FLAGSTAR BANCORP INC
Form 10-Q
November 09, 2010

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 September 30, 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 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (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 November 8, 2010, 269,278,468 shares of the registrant s common stock, $0.01 par value, were issued and outstanding.

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FORWARD LOOKING STATEMENTS

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

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

General business and economic conditions, including unemployment rates, movements in interest rates, the slope of the yield curve, any increase in mortgage fraud and other criminal activity and the potential decline of housing prices in certain geographic markets, may significantly affect our business activities, loan losses, reserves and earnings;

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

Our ability to raise additional capital;

Competitive factors for loans could negatively impact gain on loan sale margins;

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

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

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

Actions of mortgage loan purchasers, guarantors and insurers regarding repurchase and indemnity demands and uncertainty related to foreclosure procedures could adversely affect business activities and earnings;

Factors concerning the implementation of proposed enhancements could result in slower implementation times than we anticipate and negate any competitive advantage that we may enjoy; and

Financial services reform legislation recently enacted into law by the President will, among other things, eliminate the Office of Thrift Supervision, tighten capital standards, create a new Bureau of Consumer Financial Protection and result in new laws and regulations that are expected to increase our costs of operations.

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

Please also refer to Item 1A. Risk Factors to Part II of this report, Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 and Item 1A to Part II of our Quarterly Reports on Form 10-Q for the quarters ended June 30, 2010 and March 31, 2010, which are incorporated by reference herein, for further information on these and other factors affecting us.

Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore any of these statements included herein may prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved.

FLAGSTAR BANCORP, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The consolidated financial statements of the Company are as follows:

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

	September 30, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and cash items	$ 50,422	$ 73,019
Interest-bearing deposits	962,711	1,009,470
Cash and cash equivalents	1,013,133	1,082,489
Securities classified as trading	161,000	330,267
Securities classified as available for sale	503,568	605,621
Other investments restricted		15,601
Loans available for sale ($1,780,486 and $1,937,171 at fair value at September 30, 2010 and December 31, 2009, respectively)	1,943,096	1,970,104
Loans held for investment ($35,994 and $11,287 at fair value at September 30, 2010 and December 31, 2009, respectively)	7,312,226	7,714,308
Less: allowance for loan losses	(474,000)	(524,000)
Loans held for investment, net	6,838,226	7,190,308
Total interest-earning assets	10,408,601	11,121,371
Accrued interest receivable	37,898	44,941
Repossessed assets, net	198,585	176,968
Federal Home Loan Bank stock	373,443	373,443
Premises and equipment, net	233,235	239,318
Mortgage servicing rights at fair value	447,023	649,133
Mortgage servicing rights, net		3,241
Other assets	2,087,366	1,331,897
Total assets	$ 13,836,573	$ 14,013,331
Liabilities and Stockholders Equity		
Deposits	$ 8,561,943	$ 8,778,469
Federal Home Loan Bank advances	3,400,000	3,900,000
Security repurchase agreements		108,000
Long term debt	248,610	300,182
Total interest-bearing liabilities	12,210,553	13,086,651
Accrued interest payable	18,338	26,086
Secondary market reserve	77,500	66,000
Other liabilities	469,453	237,870
Total liabilities	12,775,844	13,416,607

Commitments and contingencies 21		
Stockholders Equity		
Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding at September 30, 2010 and December 31, 2009, respectively	3	3
Common stock $0.01 par value, 300,000,000 shares authorized; 153,512,990 and 46,877,067 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	1,535	469
Additional paid in capital preferred	247,837	243,778
Additional paid in capital common	1,079,042	447,449
Accumulated other comprehensive loss	(19,484)	(48,263)
Accumulated deficit	(248,204)	(46,712)
Total stockholders equity	1,060,729	596,724
Total liabilities and stockholders equity	$ 13,836,573	$ 14,013,331

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
	(Unaudited)			
Interest Income				
Loans	$111,744	$ 136,849	$ 330,745	$ 452,233
Securities classified as available for sale or trading	10,968	29,738	47,069	85,873
Interest-earning deposits	504	517	1,628	1,799
Other	1	3	3	28
Total interest income	123,217	167,107	379,445	539,933
Interest Expense				
Deposits	40,270	58,352	123,677	192,248
FHLB advances	39,816	56,116	123,755	170,210
Security repurchase agreements		1,178	2,750	3,497
Long term debt and other	2,017	3,867	8,060	9,638
Total interest expense	82,103	119,513	258,242	375,593
Net interest income	41,114	47,594	121,203	164,340
Provision for loan losses	51,399	125,544	200,978	409,420
Net interest expense after provision for loan losses	(10,285)	(77,950)	(79,775)	(245,080)
Non-Interest Income				
Loan fees and charges	24,365	29,422	60,930	97,366
Deposit fees and charges	7,585	8,438	24,796	23,655
Loan administration	12,924	(30,293)	(15,590)	(20,240)
Gain on trading securities	10,354	21,714	76,702	6,377
Loss on residual and transferors interest	(4,665)	(50,689)	(11,660)	(66,625)
Net gain on loan sales	103,211	104,416	220,034	404,773
Net loss on sales of mortgage servicing rights	(1,195)	(1,319)	(4,674)	(3,945)
Net gain on securities available for sale			6,689	
Total other-than-temporary impairment gain (loss)		34,100	35,200	(69,533)
Less: portion of other-than-temporary impairment gains (losses) recognized in other comprehensive income before taxes		36,975	38,877	(49,089)
Net impairment loss recognized in earnings		(2,875)	(3,677)	(20,444)
Other fees and charges	(7,691)	(12,582)	(36,333)	(29,189)

