for Sale. We sell a majority of the mortgage loans we produce into the secondary market on a whole loan basis or by securitizing the loans into mortgage-backed securities. At March 31, 2010, we held loans available for sale of $1.9 billion, which was a decrease of $0.1 billion from $2.0 billion held at December 31, 2009. Our loan production is typically inversely related to the level of long-term interest rates. As long-term rates decrease, we tend to originate an increasing number of mortgage loans. A significant amount of the loan origination activity during periods of falling interest rates is derived from refinancing of existing mortgage loans. Conversely, during periods of increasing long-term rates loan originations tend to decrease. The decrease in the balance of loans available for sale was principally attributable to the volume of loan originations during the three month period ended March 31, 2010, offset in part by the inclusion of approximately $441.0 million of certain loans sold to Ginnie Mae, as to which we have not yet repurchased but have the unilateral right to do so. For further information on our loans available for sale, see Note 7 in the Notes to Consolidated Financial Statements, in Item 1. Financial Statements herein.

Loans Held for Investment. Our largest category of earning assets consists of loans held for investment. Loans held for investment consist of residential mortgage loans that we do not hold for resale (usually shorter duration and adjustable rate loans and second mortgages), other consumer loans, commercial real estate loans, construction loans, warehouse loans to other mortgage lenders, and various types of commercial loans such as business lines of credit, working capital loans and equipment loans. Loans held for investment decreased from $7.7 billion in December 2009, to $7.6 billion in March 2010 due in large part to management s decision to not originate loans for portfolio. Mortgage loans held for investment decreased $187.6 million to $4.8 billion, second mortgage loans decreased $11.4 million to $210.2 million, commercial real estate loans decreased $45.1 million to $1.6 billion and consumer loans decreased $16.1 million to $407.7 million. For information relating to the concentration of credit of our loans held for investment, see Note 8 of the Notes to Consolidated Financial Statements, in Item 1. Financial Statement and Supplementary Data, herein.

60

Table of Contents

Quality of Earning Assets

The following table sets forth certain information about our non-performing assets as of the end of each of the last five quarters.

Non-Performing Loans and Assets

	For the Three Months Ended				
	March 31, 2010	**December 31, 2009**	**September 30, 2009**	**June 30, 2009**	**March 31, 2009**
	(Dollars in thousands)				
Non-performing loans	$1,136,205	$1,071,636	$1,055,358	$ 940,777	$ 893,808
Repurchased non-performing assets, net	50,735	45,697	26,601	18,384	14,830
Real estate and other repossessed assets, net	167,265	176,968	164,898	131,620	106,546
Total non-performing assets, net	$1,354,205	$1,294,301	$1,246,857	$1,090,781	$1,015,184
Ratio of non-performing assets to total assets	9.45%	9.25%	8.44%	6.67%	6.06%
Ratio of non-performing loans to loans held for investment	14.99%	13.89%	12.98%	11.18%	9.99%
Ratio of allowance to non-performing loans	47.35%	48.90%	50.03%	50.38%	52.14%
Ratio of allowance to loans held for investment	7.10%	6.79%	6.49%	5.63%	5.21%
Ratio of net charge-offs to average loans held for investment	0.66%	1.23%	0.87%	1.35%	0.75%

Delinquent Loans. Loans are considered to be delinquent when any payment of principal or interest is past due. While it is the goal of management to work out a satisfactory repayment schedule or modification with a delinquent borrower, we will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our procedures regarding delinquent loans are designed to assist borrowers in meeting their contractual obligations. We customarily mail several notices of past due payments to the borrower within 30 days after the due date and late charges are assessed in accordance with certain parameters. Our collection department makes telephone or personal contact with borrowers after a 30-day delinquency. In certain cases, we recommend that the borrower seek credit-counseling assistance and may grant forbearance if it is determined that the borrower is likely to correct a loan delinquency within a reasonable period of time. We cease the accrual of interest on loans that we classify as non-performing because they are more than 90 days delinquent or earlier when concerns exist as to the ultimate collection of principal or interest. Such interest is recognized as income only when it is actually collected. At March 31, 2010, we had $1.4 billion in loans that were determined to be delinquent. Of those delinquent loans, $1.1 billion of loans were non-performing, of which $727.0 million, or 64.0%, were single-family residential mortgage loans.

Loan Modifications. We may modify certain loans to retain customers or to maximize collection of the loan balance. We have maintained several 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. Loan modification programs for borrowers implemented during the third quarter of 2009 have resulted in a significant increase in restructured loans. These loans are classified as troubled debt restructurings (TDRs) and are included in non-accrual loans if the loan was non-accruing prior to the restructuring or if the payment amount increased significantly. These loans will continue on non-accrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months.

