

FLAGSTAR BANCORP INC

Form 10-K

March 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2015

OR

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

Commission file number: 001-16577

(Exact name of registrant as specified in its charter)

Michigan

(State or other jurisdiction of incorporation or organization)

38-3150651

(I.R.S. Employer Identification No.)

5151 Corporate Drive, Troy, Michigan

(Address of principal executive offices)

48098-2639

(Zip Code)

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

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

Title of each class

Common Stock, par value \$0.01 per share

Name of each exchange on which registered

New York Stock Exchange

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

(Do not check if a smaller reporting company)

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

The estimated aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing sale price (\$18.48 per share) as reported on the New York Stock Exchange on June 30, 2015, was approximately \$385 million. The registrant does not have any non-voting common equity shares.

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As of March 10, 2016, 56,557,895 shares of the registrant's common stock, \$0.01 par value, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement relating to the 2016 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report on Form 10-K.

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## FORWARD-LOOKING STATEMENTS

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

Generally, forward-looking statements are not based on historical facts but instead represent management's beliefs regarding future events. Such statements may be identified by words such as believe, expect, anticipate, intend, plan, believe, estimate, may increase, may fluctuate, and similar expressions or future or conditional verbs such as will, should, would and could. Such statements are based on management's current expectations and are subject to risks, uncertainties and changes in circumstances. Actual results and capital and other financial conditions may differ materially from those included in these statements due to a variety of factors, including without limitation the precautionary statements included within each individual business' discussion and analysis of its results of operations and the factors listed and described under "Risk Factors" below.

Any forward-looking statements made by or on behalf of Flagstar Bancorp, Inc. speak only as to the date they are made, and do not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made.

## PART I

### ITEM 1. BUSINESS

Where we say "we," "us," or "our," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," or "our" will include our wholly-owned subsidiary Flagstar Bank, FSB (the "Bank").

#### General

We are a Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. At December 31, 2015, based on our assets, we are the largest bank headquartered in Michigan and one of the top 10 largest savings banks in the United States. Our common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "FBC." We are considered a controlled company for NYSE purposes, because MP Thrift Investments, L.P. ("MP Thrift") held approximately 63.1 percent of our common stock as of December 31, 2015.

We primarily originate or purchase residential mortgage loans throughout the country and sell them into securitization pools, primarily to Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Government National Mortgage Association ("Ginnie Mae") (collectively, the "Agencies") or as whole loans. In addition, we originate or purchase residential first mortgage loans, consumer loans, commercial loans and warehouse loans included in held-for-investment loan portfolios. Our revenues include net interest income, income from banking services we provide customers, and noninterest income from sales of residential first mortgage loans to the Agencies, the servicing of loans for others and the sale of servicing rights related to mortgage loans serviced for others. The combination of our home lending, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our residential mortgage loan products.

The majority of our total loan originations during the year ended December 31, 2015 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale to the Agencies. At December 31, 2015, we originated or purchased residential mortgage loans in all 50 states, the U.S. Virgin Islands, and the District of Columbia through relationships with approximately 514 mortgage brokers and approximately 679 correspondents. At December 31, 2015, we also operated 10 retail centers located in nine states, which primarily originate one-to-four family residential mortgage loans as part of our Mortgage Originations segment. In addition, we originate other consumer and commercial loans through our Community Banking segment.

Our business also includes the activities conducted through our Community Banking segment. This segment provides deposits and fee based services to consumer, business, and mortgage lending customers through its Branch Banking, Business, and Commercial Banking, Government Banking, Warehouse Lending and Held-for-Investment Portfolio groups. We maintain a portfolio of commercial and industrial and commercial real estate loans with our commercial customers and we originate or purchase residential mortgage loans through referrals from our branches, consumer direct call center and our website, flagstar.com. At December 31, 2015, we operated 99 branches in Michigan. We leverage the customer relationships we have gained throughout our branch network to cross-sell products to existing customers and increase our customer base.