Total non-interest income	144,888	66,232	317,217	391,728
Non-Interest Expense				
Compensation, commissions and benefits	59,817	68,611	171,944	232,038
Occupancy and equipment	15,757	17,175	47,670	53,553
Asset resolution	34,233	26,811	96,245	69,660
Federal insurance premiums	8,522	7,666	29,209	28,514
Other taxes	1,964	12,944	3,660	15,049
Warrant (income) expense	(1,405)	3,556	(3,664)	27,561
Loss on extinguishment of debt	11,855		20,826	
General and administrative	21,756	30,143	58,985	95,017
Total non-interest expense	152,499	166,906	424,875	521,392
Loss before federal income taxes	(17,896)	(178,624)	(187,433)	(374,744)
Provision for federal income taxes		114,965		55,008
Net Loss	(17,896)	(293,589)	(187,433)	(429,752)
Preferred stock dividend/accretion	(4,690)	(4,623)	(14,059)	(12,464)
Net loss applicable to common stock	$ (22,586)	$ (298,212)	$ (201,492)	$ (442,216)
Loss per share				
Basic	$ (0.15)	$ (6.36)	$ (1.57)	$ (16.58)
Diluted	$ (0.15)	$ (6.36)	$ (1.57)	$ (16.58)

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

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

	Preferred Stock	Common Stock	Additional Paid in Capital - Preferred	Additional Paid in Capital - Common	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders Equity
Balance at December 31, 2008	$	$ 84	$	$ 119,776	$ (81,742)	$ 434,175	$ 472,293
(Unaudited)							
Net loss						(429,752)	(429,752)
Reclassification of loss on securities available for sale due to other-than- temporary impairment					13,289		13,289
Change in net unrealized loss on securities available for sale					53,682		53,682
Total comprehensive loss							(362,781)
Cumulative effect for adoption of new guidance for other-than-temporary impairments					(32,914)	32,914	
Issuance of preferred stock	6		507,488				507,494
Conversion of preferred stock	(3)	375	(268,574)	268,202			
Issuance of common stock to management		7		5,314			5,321
Reclassification of Treasury Warrants				49,673			49,673
Issuance of common stock for exercise of May Warrants		3		4,373			4,376
Restricted stock issued				(45)			(45)
Dividends on preferred stock						(8,927)	(8,927)
Accretion of preferred stock			3,537			(3,537)	
				658			658

Stock-based compensation							
Tax effect from stock-based compensation				(465)			(465)
Balance at September 30, 2009	$ 3	$ 469	$ 242,451	$ 447,486	$ (47,685)	$ 24,873	$ 667,597
Balance at December 31, 2009	$	$ 469	$ 243,778	$ 447,449	$ (48,263)	$ (46,712)	$ 596,724
(Unaudited)							
Net loss						(187,433)	(187,433)
Reclassification of gain on sale of securities available for sale					(6,689)		(6,689)
Reclassification of loss on securities available for sale due to other-than- temporary impairment					3,677		3,677
Change in net unrealized loss on securities available for sale					31,791		31,791
Total comprehensive loss							(158,654)
Issuance of common stock		1,061		626,441			627,502
Restricted stock issued				(12)			(12)
Dividends on preferred stock						(10,000)	(10,000)
Accretion of preferred stock			4,059			(4,059)	
Stock-based compensation		5		5,164			5,169
Tax effect from stock-based compensation							
Balance at September 30, 2010	$	$ 1,535	$ 247,837	$ 1,079,042	$ (19,484)	$ (248.204)	$ 1,060,729