The following table sets forth information regarding TDRs at March 31, 2010:

	TDRs		
	Performing	**Non-performing**	**Total**
	(Dollars in thousands)		
Residential	$ 410,078	$ 191,944	$ 602,022
Commercial	31,676	142,011	173,687
	$ 441,754	$ 333,955	$ 775,709

61

Table of Contents

The following table sets forth information regarding delinquent loans at the dates listed. At March 31, 2010, 62.3% of all delinquent loans are loans in which we had a first lien position on residential real estate.

Delinquent Loans

Days Delinquent	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
30 59		
First mortgages	$ 99,122	$ 103,785
Second mortgages	4,277	4,386
HELOC	4,582	4,486
CRE	69,243	27,807
Other	1,606	3,036
Total 30- 59 days delinquent	178,830	143,500
60 - 89		
First mortgages	63,646	71,804
Second mortgages	2,485	4,164
HELOC	2,639	3,807
CRE	25,584	6,818
Other	903	1,032
Total 60- 89 days delinquent	95,257	87,625
90 +		
First mortgages	709,419	659,469
Second mortgages	11,648	8,202
HELOC	8,005	7,652
CRE	395,801	385,687
Other	11,332	10,626
Total 90+ days delinquent	1,136,205	1,071,636
Total delinquent loans	$ 1,410,292	$ 1,302,761

We calculate our delinquent loans using a method required by the OTS when we prepare regulatory reports that we submit to the OTS each quarter. This method, also called the OTS Method, considers a loan to be delinquent if no payment is received after the first day of the month following the month of the missed payment. Other companies with mortgage banking operations similar to ours may use the Mortgage Bankers Association Method (MBA Method) which considers a loan to be delinquent if payment is not received by the end of the month of the missed payment. The key difference between the two methods is that a loan considered delinquent under the MBA Method would not be considered delinquent under the OTS Method for another 30 days. Under the MBA Method of calculating delinquent loans, 30 day delinquencies equaled $241.8 million, 60 day delinquencies equaled $138.9 million and 90 day delinquencies equaled $1.2 billion at March 31, 2010. Total delinquent loans under the MBA Method total $1.6 billion or 20.93% of loans held for investment at March 31, 2010. By comparison, delinquent loans under the MBA Method total $1.5 billion or 19.4% of loans held for investment at December 31, 2009.

The following table sets forth information regarding non-performing loans as to which we have ceased accruing interest:

Non-Accrual Loans

	At March 31, 2010			
	Investment Loan Portfolio	Non-Accrual Loans	As a % of Loan Specified Portfolio	As a % of Non-Accrual Loans
	(Dollars in thousands)			
Mortgage loans	$ 4,803,425	$ 709,419	14.8%	62.7%
Second mortgages	210,208	11,648	5.5	1.0
Commercial real estate	1,555,163	390,533	25.1	34.6
Construction	15,544	5,954	38.3	0.5
Warehouse lending	576,719			
Consumer	407,742	8,899	2.18	0.8
Commercial non-real estate	11,878	4,484	37.75	0.4
Total loans	7,580,679	$ 1,130,937	14.9%	100.0%
Less allowance for loan losses	(538,000)			
Total loans held for investment, net	$ 7,042,679			

Allowance for Loan Losses. The allowance for loan losses represents management s estimate of probable losses in our loans held for investment portfolio as of the date of the consolidated financial statements. The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be inherent in the loan portfolio but that have not been specifically identified.

We perform a detailed credit quality review at least annually on large commercial loans as well as on selected other smaller balance commercial loans. Commercial and commercial real estate loans that are determined to be substandard and certain delinquent residential mortgage loans that exceed $1.0 million are treated as impaired and are individually evaluated to determine the necessity of a specific reserve in accordance with the provisions of U.S. GAAP. The accounting guidance requires a specific allowance to be established as a component of the allowance for loan losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of the expected future cash flows discounted at the loan s effective interest rate, the observable market price of the loan, or the fair value of the collateral if the loan is collateral dependent, reduced by estimated disposal costs. In estimating the fair value of collateral, we utilize outside fee-based appraisers to evaluate various factors such as occupancy and rental rates in our real estate markets and the level of obsolescence that may exist on assets acquired from commercial business loans.

A portion of the allowance is also allocated to the remaining classified commercial loans by applying projected loss ratios, based on numerous factors identified below, to the loans within the different risk ratings.

Additionally, management has sub-divided the homogeneous portfolios, including consumer and residential mortgage loans, into categories that have exhibited a greater loss exposure (such as sub-prime loans, high loan to value loans and also loans by state). The portion of the allowance allocated to other consumer and residential mortgage loans is determined by applying projected loss ratios to various segments of the loan portfolio. Projected loss ratios incorporate factors such as recent charge-off experience, current economic conditions and trends, and trends with respect to past due and non-accrual amounts.