At December 31, 2015, we had 2,713 full-time equivalent employees inclusive of account executives and loan officers.

#### Mortgage Originations

We originate, acquire and sell one-to-four family residential mortgage loans. Substantially all of the residential mortgage loans we sell are delivered into the secondary market on a whole loan basis or securitizing the loans into mortgage-backed securities with the agencies.

#### Mortgage Servicing

We also service and sub-service mortgage loans on a fee basis for others, and we service residential mortgages held-for-investment for our own portfolio.

## Lending Activities

Our principal lending activities consist of the origination of residential first mortgage, second mortgage, HELOC and commercial loans generally located within our primary market and service areas.

**Residential first mortgage loans.** We originate conforming and non-conforming residential first mortgage loans that are generally made to consumers for the purchase or refinance of a residence. These loans are generally financed over a 15-year to 30-year term and, in most cases, are extended to borrowers to finance their primary residence. Applications are underwritten centrally using consistent credit policies and processes.

**Second mortgage loans.** The majority of second mortgages we originate are closed in conjunction with the closing of the residential first mortgages originated by us. We generally require the same levels of documentation and ratios as with our residential first mortgages. Second mortgage loans require full documentation and are underwritten and priced to ensure high credit quality and loan profitability.

**Home Equity Line of Credit ("HELOC") loans.** HELOC guidelines and pricing parameters have been established to attract high credit quality loans with long term profitability. HELOCs, which are secured by a first-lien or junior-lien on the borrower's residence, allow customers to borrow against the equity in their homes or refinance existing mortgage debt. Applications are underwritten centrally in conjunction with an automated underwriting system. The HELOC underwriting criteria are based on minimum credit scores, debt-to-income ratios, and LTV ratios, with current collateral valuations.

**Commercial loans.** Commercial loans include commercial and industrial, commercial real estate and warehouse loans. Commercial and industrial loans are made to commercial customers involved in a broad range of industries for use in normal business operations to finance working capital needs, equipment purchases and other capital investments. Our commercial and industrial customers are involved in financial, insurance, service, manufacturing, and distribution. Commercial borrowers are made of up primarily of Michigan relationships, as well as national finance companies. Commercial real estate loans consist of loans to developers and support income producing commercial real estate properties. These loans are made to finance properties such as owner-occupied, retail, office, multi-family apartment buildings, industrial buildings, and residential developments. They are repaid through cash flows related to the operation, sale, or refinance of the property. Warehouse loans are lines of credit to other mortgage lenders. In 2016, we launched a national home builder finance program to grow our balance sheet, increase commercial deposits and develop incremental revenue through our retail purchase mortgage channel.

## Deposits

Deposits include retail, commercial, government and company controlled deposits. Through our branches and commercial relationships, we gather deposits and offer a line of consumer and commercial financial products to individuals and businesses. We continue to focus our efforts towards the growth of our core deposits, which includes checking, savings and money market deposit accounts. We believe core deposits represent a more stable funding source. Government deposits are gathered from local municipalities primarily across the state of Michigan and are comprised mainly of property taxes that are collected. See Note 12 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for more information regarding deposits.

## Borrowed funds

The Federal Home Loan Bank provides funding on a fully collateralized basis to us. We are currently authorized through a resolution of our board of directors to apply for advances from the Federal Home Loan Bank using approved loan types as collateral, such as residential first mortgage loans, home equity lines of credit, commercial real

estate loans.

We have arrangements with the Federal Reserve Bank of Chicago to borrow as appropriate from its discount window. The discount window is a borrowing facility that is intended to be used only for short-term liquidity needs arising from special or unusual circumstances. The amount we are allowed to borrow is based on the lendable value of the collateral that we agree to provide. To collateralize the line, we pledge commercial and industrial loans that are eligible based on Federal Reserve Bank of Chicago guidelines.