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

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

	For the Nine Months Ended September 30, 2010	2009
	(Unaudited)	
Operating Activities		
Net loss	$ (187,433)	$ (429,752)
Adjustments to net loss to net cash used in operating activities		
Provision for loan losses	200,978	409,420
Depreciation and amortization	13,748	17,075
Increase in valuation allowance in mortgage servicing rights	961	3,774
Loss on fair value of residential mortgage servicing rights net of hedging gains (losses)	231,923	91,078
Stock-based compensation expense	5,169	658
Gain on interest rate swap	(728)	(326)
Net loss on the sale of assets	5,908	1,241
Net gain on loan sales	(220,034)	(404,773)
Net loss on sales of mortgage servicing rights	4,674	3,945
Net gain on sale of securities classified as available for sale	(6,689)	
Other than temporary impairment losses on securities classified as available for sale	3,677	20,444
Net gain on trading securities	(76,702)	(6,377)
Net loss on residual and transferor interest	11,660	66,625
Proceeds from sales of loans available for sale	18,019,645	24,267,675
Origination and repurchase of mortgage loans available for sale, net of principal repayments	(18,101,403)	(25,236,411)
Purchase of trading securities	(899,011)	(744,946)
Proceeds from sales of trading securities	1,143,279	1,079,716
Decrease in accrued interest receivable	7,043	5,350
Increase in other assets	(757,727)	(533,774)
Decrease in accrued interest payable	(7,748)	(11,223)
Net tax effect of stock grants issued		465
Increase in liability for checks issued	7,547	9,701
Decrease in federal income taxes payable		(36,527)
Increase in other liabilities	145,914	62,936
Net cash used in operating activities	(455,349)	(1,364,006)
Investing Activities		
Net change in other investments	15,601	(6,987)
Proceeds from the sale of investment securities available for sale	418,178	
Net (purchase) repayment of investment securities available for sale	(124,815)	46,487
Proceeds from sales of portfolio loans	(65,077)	9,184
Origination of portfolio loans, net of principal repayments	25,545	437,396
Investment in unconsolidated subsidiary		1,547
Proceeds from the disposition of repossessed assets	169,063	178,539

Acquisitions of premises and equipment, net of proceeds	(7,287)	(9,692)
Proceeds from the sale of mortgage servicing rights	124,729	119,815
Net cash provided by investing activities	555,937	776,289
Financing Activities		
Net (decrease) increase in deposit accounts	(216,526)	692,963
Net decrease in Federal Home Loan Bank advances	(500,000)	(400,000)
Payment on long-term debt	(25)	(25)
Net decrease in security repurchase agreements	(108,000)	
Net receipt of payments of loans serviced for others	80,417	24,345
Net receipt of escrow payments	6,688	6,032
Net tax benefit for stock grants issued		(465)
Dividends paid to preferred stockholders	(10,000)	(7,222)
Issuance of junior subordinated debt		50,000
Issuance of preferred stock		544,365
Issuance of common stock	577,502	6,696
Net cash (used in) provided by financing activities	(169,944)	916,689
Net (decrease) increase in cash and cash equivalents	(69,356)	328,972
Beginning cash and cash equivalents	$ 1,082,489	$ 506,905
Ending cash and cash equivalents	$ 1,013,133	$ 835,877

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

	For the Nine Months Ended September 30, 2010	2009
Supplemental Disclosure of Cash Flow Information:		
Loans held for investment transferred to repossessed assets	$ 447,445	$ 492,798
Total interest payments made on deposits and other borrowings	$ 265,990	$ 386,816
Federal income taxes paid	$ 541	$ 1,510
Reclassification of mortgage loans originated for investment to mortgage loans available for sale	$ 146,114	$ 32,987
Reclassification of mortgage loans originated available for sale to held for investment loans	$ 81,037	$ 42,171
Recharacterization of mortgage loans available for sale to investment securities available for sale	$ 159,422	$ 314,625
Mortgage servicing rights resulting from sale or securitization of loans	$ 157,177	$ 267,960
Conversion of mandatory convertible participating voting preferred stock to common stock	$	$ 271,577
Conversion of convertible trust securities	$ 50,000	$

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

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

Note 1 Nature of Business

Flagstar Bancorp, Inc. (Flagstar or the Company), is the holding company for its principal subsidiary, Flagstar Bank, FSB (the Bank), a federally chartered stock savings bank founded in 1987. With $13.8 billion in assets at September 30, 2010, Flagstar is the largest insured depository institution headquartered in Michigan. Unless otherwise specified, references herein to the Company shall include the business operations of the Company and the Bank.

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. The Company s 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 (FHLB) of Indianapolis and is subject to regulation, examination and supervision by the Office of Thrift Supervision (including any successors thereto 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. The Company s 10 trust subsidiaries and four securitization trusts are considered variable interest entities and are not consolidated in the Company s consolidated financial statements because the Company is not the primary beneficiary of those entities. Prior to January 1, 2010, the securitization trusts were not consolidated in the Company s consolidated financial statements because they were qualified special purpose entities under FASB ASC Topic 860, *Transfers and Servicing*. The concept of the special purpose entity was eliminated from ASC Topic 860 effective January 1, 2010. 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 nine month period ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, reference should be made 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 are available on the Company s Investor Relations web page, at **www.flagstar.com**, and on the SEC website, at **www.sec.gov**.