Our assessments of loss exposure from interest-only residential mortgage loan products and adjustable rate residential mortgage loans are based upon consideration of the historical loss rates associated with those types of loans. Such loans are included within first mortgage residential loans, as to which we establish a reserve based on a number of factors, such as days past due, delinquency and severity rates in the portfolio, loan-to-value ratios based on most recently available appraisals or broker price opinions, and availability of mortgage insurance or government guarantees. The severity rates used in the determination of the adequacy of the allowance for loan losses are indicative of, and thereby inclusive of consideration of, declining collateral values. In the current low-interest rate environment, future resets of interest rates on adjustable rate loans (which are estimated to apply to $3.0 billion of loans for 2010) are generally expected to result in identical or lower rates for the borrowers.

As the process for determining the adequacy of the allowance requires subjective and complex judgment by management about the effect of matters that are inherently uncertain, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses. In estimating the amount of credit losses inherent in our loan portfolio various assumptions are made. For example, when assessing the condition of the overall economic environment assumptions are made regarding current economic trends and their impact on the loan portfolio. In the event the national economy were to sustain a prolonged downturn, the loss factors applied to our portfolios may need to be revised, which may significantly impact the measurement of the allowance for loan losses. For impaired loans that are collateral dependent, the estimated fair value of the collateral may deviate significantly from the net proceeds received when the collateral is sold.

The deterioration in credit quality that began in the latter half of 2007 continued throughout 2008, 2009 and throughout the first three months in 2010 with further worsening in the local and national economies and steep declines in the real estate market. This deterioration is reflected in the substantial increase in delinquency rates and an increase in seriously delinquent and nonperforming loans. The overall delinquency rate (loans over 30 days delinquent using the OTS Method) increased for the first three months in 2010 to 18.60%, up from 16.89% as of December 31, 2009 and, for seriously delinquent loans (loans over 90 days delinquent using the OTS Method), to 14.98% from 13.89%, respectively. At March 31, 2010, nonperforming loans totaled $1.14 billion, an increase of $64.6 million, or 6.0%, over the amount at December 31, 2009. Certain portfolios have shown particular credit weakness. These include the residential loan portfolios, including residential first mortgages, construction and land lot loans, as well as the commercial real estate portfolio.

Residential Real Estate. As of March 31, 2010, non-performing residential first mortgages, including land lot loans, increased to $709.4 million, up $49.9 million or 7.6%, from $659.5 million at the end of 2009. Although our portfolio is diversified throughout the United States, the largest concentrations of loans are in California, Florida and Michigan. Each of those real estate markets has experienced steep declines in real estate values beginning in 2007 and continuing through the first quarter of 2010. Net charge-offs within the residential first mortgage portfolio, totaled $29.0 million for the three month period ended March 31, 2010 compared to $32.8 million for the quarter ended December 31, 2009, which represents an 11.6% decrease.

The overall delinquency rate in the residential construction loan portfolio was 43.8% as of March 31, 2010, up from 42.45% as of December 31, 2009. Non-performing construction loans increased to $6.0 million, or 38.3% of the construction loan portfolio as of March 31, 2010 up from 29.06% as of December 31, 2009. With the real estate market declines, downward pressure on new home prices, and lack of end loan financing, this portfolio is experiencing declines in credit quality. Net charge-offs in the construction loan portfolio totaled approximately $20,000 for the three month period ended March 31, 2010 down from $434,000 for the quarter ended December 31, 2009. Management expects charge-offs to increase somewhat in the coming year based on the current level of delinquencies.

Commercial Real Estate. The commercial real estate portfolio has experienced deterioration in credit beginning in mid-2007 and continuing into 2010 primarily in the commercial land residential development loans. The credit deterioration continued in the current year within those portfolios and the office and retail loan portfolios are now under increasing pressure from worsening economic conditions. Non-performing commercial real estate loans have increased to 25.5% of the portfolio at March 31, 2010 up from 24.10% as of the end of 2009. Net charge-offs within the commercial real estate portfolio totaled $8.1 million for the three month period ended March 31, 2010 down from $42.3 million for the quarter ended December 31, 2009.

Management maintains an unallocated allowance to recognize the uncertainty and imprecision underlying the process of estimating expected loan losses for the entire loan portfolio. Determination of the probable losses inherent in the portfolio, which is not necessarily captured by the allocation methodology discussed above, involves the exercise of judgment.

The allowance for loan losses increased to $538.0 million at March 31, 2010 from $524.0 million at December 31, 2009. The allowance for loan losses as a percentage of non-performing loans decreased to 47.4% from 48.9% at December 31, 2009, which reflects the changes in assumptions for loss rates as well as the effect of charge-offs taken during the period in light of the virtually static nature of the Bank s portfolio (i.e., few new loans). The allowance for loan losses as a percentage of investment loans increased to 7.10% from 6.79% as of December 31, 2009.