#### Non-bank Subsidiaries

At December 31, 2015, our corporate legal structure consisted of the Bank, including its wholly-owned subsidiaries and wholly-owned non-bank subsidiaries through which we conduct other non-material business or which are inactive. The Bank comprised of 99.5 percent of our total assets at December 31, 2015. We also own nine statutory trusts that are not



consolidated with our operations. For additional information, see Notes 1, 7 and 26 of the Notes to the Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

### Regulation and Supervision

The banking industry is highly regulated. Statutory and regulatory controls are designed primarily for the protection of depositors and the financial system, and not for the purpose of protecting our shareholders. The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on us and the Bank. Changes in applicable laws or regulations, and in their interpretation and application by regulatory agencies, cannot be predicted and may have a material effect on our business and results.

The Bank is a savings and loan holding company. We must comply with a wide variety of banking, consumer protection and securities laws, regulations and supervisory expectations and are regulated by multiple regulators, including the Board of Governors of the Federal Reserve (the "Federal Reserve"), the Office of the Comptroller of the Currency ("OCC") of the U.S. Department of the Treasury ("U.S. Treasury"), Consumer Financial Protection Bureau (the "CFPB"), the Federal Deposit Insurance Corporation ("FDIC") and the Securities and Exchange Commission (the "SEC") or collectively "the regulatory agencies." The Bank's deposits are insured by the FDIC through the Deposit Insurance Fund.

As a general matter, the regulatory agencies are taking a more stringent approach to supervising and regulating financial institutions and financial products and services over which they exercise their respective supervisory authorities. We, the Bank and our products and services all remain subject to greater supervisory scrutiny and enhanced supervisory requirements and expectations.

### Consent Order with OCC

Effective October 23, 2012, the Bank's board of directors executed a Stipulation and Consent (the "Stipulation"), accepting the issuance of a Consent Order (the "Consent Order") by the OCC. The Consent Order replaces the supervisory agreement entered into between the Bank and the Office of Thrift Supervision (the "OTS") on January 27, 2010, which the OCC terminated simultaneous with issuance of the Consent Order." For further information and a complete description of all of the terms of the Consent Order, please refer to the copy of the Consent Order filed with the SEC as an exhibit to our Current Report on Form 8-K filed on October 24, 2012.

### Supervisory Agreement

We are also subject to the Supervisory Agreement with the Board of Governors of the Federal Reserve (the "Supervisory Agreement"), dated January 27, 2010. A failure to comply with the Supervisory Agreement could result in the initiation of further enforcement action by the Federal Reserve, including the imposition of further operating restrictions, and could result in additional enforcement actions against the Company. The Company has taken actions which it believes are appropriate to comply with and intends to maintain compliance with all of the requirements of the Supervisory Agreement. For further information and a complete description of all of the terms of the Supervisory Agreement, please refer to the copy of the Supervisory Agreement filed with the SEC as an exhibit to the Company's Current Report on Form 8-K filed on January 28, 2010.

### Consent Order with CFPB

On September 29, 2014, the Bank entered into a Consent Order with the CFPB. The Consent Order relates to alleged violations of federal consumer financial laws arising from the Bank's residential first mortgage loan loss mitigation practices and default servicing operations dating back to 2011. Under the terms of the Consent Order, the Bank has

paid \$28 million for borrower remediation and \$10 million in civil money penalties. The settlement does not involve any admission of wrongdoing on the part of the Bank or its employees, directors, officers, or agents.