Note 3 Recent Developments

Equity Offerings

On November 2, 2010, the Company completed a registered offering of 14,192,250 shares of its Mandatorily Convertible Non-Cumulative Perpetual Preferred Stock Series D (the Convertible Preferred Stock), which included 692,250 shares issued pursuant to the underwriter s over-allotment option, and a registered offering of 115,655,000 shares of its common stock, par value $0.01 per share (Common Stock), which included 5,655,000 shares issued pursuant to the underwriter s over-allotment option. The public offering price of the Convertible Preferred Stock and the Common Stock was $20.00 and $1.00 per share, respectively. Upon stockholder approval of an amendment to increase the number of authorized shares of Common Stock from 300,000,000 shares to 700,000,000 shares, each share of Convertible Preferred Stock will be automatically converted into 20 shares of Common Stock, based on a conversion price of $1.00 per share of Common Stock. MP Thrift Investments, L.P. (MP Thrift), participated in the registered offerings and purchased 8,884,637 shares of Convertible Preferred Stock and 72,307,263 shares of Common Stock at the offering price. The offerings resulted in aggregate net proceeds to the Company of approximately $385.8 million, after deducting underwriting fees and offering expenses.

Asset Sale

On November 2, 2010, the Company announced that it had entered into an agreement to sell approximately $474 million of non-insured non-performing residential first mortgage loans and will reclassify an additional $86 million in residential non-performing loans as available for sale.

The Company expects to receive approximately $209 million, or 44% of book value before allocated allowance for loan losses, for the $474 million of non-performing loans. Approximately $133 million of the allowance for loan losses is currently allocated to the $474 million of non-performing loans. In aggregate, the Company expects a loss of approximately $132 million on the transaction, which is expected to close in the fourth quarter 2010. The Company also expects that the carrying value of the remaining residential non-performing (excluding those insured by the Federal Housing Administration (FHA) or U.S. Department of Veterans Affairs (VA) loans will be reclassified to available for sale on the Company s balance sheet and reflect fair value based upon the value at which the above-mentioned transaction is completed.

Note 4 Supervisory Agreements

On January 27, 2010, the Company and the Bank each entered into respective supervisory agreements with the OTS (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 its 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 the Company.

Note 5 Recent Accounting Developments

ASU No. 2010-20, Receivables (Topic 310): Disclosure about Credit Quality of Financing Receivables and Allowance For Credit Losses. This guidance requires an entity to provide disclosures that facilitate the evaluation of the nature of credit risk inherent in its portfolio of financing receivables; how that risk is analyzed and assessed in determining the allowance for credit losses; and the changes and reasons for those changes in the allowance for credit losses. To achieve those objectives, disclosures on a disaggregated basis must be provided on two defined levels: (1) portfolio segment; and (2) class of financing receivable. This guidance makes changes to existing disclosure requirements and includes additional disclosure requirements relating to financing receivables. Short-term accounts receivable, receivables measured at fair value or lower of cost or fair value and debt securities are exempt from this guidance. The disclosures related to period-end information are required to be provided in all interim and annual periods ending on or after December 15, 2010. Disclosures of activity that occurs during the reporting period are required in interim and annual periods beginning on or after December 15, 2010. The provisions of this guidance are not expected to have a significant impact on the Company s consolidated financial condition, results of operations or liquidity.

Note 6 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;

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- 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; and

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

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 applied the fair value option to certain non-investment grade residual securities that arose from private-label securitizations. Accordingly, these residual securities are classified as trading securities. As of September 30, 2010, the Company s residuals interests were deemed to have no value.

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 economically 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 and other hedging instruments, are recognized each period within the combination of loan administration income (loss) on the consolidated statement of operations and in gain (loss) on trading securities, to the extent such instruments are held on the balance sheet.

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. See Note 8, Loans Available for Sale, for further information.

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 by other market participants to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments as held by the Company 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 may 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.

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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, U.S. 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 11, Private Label Securitization Activity, for the key assumptions used in the residual interest valuation process. At September 30, 2010, the Company s residual interests were deemed to have no value.

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. At September 30, 2010, no such investments were outstanding.

Loans available for sale. At September 30, 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 September 30, 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 as to which the Company has the unilateral right to repurchase from certain securitization transactions, but has not yet repurchased, are classified as available for sale and 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 and 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 September 30, 2010, substantially all of the impaired loans were evaluated based on the fair value of the collateral rather than on discounted cash flows. If the fair value of collateral is used to establish an allowance, the underlying impaired loan must be assigned a classification in the fair value hierarchy. To the extent 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). Residential MSRs are accounted for at fair value on a recurring basis, while servicing rights associated with consumer loans are carried at amortized cost and are periodically evaluated for impairment. At September 30, 2010, the Company no longer had any MSR s associated with consumer loans.

Residential Mortgage Servicing Rights. Management believes that 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 12, 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.