Table of Contents

The following tables set forth certain information regarding our allowance for loan losses as of March 31, 2010 and the allocation of the allowance for loan losses over the past five years:

Allowance for Loan Losses

	At March 31, 2010			
	Investment Loan Portfolio	Percent of Portfolio	Allowance Amount	Percentage to Total Allowance
	(Dollars in thousands)			
Mortgage loans	$4,803,425	63.3%	$281,925	52.4%
Second mortgages	210,208	2.8	36,500	6.8
Commercial real estate	1,555,163	20.5	163,804	30.4
Construction	15,544	0.2	2,252	0.4
Warehouse lending	576,719	7.6	3,990	0.7
Consumer	407,742	5.4	36,151	6.7
Commercial non-real estate	11,878	0.2	3,144	0.6
Unallocated			10,234	2.0
Total	$7,580,679	100.0%	$538,000	100.0%

The following tables set forth certain information regarding our composition of allowance for loan losses as of March 31, 2010:

Composition of Allowance for Loan Losses
As of March 31, 2010

Description	General Reserves	Specific Reserves	Total
	(Dollars in thousands)		
First mortgage loans	$ 252,599	$ 29,326	$ 281,925
Second mortgage loans	36,477	23	36,500
Commercial real estate loans	50,981	112,823	163,804
Construction loans residential	1,995	257	2,252
Warehouse lending	2,422	1,568	3,990
Consumer loans, including home equity lines of credit	35,964	187	36,151
Non-real estate commercial	934	2,210	3,144
Other and unallocated	10,234		10,234
Total allowance for loan losses	$ 391,606	$ 146,394	$ 538,000

The allowance for loan losses is considered adequate based upon management s assessment of relevant factors, including the types and amounts of non-performing loans, historical and current loss experience on such types of loans, and the current economic environment.

The following table sets forth information regarding non-performing loans as of March 31, 2010:

Non-performing loans	March 31, 2010
	(Dollars in thousands)
Loans secured by real estate	

Home loans secured by first lien	$	709,419
Home loans secured by second lien		11,648
Home equity lines of credit		8,005
Construction residential		5,954
Commercial		395,801
Total non-performing loans secured by real estate		1,130,827
Commercial		4,484
Other consumer		894
Total non-performing loans held in portfolio	$	1,136,205

Table of Contents

In response to increasing rates of delinquency and steeply declining market values, management implemented a program to modify the terms of existing loans in an effort to mitigate losses and keep borrowers in their homes. These aggressive modification programs began in the latter months of 2008 and increased substantially in 2009. As of March 31, 2010, we had $794.6 million in restructured loans in the loans held for investment portfolio, of which $334.0 million were included in non-performing loans.

Restructured loans by loan type are presented in the following table:

Restructured Loans
March 31, 2010
(Dollars in thousands)

First mortgage loans	$ 605,144
Second mortgage loans	15,710
Commercial	173,687
HELOC	52
Other consumer	
Total	$ 794,593

The following table shows the activity in the allowance for loan losses during the indicated periods (dollars in thousands):

Activity Within the Allowance For Loan Losses

	For the Three Months Ended		For the Year Ended
	March 31, 2010	March 31, 2009	December 31, 2009
Beginning balance	$ 524,000	$ 376,000	$ 376,000
Provision for loan losses	63,559	158,214	504,370
Charge-offs			
First mortgage	(29,684)	(25,775)	(127,257)
Second mortgage	(6,695)	(12,687)	(42,695)
Commercial	(8,481)	(22,633)	(147,549)
Construction residential	(21)	(789)	(2,922)
Warehouse	(471)		(1,123)
Consumer:			
HELOC	(4,877)	(6,199)	(35,807)
Other consumer	(634)	(784)	(4,634)
Other	(697)	(575)	(2,789)
Total charge-offs	(51,560)	(69,442)	(364,776)
Recoveries			
First mortgage	664	834	2,802
Second mortgage	265	84	888
Commercial	373		2,586
Construction residential	1	33	35

Warehouse			12
Consumer:			
HELOC	354	72	822
Other consumer	301	106	411
Other	43	99	850
Total recoveries	2,001	1,228	8,406
Charge-offs, net of recoveries	(49,559)	(68,214)	(356,370)
Ending balance	$ 538,000	$ 466,000	$ 524,000
Net charge-off ratio	2.65%	3.00%	4.20%

66

Repossessed Assets. Real property that we acquire as a result of the foreclosure process is classified as real estate owned until it is sold. It is transferred from the loans held for investment portfolio at the lower of cost or market value, less disposal costs. Management decides whether to rehabilitate the property or sell it as is and whether to list the property with a broker. At March 31, 2010, we had $167.3 million of repossessed assets compared to $177.0 million at December 31, 2009. The decrease was the result of a decrease of $19.7 million in new foreclosures, to $40.8 million during the three month period ended March 31, 2010 as compared to $60.5 million during the three month period ended December 31, 2009.