#### Holding Company Status, Acquisitions and Activities

We are a unitary savings and loan holding company, as defined by federal banking law, as is our controlling stockholder, MP Thrift. We may only conduct, or acquire control of companies engaged in, activities permissible for a savings and loan holding company pursuant to the relevant provisions of the Savings and Loan Holding Company Act and relevant regulations. Without prior written approval of the Federal Reserve, neither we, nor MP Thrift may: (i) acquire control of another savings association or holding company thereof, or acquire all or substantially all of the assets thereof; or (ii) acquire or retain, with certain exceptions, more than 5 percent of the voting shares of a non-subsiary savings association or a non-

subsidiary savings and loan holding company. We are prohibited from acquiring control of a depository institution that is not federally insured or retaining control of a savings association subsidiary for more than one year after the date that such subsidiary becomes uninsured. Similarly, we may not be acquired by a bank holding company, or any company, unless the Federal Reserve approves such transaction. In all situations, the public must have an opportunity to comment on any such proposed acquisition, and the OCC or the Federal Reserve must complete an application review. In addition, the Gramm-Leach-Bliley Act (the "GLBA") generally restricts any non-financial entity from acquiring us.

#### Source of Strength

The Dodd-Frank Act codified the Federal Reserve's "source of strength" doctrine and extended it to savings and loan holding companies. Under the Dodd-Frank Act, the prudential regulatory agencies are required to promulgate joint rules requiring bank holding companies and savings and loan holding companies to serve as a source of financial strength for any depository institution subsidiary by maintaining the ability to provide financial assistance to such insured depository institution in the event that it suffers financial distress.

#### Regulatory Capital Requirements

The Bank and the holding company are currently subject to the regulatory capital framework and the implementation of the agreement reached by the Basel Committee on Banking and Supervision "Basel III" as adopted by the OCC and Federal Reserve. The OCC and Federal Reserve have risk-based capital adequacy guidelines intended to measure capital adequacy with regard to a banking organization's balance sheet, including off-balance sheet exposures such as unused portions of loan commitments, letters of credit, and recourse arrangements. The Bank is required to comply with these capital adequacy standards. Beginning in 2015, our holding company was required to comply with the Federal Reserve Bank's capital adequacy guidelines. Prior to 2015, these rules did not apply to savings and loan holding companies. Federal law and regulations established five levels of capital compliance: well-capitalized, adequately capitalized, under-capitalized, significantly under-capitalized and critically under-capitalized.

At December 31, 2015, the Bank and the holding company were considered "well-capitalized" for regulatory purposes under the Prompt Corrective Action framework. An institution is considered well-capitalized if its ratio of total risk-based capital to risk-weighted assets is 10.0 percent or more, its ratio of Tier 1 capital to risk-weighted assets is 8.0 percent or more, its ratio of common equity tier 1 capital to risk-weighted assets is 6.5 percent or more, and its leverage ratio of Tier 1 capital to total assets is 5.0 percent or more. Any institution that is not well capitalized or adequately capitalized is considered under-capitalized. Any institution with a tangible equity to total assets ratio of 2.0 percent or less is considered critically under-capitalized. See Note 22 - Regulatory Matters - Regulatory Capital, for additional information.

Effective on January 1, 2015, the capital framework under the Basel III final rule replaced the existing regulatory capital rules for all banks, savings associations, and U.S. bank holding companies with greater than \$500 million in total assets, and all savings and loan holding companies. The final rule implements a new common equity Tier 1 minimum capital requirement. In addition, the new regulations subject a banking organization to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization did not maintain a capital conservation buffer of common equity Tier 1 capital in an amount greater than 2.5 percent of its total risk-weighted assets. The effect of the capital conservation buffer will be to increase the minimum common equity Tier 1 capital ratio to 7.0 percent, the minimum Tier 1 risk-based capital ratio to 8.5 percent and the minimum total risk-based capital ratio to 10.5 percent. The capital conservation buffer becomes effective January 1, 2016 with transition provisions through 2018.

The new regulations grandfather the regulatory capital treatment of hybrid debt and equity securities, such as trust preferred securities issued prior to May 19, 2010, for banks or holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009. Although the Company may continue to include our existing trust preferred securities as Tier 1 capital, the prohibition on the use of these securities as Tier 1 capital going forward may limit the Company's ability to raise capital in the future.

Various aspects of Basel III are subject to multi-year transition periods through December 31, 2018. Basel III will materially change our Tier 1, Tier 1 common and total capital calculations.