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Assets and liabilities measured at fair value on a recurring basis

The following tables presents the financial instruments carried at fair value as of September 30, 2010 and December 31, 2009, by caption on the Consolidated Statement of Financial Condition and by the valuation hierarchy (as described above):

September 30, 2010	Level 1	Level 2	Level 3	Total Carrying Value in the Consolidated Statement of Financial Condition
		(Dollars in thousands)		
Securities classified as trading:				
Mortgage-backed securities	$161,000	$	$	$ 161,000
Total securities classified as trading	161,000			161,000
Securities classified as available for sale	8,461		495,107	503,568
Loans available for sale		1,780,486		1,780,486
Loans held for investment		35,994		35,994
Residential mortgage servicing rights			447,023	447,023
Derivative assets:				
Rate lock commitments			50,540	50,540
Agency forwards	5,096			5,096
U.S. Treasury futures				
Total derivative assets	5,096		50,540	55,636
Total assets at fair value	174,557	1,816,480	992,670	2,983,707
Derivative liabilities:				
Interest rate swaps	19			19
U.S. Treasury futures	2,649			2,649
Forward agency and loan sales		19,117		19,117
Total derivative liabilities	2,668	19,117		21,785
Warrant liabilities		1,447		1,447
Total liabilities at fair value	2,668	20,564		23,232
Net assets and liabilities at fair value	$171,889	$1,795,916	$992,670	$ 2,960,475

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December 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	$	$	$ 2,057	$ 2,057
Mortgage-backed securities	328,210			328,210
Total securities classified as trading	328,210		2,057	330,267
Securities classified as available for sale	67,245		538,376	605,621
Loans available for sale		1,937,171		1,937,171
Loans held for investment		11,287		11,287
Residential mortgage servicing rights			649,133	649,133
Other investments-restricted	15,601			15,601
Derivative assets:				
Rate lock commitments			10,061	10,061
Forward agency and loan sales		27,764		27,764
Total derivative assets		27,764	10,061	37,825
Total assets at fair value	411,056	1,976,222	1,199,627	3,586,905
Derivative liabilities:				
Interest rate swaps	747			747
Agency forwards	29,883			29,883
U.S. Treasury futures	19,345			19,345
Total derivative liabilities	49,975			49,975
Warrant liabilities		5,111		5,111
Total liabilities at fair value	49,975	5,111		55,086
Net assets and liabilities at fair value	$361,081	$1,971,111	$1,199,627	$ 3,531,819

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 herein do not reflect the effect of the Company s risk management activities related to such Level 3 instruments.

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Fair value measurements using significant unobservable inputs

The tables below include a roll forward of the consolidated statement of financial condition amounts for the three and nine months ended September 30, 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 September 30, 2010	Fair Value, July 1, 2010	Total Realized/ Unrealized Gains/ (Losses)	Purchases, Issuances and Settlements, net	Transfers in and/or Out of Level 3	Fair Value September 30, 2010	Changes in Unrealized Gains and (Losses) Related to Financial Instruments Held at September 30, 2010
			(Dollars in thousands)			
Securities classified as trading:						
Residual interests [1]	$	$	$	$	$	$
Securities classified as available for sale [2][3]	517,406	4,365	(26,664)		495,107	4,364
Residential mortgage servicing rights	473,724	34,774	(61,476)		447,022	
Derivative financial instruments:						
Rate lock commitments	46,160		4,380		50,540	
Totals	$1,037,290	$39,139	$(83,760)	$	$992,669	$ 4,364

For the Three Months Ended September 30, 2009	Fair Value, July 1, 2009	Total Realized/ Unrealized Gains/ (Losses)	Purchases, Issuances and Settlements, net	Transfers In and/or Out of Level 3	Fair Value, September 30, 2009	Changes in Unrealized Gains and (Losses) Related to Financial Instruments Held at September 30, 2009
			(Dollars in thousands)			

Securities classified as trading:						
Residual interests [1]	$ 16,402	$ (13,133)	$	$	$ 3,269	$
Securities classified as available for sale [2] [3]	554,055	71,651	23,296		649,002	74,525
Residential mortgage servicing rights	658,209	(170,879)	76,699		564,029	
Derivative financial instruments:						
Rate lock commitments	29,200		11,405		40,605	
Totals	$1,257,866	$(112,361)	$111,400	$	$1,256,905	$74,525

(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 sponsored 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.

For the Nine Months Ended September 30, 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 September 30, 2010	Changes in Unrealized Gains and (Losses) Related to Financial Instruments Held at September 30, 2010
	(Dollars in thousands)					
Securities classified as trading:						
Residual interests [1]	$ 2,057	$ (2,057)	$	$	$	$
Securities classified as available for sale [2][3]	538,376	26,602	(69,871)		495,107	30,279
Residential mortgage servicing rights	649,133	(233,541)	31,431		447,023	
Derivative financial instruments:						
Rate lock commitments	10,061		40,479		50,540	
Totals	$ 1,199,627	$ (208,996)	$ 2,039	$	$ 992,670	$ 30,279

For the Nine Months Ended September 30, 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, September 30, 2009	Changes in Unrealized Gains and (Losses) Related to Financial Instruments Held at September 30, 2009
	(Dollars in thousands)					
Securities classified as trading:						
Residual interests [1]	$ 24,808	$ (21,539)	$	$	$ 3,269	$
Securities classified as available for sale [2] [3]	563,083	87,420	(1,501)		649,002	107,863
	511,294	(215,222)	267,957		564,029	

Residential mortgage servicing rights						
Derivative financial instruments:						
Rate lock commitments	78,613		(38,008)		40,605	
Totals	$1,177,798	$(149,341)	$228,448	$	$1,256,905	$107,863

(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 sponsored 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.