The following schedule provides the activity for repossessed assets during each of the past five quarters:

Net Repossessed Asset Activity

	March 31, 2010	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009
			(Dollars in thousands)		
Beginning balance	$176,968	$164,898	$131,620	$106,486	$109,237
Additions	40,750	60,466	69,032	57,604	21,571
Disposals	(50,453)	(48,396)	(35,754)	(32,470)	(24,322)
Ending balance	$167,265	$176,968	$164,898	$131,620	$106,486

Accrued Interest Receivable. Accrued interest receivable increased to $52.7 million at March 31, 2010 from $44.9 million at December 31, 2009. Our total earning assets decreased (slightly 1.0% decrease), as the balance of non-accrual loans stayed the same at $1.1 million at March 31, 2010 as compared to $1.1 million at December 31, 2009. We typically collect interest in the month following the month in which it is earned.

Premises and Equipment. Premises and equipment, net of accumulated depreciation, totaled $237.9 million at March 31, 2010, a decrease of $1.4 million, or 0.4%, from $239.3 million at December 31, 2009. Our investment in property and equipment decreased due to our decision to limit branch expansion.

Mortgage Servicing Rights. At March 31, 2010, MSRs included residential MSRs carried at fair value amounting to $540.8 million and consumer MSRs carried at lower of amortized cost or market amounting to $2.6 million. At December 31, 2009, residential MSRs amounted to $649.1 million and consumer MSRs carried at amortized cost amounted to $3.2 million. During the three months ended March 31, 2010 and 2009, we recorded additions to our residential MSRs of $48.3 million and $82.7 million, respectively, due to loan sales or securitizations. Also, during the three month period ended March 31, 2010, we reduced the amount of MSRs by $115.1 million related to bulk servicing sales and $15.3 million related to loans that paid off during the period and decreases of $26.2 million related to the realization of expected cash flows and market driven changes, primarily as a result of increases in mortgage loan rates that led to an expected decrease in prepayment speeds. See Note 11 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

The principal balance of the loans underlying our total MSRs was $48.3 billion at March 31, 2010 versus $56.6 billion at December 31, 2009, with the decrease primarily attributable to our bulk and flow servicing sale of $10.8 billion in underlying loans partially offset by loan origination activity for 2010.

Other Assets. Other assets are comprised of the following:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Repurchased assets with government insurance	$ 867,660	$ 826,349
Repurchased assets without government insurance	50,735	45,697
Derivative assets, including margin accounts	157,633	202,436
Escrow advances	108,699	102,372

Servicing sales	90,947	
Tax assets, net	78,351	77,442
Other	84,978	77,601
Total other assets	$ 1,439,003	$ 1,331,897

Other assets increased $0.1 billion, or 7.7%, to $1.4 billion at March 31, 2010 from $1.3 billion at December 31, 2009. We sell a majority of the mortgage loans it produces into the secondary market on a whole loan basis or by securitizing the loans into mortgage-backed securities. When we sell or securitize mortgage loans, we make customary representations and warranties. If a defect is identified, we may be required to either repurchase the loan or indemnify the purchaser for losses it sustains on the loan. Repurchased loans that are performing according to their terms are included within loans held for investment portfolio. Repurchased loans that are not performing when repurchased are included within the other assets category. A significant portion of these are government-guaranteed or insured loans that are repurchased from Ginnie Mae securitizations in place of continuing to advance delinquent principal and interest installments to security holders after a specified delinquency period. Losses and expenses incurred on these repurchases through the foreclosure process generally are reimbursed according to claim filing guidelines. The balance of such loans held by us was $867.7 million at March 31, 2010 and $826.3 million at December 31, 2009. The balance has increased substantially year over year due to the growth in our government lending area throughout 2007 and 2008 combined with the increase in the default levels within the marketplace.

Liabilities

Deposits. Our deposits can be subdivided into four areas: the retail division, the government banking, the national accounts division and Company controlled deposits. Retail deposit accounts decreased $332.8 million, or 6.1% to $5.1 billion at March 31, 2010, from $5.4 billion at December 31, 2009. Saving and checking accounts totaled 24.0% of total retail deposits. In addition, at March 31, 2010, retail certificates of deposit totaled $3.3 billion, with an average balance of $30,022 and a weighted average cost of 2.96% while money market deposits totaled $562.9 million, with an average cost of 0.94%. Overall, the retail division had an average cost of deposits of 2.18% at March 31, 2010 versus 2.12% at December 31, 2009.

We call on local municipal agencies as another source for deposit funding. Government banking deposits increased $92.8 million or 16.6% to $650.3 million at March 31, 2010, from $557.5 million at December 31, 2009. These balances fluctuate during the year as the municipalities collect semi-annual assessments and make necessary disbursements over the following six-months. These deposits had a weighted average cost of 0.59% at March 31, 2010 versus 0.60% at December 31, 2009. These deposit accounts include $180.9 million of certificates of deposit with maturities typically less than one year and $455.6 million in checking and savings accounts.