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

Assets Measured at Fair Value on a Nonrecurring Basis

	Balance at September 30, 2010	**Level 1**	**Level 2**	**Level 3**
		(Dollars in thousands)		
Loans held for investment	$337,731	$	$337,731	$
Repossessed assets	198,585		198,585	
Consumer loan servicing rights				
Totals	$536,316	$	$536,316	$

	Balance at December 31, 2009	**Level 1**	**Level 2**	**Level 3**
		(Dollars in thousands)		
Loans held for investment	$557,808	$	$557,808	$
Repossessed assets	176,968		176,968	
Consumer loan servicing rights	3,241			3,241
Totals	$738,017	$	$734,776	$3,241

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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:

	September 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(Dollars in thousands)			
Financial Instruments:				
Assets:				
Cash and cash equivalents	$ 1,013,133	$ 1,013,133	$ 1,082,489	$ 1,082,489
Securities trading	161,000	161,000	330,267	330,267
Securities available for sale	503,568	503,568	605,621	605,621
Other investments restricted			15,601	15,601
Loans available for sale	1,943,096	1,959,348	1,970,104	1,975,819
Loans held for investment, net	6,838,226	6,824,347	7,190,308	7,120,802
Repossessed assets	198,585	198,585	176,968	176,968
FHLB stock	373,443	373,443	373,443	373,443
Mortgage servicing rights	447,023	447,023	652,374	652,656
Liabilities:				
Retail deposits:				
Demand deposits and savings accounts	(1,899,529)	(1,817,918)	(1,900,855)	(1,799,776)
Certificates of deposit	(3,494,141)	(3,588,690)	(3,546,616)	(3,643,218)
Government accounts	(770,404)	(774,507)	(557,495)	(549,990)
National certificates of deposit	(1,257,926)	(1,287,737)	(2,017,080)	(2,455,684)
Company controlled deposits	(1,139,943)	(1,138,705)	(756,423)	(756,423)
FHLB advances	(3,400,000)	(3,671,301)	(3,900,000)	(4,136,489)
Security repurchase agreements			(108,000)	(110,961)
Long term debt	(248,610)	(89,299)	(300,182)	(284,464)
Warrant liabilities	(1,447)	(1,447)	(5,111)	(5,111)
Derivative Financial Instruments:				
Forward delivery contracts	(19,117)	(19,117)	27,764	27,764
Commitments to extend credit	50,540	50,540	10,061	10,061
Interest rate swaps	(19)	(19)	(747)	(747)
U.S. Treasury and agency futures/forwards	(2,447)	(2,447)	(49,228)	(49,228)

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 of 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.

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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 7 Investment Securities

As of September 30, 2010 and December 31, 2009, investment securities were comprised of the following:

	Current Maturities		September 30, 2010		December 31, 2009
			(Dollars in thousands)		
Securities trading					
U.S. government treasury bonds	2012	$	161,000	$	
U.S. government sponsored agencies	2038-2039				328,210
Non-investment grade residual interests					2,057
Total securities trading		$	161,000	$	330,267
Securities available-for-sale					
Non-agency securities	2035-2037	$	495,107	$	538,376
U.S. government sponsored agencies	2010-2040		8,461		67,245
Total securities available-for-sale		$	503,568	$	605,621
Other investments restricted					
Mutual funds		$		$	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.

For U.S. Treasury bonds and U.S. government sponsored agency mortgage-backed securities held, we recorded a gain of $76.7 million during the nine month period ended September 30, 2010, of which $4.1 million was unrealized gain on securities held at September 30, 2010. For the nine month period ended September 30, 2009, we recorded a net gain of $6.4 million, $16.8 million of which was unrealized loss on agency mortgage-backed securities at September 30, 2009.

The non-investment grade residual interests resulting from the Company s private label securitizations were zero at September 30, 2010 versus $2.1 million at December 31, 2009. 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 ratios, borrower credit scores and property type. 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.

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Available-for-Sale

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. At September 30, 2010 and December 31, 2009, the Company had $503.6 million and $605.6 million, respectively, in securities classified as available-for-sale which were comprised of U.S. government sponsored agency and non-agency collateralized mortgage obligations.