In past years, our national accounts division garnered wholesale deposits through the use of investment banking firms. For the year ended December 31, 2006 and through June 30 2007, we did not solicit any funds through this division as we were able to access more attractive funding sources through FHLBI advances, security repurchase agreements and other forms of deposits that provide the potential for a long term customer relationship. These deposit accounts decreased $0.2 billion, or 11.1%, to $1.8 billion at March 31, 2010, from $2.0 billion at December 31, 2009. These deposits had a weighted average cost of 2.67% at March 31, 2010 versus 2.52% at December 31, 2009. We do not anticipate adding any national account deposits in 2010.

Company controlled deposits are accounts that represent the portion of the investor custodial accounts controlled by Flagstar that have been placed on deposit with the Bank. These deposits do not bear interest. Company controlled deposits decreased $175.6 million to $580.8 million at March 31, 2010 from $756.4 million at December 31, 2009. This decrease is the result of our decrease in mortgage loans being serviced for others during the three month period ended March 31, 2010 as well as a higher volume of loan payoffs which accrue until remitted to the respective U.S. government sponsored agency for whom the Bank is servicing loans.

We participate in the Certificate of Deposit Account Registry Service (CDARS) program, through which certain customer certificates of deposit (CD) are exchanged for CDs of similar amounts from other participating banks. This gives our customers the potential to receive FDIC insurance up to $50 million. At March 31, 2010, $337.7 million of our total CDs were related to this program.

Table of Contents

The composition of our deposits was as follows:

Deposit Portfolio

	March 31, 2010			December 31, 2009		
	Balance	Month End Rate [4]	Percent of Balance	Balance	Month End Rate [4]	Percent of Balance
	(Dollars in thousands)					
Demand accounts	$ 539,314	0.40	6.62%	$ 546,218	0.38	6.22%
Saving accounts	689,480	0.86	8.46	724,278	0.73	8.25
MMDA	562,926	0.94	6.91	632,099	0.56	7.18
Certificates of deposit [1]	3,330,182	2.96	40.89	3,552,090	2.94	40.40
Total retail deposits	5,121,902	2.18	62.88	5,454,685	2.12	62.05
Municipal deposits [2]	650,247	0.59	7.98	557,495	0.60	6.35
National accounts	1,792,743	2.67	22.01	2,009,866	2.52	22.98
Company controlled deposits [3]	580,787		7.13	756,423		8.62
Total deposits	$ 8,145,679	2.01	100.0%	$ 8,778,469	1.93	100.0%

(1) The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was approximately $1.6 billion and $1.6 billion at March 31, 2010 and December 31, 2009, respectively.

(2) Government accounts includes funds from municipalities and public schools.

(3)

These accounts represent the portion of the investor custodial accounts and escrows controlled by the Company that have been placed on deposit with the Bank.

(4) This rate reflects the average rate for the deposit portfolio at the end of the noted month.

FHLBI Advances. At March 31, 2010, FHLBI advances remained unchanged from $3.9 billion at December 31, 2009. We rely upon advances from the FHLBI 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 medium-term financing. The outstanding balance of FHLBI advances fluctuates from time to time depending upon our current inventory of mortgage loans available for sale and the availability of lower cost funding from our deposit base, the company controlled deposits that we hold, or alternative funding sources such as repurchase agreements. In the fourth quarter of 2009, we prepaid $650 million in higher cost advances to remove them from the balance sheet to deleverage the balance sheet. We incurred a $16.4 million penalty to prepay these advances.

The $2.2 billion portfolio of putable FHLBI advances we hold, which matures in 2012 and 2013, is callable by the FHLBI during 2010 and thereafter based on FHLBI volatility models. If these advances are called, we will need to find an alternative source of funding, which could be at a higher cost and, therefore, negatively impact our consolidated results of operations.

Security Repurchase Agreements. Security repurchase agreements remained unchanged at $108.0 million at March 31, 2010 and December 31, 2009, respectively. Securities sold under agreements to repurchase are generally accounted for as collateralized financing transactions and are recorded at the amounts at which the securities were sold plus accrued interest. Securities, generally mortgage backed securities, are pledged as collateral under these financing arrangements. The fair value of collateral provided to a party is continually monitored, and additional collateral is obtained or requested to be returned, as appropriate.

Long-Term Debt. As part of our overall capital strategy, we may raise capital through the issuance of trust-preferred securities by our special purpose financing entities formed for the offerings. The trust preferred securities outstanding mature 30 years from issuance, are callable after five years, and pay interest quarterly. The majority of the net proceeds from these offerings has been contributed to the Bank as additional paid in capital and subject to regulatory limitations, is includable as regulatory capital. Under these trust preferred arrangements, we have the right to defer dividend payments to the trust preferred security holders for up to five years.

Accrued Interest Payable. Accrued interest payable decreased $4.4 million, or 16.9%, to $21.7 million at March 31, 2010 from $26.1 million at December 31, 2009. These amounts represent interest payments that are payable to depositors and other entities from which we borrowed funds. These balances fluctuate with the size of our interest-bearing liability portfolio and the average cost of our interest-bearing liabilities. A significant portion of the decrease was a result of the decrease in rates on our deposit accounts. For the three month period ended March 31, 2010, the average overall rate on our deposits decreased 96 basis points to 2.28% from 3.24% for the same period in

2009.

Secondary Market Reserve. We sell most of the residential mortgage loans that we originate into the secondary mortgage market. When we sell mortgage loans we make customary representations and warranties to the purchasers about various characteristics of each loan, such as the manner of origination, the nature and extent of underwriting standards applied and the types of documentation being provided. Typically these representations and warranties are in place for the life of the loan. If a defect in the origination process is identified, we may be required to either repurchase the loan or indemnify the purchaser for losses it sustains on the loan. If there are no such defects, we have no liability to the purchaser for losses it may incur on such loan. We maintain a secondary market reserve to account for the expected losses related to loans we might be required to repurchase (or the indemnity payments we may have to make to purchasers). The secondary market reserve takes into account both our estimate of expected losses on loans sold during the current accounting period, as well as adjustments to our previous estimates of expected losses on loans sold. In each case these estimates are based on our most recent data regarding loan repurchases, and actual credit losses on repurchased loans, among other factors. Increases to the secondary market reserve for current loan sales reduce our net gain on loan sales. Adjustments to our previous estimates are recorded as an increase or decrease in our other fees and charges. The amount of the secondary market reserve equaled $76.0 million and $66.0 million at March 31, 2010 and December 31, 2009, respectively. The increase in our secondary market reserve was the result of the increase in our loss rate during the previous year on repurchases or indemnification to the purchaser of loans sold and the increase in volume of loans repurchased or indemnified.

Other Liabilities. Other liabilities increased $438.6 million, or 184.4%, to $676.5 million at March 31, 2010 from $237.9 million at December 31, 2009. A significant portion of our other liabilities is the result of us recognizing on our balance sheet certain loans sold to Ginnie Mae, that we as the servicer, have the option to repurchase without Ginnie Mae s prior authorization, any individual loan when certain delinquency criteria are met. Once we have the unilateral ability to repurchase the delinquent loan, we have effectively regained control over the loan and are required to recognize the loan along with a corresponding liability. The repurchase option asset and corresponding liability, which we include as part of our other liabilities was $441.0 at March 31, 2010.

Liquidity and Capital Resources

Our principal uses of funds include loan originations and operating expenses, and in the past also included the payment of dividends and stock repurchases. At March 31, 2010, we had outstanding rate-lock commitments to lend $1.8 billion in mortgage loans. We have commitments of $359 thousand for consumer and $157 thousand for second mortgages as of March 31, 2010. These commitments may expire without being drawn upon and therefore, do not necessarily represent future cash requirements. Total unused collateralized lines of credit, including construction, consumer, first and second HELOCs and commercial totaled $1.2 billion at March 31, 2010.

We suffered a loss in excess of $81.9 million during three month period ended March 31, 2010. On January 30, 2009, we consummated a transaction with MP Thrift in which we raised $250 million. On that same date, we entered into a letter of agreement with the Treasury, in exchange for 266,657 shares of our fixed rate cumulative perpetual preferred stock for $266.7 million. Management and certain members of our board of directors also acquired, in the aggregate, $5.3 million of common stock on that date. In addition, we entered into a closing agreement with MP Thrift pursuant to which we will sell an additional $100 million in equity capital, and, in February 2009, we consummated two related transactions in which we raised $50 million of the additional $100 million. Of these amounts, $475 million was invested immediately into the Bank as equity capital. As a result, the OTS advised that there would not be any change to our well capitalized regulatory capital classification. On June 30, 2009, MP Thrift acquired the $50.0 million of trust preferred securities pursuant to which we issued 50,000 shares that are convertible into common stock. In addition, in our rights offering that expired on February 8, 2010, our stockholders, including MP Thrift, exercised their rights to purchase 423,342,162 shares of common stock for approximately $300.6 million. On March 31, 2010, we completed a registered offering of 575 million shares of common stock, which included an over-allotment option for 75 million shares that was exercised in full on March 29, 2010. The offering resulted in aggregate net proceeds of approximately $276.1 million; of this amount, $261.4 million was invested immediately into the Bank as equity capital.

We did not pay any cash dividends on our common stock during 2010 and 2009. On February 19, 2008, our Board of Directors suspended future dividends payable on our common stock. Under the capital distribution regulations, a savings association that is a subsidiary of a savings and loan holding company must either notify or seek approval from the OTS of an association capital distribution at least 30 days prior to the declaration of a dividend or the approval by the board of directors of the proposed capital distribution. The 30-day period allows the OTS to determine whether the distribution would not be advisable. We currently must seek approval from the OTS prior to making a capital distribution from the Bank. In addition, we are prohibited from increasing dividends on our common stock above $0.05 without the consent of Treasury pursuant to the terms of the TARP.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, 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 classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

At March 31, 2010, the Bank had regulatory capital ratios that categorized the Bank as well-capitalized per regulatory standards. At March 31, 2010, the Bank had regulatory capital ratios of 9.4% for Tier 1 capital and 17.9% for total risk-based capital. Upon receipt of the majority amount from our rights offering from MP Thrift on January 27, 2010, $300 million was immediately invested into the Bank to further improve its capital level and to fund lending activity.