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:

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Amortized cost	$ 549,039	$ 679,872
Gross unrealized holding gains	2,708	2,118
Gross unrealized holding losses	(48,179)	(76,369)
Estimated fair value	$ 503,568	$ 605,621

The following table summarizes by duration the unrealized loss positions, at September 30, 2010, on these 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	$		$	$ 7,866	22	$
Collateralized mortgage obligations	578,499	12	(48,179)			
Totals	$ 578,499	12	$ (48,179)	$ 7,866	22	$

The unrealized loss on securities-available-for-sale amounted to $48.2 million on $586.4 million of principal of agency and non-agency securities at September 30, 2010. These CMOs consist of interests in investment vehicles backed by mortgage loans.

An investment impairment analysis of these securities 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 tranche owned; in the case of CMOs 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 portfolio reflect the economic conditions present in the U.S. over the course of the last several 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 (so-called strategic defaults.)

In the nine month period ended September 30, 2010, additional OTTI due to credit losses on eight investments with existing other-than-temporary impairment credit losses totaled $3.7 million while additional OTTI due to credit loss was recognized on two securities that did not already have such losses; all OTTI due to credit losses was recognized in current operations.

At September 30, 2010, the Company had total other-than-temporary impairments of $35.2 million on 12 securities in the available-for-sale portfolio with $38.9 million in total credit losses recognized through operations. At December 31, 2009, the Company had total OTTI of $111.6 million on 12 securities in the available-for-sale portfolio with $35.3 million in total credit losses recognized through operations.

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The following table shows the activity for OTTI credit net loss for the nine months ended September 30, 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	September 30, 2010 Balance
	(Dollars in thousands)				
Collateralized mortgage obligations	$(35,272)		$ (3,677)		$(38,949)

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 September 30, 2010, there was a $0.1 million loss on sales of $17.1 million of agency securities with underlying mortgage products recently originated by the Bank as compared with a $0.1 million gain on $190.5 million of sales during the quarter ended September 30, 2009. During the nine months ended September 30, 2010, sales of agency securities with underlying mortgage products originated by the Bank were $160.5 million resulting in $0.1 million of net gain on loan sale as compared with a $13.0 million gain on $653.0 million of sales during the nine month period ended September 30, 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 September 30, 2010 and 2009, the Company sold no U.S. government sponsored agency and non-agency securities available for sale. During the nine months ended September 30, 2010, the Company sold $251.0 million of agency and non-agency securities resulting in a net gain of $6.7 million versus no sales for the period ended September 30, 2009.

As of September 30, 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	$ 182,064	$ 170,252
Flagstar Home Equity Loan Trust 2006-1	161,404	146,643
Total	$ 343,468	$ 316,895

Other Investments Restricted

The Company has other investments in its insurance subsidiary which are restricted as to their use. These assets are held in trust and can only be used to pay insurance claims in that subsidiary arising from mortgage reinsurance agreements with certain mortgage insurance companies. These securities had a fair value that approximates their recorded amount for each period presented. During 2009, the Company executed commutation agreements with two of the four mortgage insurance companies with which it had reinsurance agreements and terminated its agreement with one of the four mortgage insurance companies. During the third quarter 2010, the Company terminated its last reinsurance agreement with the last of the four mortgage insurance companies. Under each commutation agreement, the respective mortgage insurance company took back the ceded risk (thus again assuming the entire insured risk) and received rights to all of the related future premiums. In addition, the mortgage insurance company received all the cash held in trust attributable to the related reinsurance arrangement. The Company had securities related to its remaining reinsurance agreements of zero and $15.6 million at September 30, 2010 and December 31, 2009, respectively.

Note 8 Loans Available for Sale

The following table summarizes loans available for sale:

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans	$ 1,943,096	$ 1,970,104
Total	$ 1,943,096	$ 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 on or after January 1, 2009 are affected. At September 30, 2010 and December 31, 2009, $1.8 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 are available. If such market prices are not available, the fair values of loans are 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 unilateral right to repurchase, without Ginnie Mae s prior authorization, any individual loan in a Ginnie Mae securitization pool if that loan meets certain criteria, including being delinquent greater than 90 days. Once the Company has the unilateral right to repurchase the delinquent loan, the Company has effectively regained control over the loan and must under U.S. GAAP, re-recognize the loan on its balance sheet, in loans available for sale, and establish a corresponding repurchase liability on its balance sheet regardless of the Company s intention to repurchase the loan. At September 30, 2010, the Company s re-recognized loans, included in loans available for sale, and corresponding liability, included in other liabilities, was $135.6 million.