On March 31, 2010, the Company completed a registered offering of 575,000,000 shares of common stock, which included 75,000,000 shares issued pursuant to the underwriters over-allotment option, which was exercised in full on March 29, 2010. The Company issued and sold to the Underwriters 575,000,000 shares of the Company s common stock, $0.01 par value per share. The public offering price of the Common Stock was $0.50 per share. The offering resulted in aggregate net proceeds of approximately $276.1 million, after deducting underwriting fees and offering expenses.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our exposure to interest rate risk arises from three distinctly managed mechanisms home lending, mortgage servicing, and structural balance sheet maturity or repricing mismatches.

In our home lending operations, we are exposed to market risk in the form of interest rate risk from the time we commit to an interest rate on a mortgage loan application through the time we sell, or commit to sell, the mortgage loan. On a daily basis, we analyze various economic and market factors to project the amount of mortgage loans we expect to sell for delivery at a future date. The actual amount of loans sold will be a percentage of the amount of mortgage loans on which we have issued binding commitments (and thereby locked in the interest rate) but have not yet closed (pipeline loans) to actual closings. If interest rates change in an unanticipated fashion, the actual percentage of pipeline loans that close may differ from the projected percentage. A mismatch of our commitments to fund mortgage loans and our commitments to sell mortgage loans may have an adverse effect on the results of operations in any such period. For instance, a sudden increase in interest rates may cause a higher percentage of pipeline loans to close than we projected, and thereby exceed our commitments to sell that pipeline of loans. As a result, we could incur losses upon sale of these additional loans to the extent the market rate of interest is higher than the mortgage interest rate committed to by us on pipeline loans we had initially anticipated to close. To the extent that the hedging strategies utilized by us are not successful, our profitability may be adversely affected.

We also service residential mortgages for various external parties. We receive a service fee based on the unpaid balances of servicing rights as well as ancillary income (late fees, float on payments, etc.) as compensation for performing the servicing function. An increase in mortgage prepayments, as is often associated with declining interest rates, can lead to reduced values on capitalized mortgage servicing rights and ultimately reduced loan servicing revenues. In the first quarter of 2008, we began to specifically hedge the market risk associated with mortgage servicing rights using a portfolio of Treasury note futures and options. To the extent that the hedging strategies are not effective, our profitability associated with the mortgage servicing activity may be adversely affected.

In addition to the home lending and mortgage servicing operations, our banking operations may be exposed to market risk due to differences in the timing of the maturity or repricing of assets versus liabilities, as well as the potential shift in the yield curve. This risk is evaluated and managed on a company-wide basis using a net portfolio value (NPV) analysis framework. The NPV analysis is intended to estimate the net sensitivity of the fair value of the assets and liabilities to sudden and significant changes in the levels of interest rates.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures. A review and evaluation was performed by our principal executive and financial officers regarding the effectiveness of our disclosure controls and procedures as of March 31, 2010 pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended. Based on that review and evaluation, the principal executive and financial officers have concluded that our current disclosure controls and procedures, as designed and implemented, are operating effectively.

(b) Changes in Internal Controls. During the quarter ended March 31, 2010, there has been no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934, as amended, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

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

Sale of Unregistered Securities

On September 29, 2009, the Company and Joseph P. Campanelli entered into a purchase agreement, pursuant to which Mr. Campanelli will purchase 1,987,500 shares of the Company s common stock at a purchase price of $1.05 per share. On March 31, 2010, Mr. Campanelli purchased 525,000 shares pursuant to the purchase agreement. In addition, Mr. Campanelli will purchase 243,750 shares of common stock on each June 30 and December 31 in 2010, 2011 and 2012. The Common Stock was offered and sold, or will be sold, to Mr. Campanelli in offerings exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder.

Issuer Purchases of Equity Securities

The Company made no purchases of its equity securities during the quarter ended March 31, 2010.

Item 3. Defaults upon Senior Securities

None.

Item 4. (Removed and Reserved)

None.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

Exhibit No.	Description
11	Computation of Net Loss per Share
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

* Incorporated herein by reference

\+ Constitutes a management contract or compensation plan or arrangement

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.

Date: May 10, 2010

/s/ Joseph P. Campanelli
Joseph P. Campanelli
Chairman of the Board, President and
Chief Executive Officer
(Duly Authorized Officer)

/s/ Paul D. Borja
Paul D. Borja
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT INDEX

Exhibit No.	Description
11	Computation of Net Loss per Share
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

* Incorporated herein by reference

\+ Constitutes a management contract or compensation plan or arrangement