Note 9 Loans Held for Investment

Loans held for investment are summarized as follows:

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans	$ 4,479,814	$ 4,990,994
Second mortgage loans	185,062	221,626
Commercial real estate loans	1,341,009	1,600,271
Construction loans	9,956	16,642
Warehouse lending	913,494	448,567
Consumer loans	373,086	423,842
Commercial loans	9,805	12,366
Total	7,312,226	7,714,308
Less allowance for loan losses	(474,000)	(524,000)
Total	$ 6,838,226	$ 7,190,308

For the three and nine month periods ended, September 30, 2010, the Company transferred $7.5 million and $76.2 million, respectively 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 September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Balance, beginning of period	$ 530,000	$ 474,000	$ 524,000	$ 376,000
Provision charged to operations	51,399	125,544	200,978	409,420
Charge-offs	(109,838)	(73,540)	(257,486)	(262,565)

Recoveries	2,439	1,996	6,508	5,145
Balance, end of period	$ 474,000	$ 528,000	$ 474,000	$ 528,000

There were loans totaling $14.6 million and $0.6 million greater than 90 days past due that were still accruing interest as of September 30, 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 and 2010 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. At September 30, 2010, TDRs totaled $748.8 million of which $299.0 million were non-accruing.

Loans on which interest accruals have been discontinued totaled approximately $0.9 billion at September 30, 2010 and $1.1 billion at December 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 only 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. TDRs of impaired loans that perform under the restructured terms will remain 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, provided the loan continues to perform according to its restructured terms. Interest that would have been accrued on non-accrual loans totaled approximately $26.8 million and $25.7 million during the nine months ended September 30, 2010 and 2009, respectively.

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. The following table details impaired loans by loan loss allowance allocation and interest earned.

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Impaired loans with no allowance for loan losses allocated (1)	$ 112,183	$ 160,188
Impaired loans with allowance for loan losses allocated	859,621	891,022
Total impaired loans	$ 971,804	$ 1,051,210
Amount of the allowance allocated to impaired loans	$ 155,588	$ 172,741
Average investment in impaired loans	$ 1,024,964	$ 796,112
Cash-basis interest income recognized during impairment (2)	$ 23,892	$ 26,602

(1) Includes loans for which the principal balance has been charged down to net realizable value. Those impaired loans not requiring an allowance represents loans for which expected discounted cash flows or the fair value of the collateral less estimated selling costs exceeded the recorded investments in such loans. At September 30, 2010, approximately 43.72% of the total impaired loans were evaluated based on the fair value of related collateral.

(2) Includes interest income recognized during the nine months ended September 30, 2010 and year ended December 31, 2009, respectively.

The Company announced on November 2, 2010, that it had entered into an agreement to sell approximately $474.0 million of non-insured non-performing residential first mortgage loans and will reclassify an additional $86.0 million in residential non-performing loans as available for sale. See Note 3, Recent Developments, for further information.

Note 10 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 FHLB of Indianapolis and other potential future obligations. The following table details pledged asset by asset class, and the carrying value of pledged investments and the investments maturities.

	September 30, 2010		December 31, 2009	
	Carrying Value	Investment Maturities	Carrying Value	Investment Maturities
	(Dollars in thousands)			
Securities classified as trading:				
U.S. government treasury bonds	$ 158,945	2012	$	
U.S. government sponsored agencies			328,210	2038-2039
Securities classified as available for sale:				
U.S. government sponsored agencies	743	2010-2040	47,213	2010-2040
Non-agency securities	146,643	2035-2037	538,376	2035-2037
Loans held for investment:				
Mortgage loans	5,446,622	Various	5,526,865	Various
Second mortgage loans	154,371	Various	194,319	Various
Consumer loans	262,499	Various	286,602	Various
Commercial real estate loans	582,411	Various	751,472	Various
Other assets:				
Government guaranteed repurchased Ginnie Mae assets	1,515,928	Various		
Totals	$ 8,268,162		$ 7,673,057	

Note 11 Private-label Securitization Activity

The Company has, in the past, securitized fixed and adjustable rate second mortgage loans and home equity line of credit loans for sale in the non-agency secondary market. The Company acted as the principal underwriter of the beneficial interests that were sold to investors. The financial assets were derecognized when they were transferred to the securitization trust, which then issued and sold mortgage-backed securities to third party investors. The Company relinquished control over the loans at the time the financial assets were transferred to the securitization trust. The Company typically recognized a gain on the sale on the transferred assets.

The Company retained 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 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 within the securitization trust, which will equal the excess of the loan pool balance over the note principal balance and are comprised of the overcollateralization amount and any 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 have been 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, until March 2008, draws on the home equity lines of credit in the trust established in the FSTAR 2005-1 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 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 have been reported in the consolidated statement of operations.

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, until November 2007, draws on the home equity lines of credit in the trust established in the FSTAR 2006-2 HELOC Securitization were purchased from the Company by the trust, resulting in additional residual interests to the Company. These residual interests were recorded as securities classified as trading and 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 have been reported in the consolidated statement of operations.

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During 2009 and for the nine months ended September 30, 2010, the Company did not engage in any private-label securitization activity. At September 30, 2010, the Company had a zero balance of residuals as compared to $2.1 million at December 31, 2009. Transferor s interests at September 30, 2010 were $16.6 million as compared to $19.1 million at December 31, 2009.

Summary of Securitization Activity

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

	For the Three Months Ended	For the Nine Months Ended