#### Standards for Safety and Soundness

Federal law requires each U.S. bank regulatory agency to prescribe certain safety and soundness standards for all insured financial institutions. To that end, the U.S. bank regulatory agencies adopted Interagency Guidelines Establishing

Standards for Safety and Soundness. These are used by the U.S. bank regulatory agencies to identify and address problems at insured financial institutions before capital becomes impaired. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, compensation and benefits, earnings, and other operational and managerial standards as the agency deems appropriate. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. If the appropriate U.S. banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

#### Qualified Thrift Lender

The Bank is required to meet a Qualified Thrift Lender ("QTL") test to avoid certain restrictions on operations, including restrictions applicable to multiple savings and loan holding companies, restrictions on the ability to branch interstate, and our mandatory registration as a bank holding company under the Bank Holding Company Act of 1956. A savings bank satisfies the QTL test if: (i) on a monthly basis, for at least nine months out of each twelve month period, at least 65 percent of a specified asset base of the savings bank consists of loans to small businesses, credit card loans, educational loans, or certain assets related to domestic residential real estate, including residential mortgage loans and mortgage securities, as well as a portion of residential loans originated and sold within 90 days of origination; or (ii) at least 60 percent of the savings bank's total assets consist of cash, U.S. government or government agency debt or equity securities, fixed assets, or loans secured by deposits, real property used for residential, educational, church, welfare, or health purposes, or real property in certain urban renewal areas. The Bank is currently, and expects to remain, in compliance with QTL standards.

#### FDIC Insurance and Assessment

The FDIC insures the deposits of the Bank and such insurance is backed by the full faith and credit of the U.S. government through the Deposit Insurance Fund ("DIF"). The Dodd-Frank Act raised the standard maximum deposit insurance amount to \$250,000 per depositor, per insured financial institution for each account ownership category. Deposits held in noninterest bearing transaction accounts are now aggregated with any interest bearing deposits the owner may hold in the same ownership category and the combined total is insured up to at least \$250,000.

Pursuant to the Dodd-Frank Act, the minimum reserve ratio designated by the FDIC each year is 1.35 percent of the assessment base, as opposed to 1.15 percent under prior law. The FDIC is required to meet the minimum reserve ratio by September 30, 2020 and is required to offset the effect of the increased reserve ratio for banks with assets less than \$10 billion. The FDIC has established a higher reserve ratio of 2 percent as a long-term goal beyond what is required by statute. The FDIC is operating under a DIF Restoration Plan while the reserve ratio remains below the minimum target. The Restoration Plan allows the FDIC to evaluate whether growth in the DIF under current assessment rates is likely to be sufficient to meet the statutory requirements. In October of 2015, the FDIC proposed to increase the DIF to the statutorily required minimum level of 1.35 percent. The Dodd-Frank Act made banks with \$10 billion or more in total assets responsible for the increase from 1.15 percent to 1.35 percent. Under the current rule regular assessment rates for all banks will decline when the reserve ratio reaches 1.15 percent, which the FDIC expects will occur in early 2016. The proposed rule will impose on the Bank a surcharge of 4.5 cents per \$100 of our assessment base, after making certain adjustments. The FDIC expects the reserve ratio would likely reach 1.35 percent after approximately two years of payments of the proposed surcharges. The DIF is funded mainly through quarterly assessments on insured banks.

The FDIC maintains the DIF by assessing each financial institution an insurance premium. The FDIC defined deposit insurance assessment base for an insured depository institution is equal to the average consolidated total assets during the assessment period, minus average tangible equity.

During 2015, the Bank was classified as a small institution for deposit insurance assessment purposes. As a small institution, the Bank was assigned to one of three Capital Groups based on our capitalization level. The Bank was also assigned to one of three Supervisory Groups based on the supervisory evaluations provided by the Bank's primary federal regulator. Our assessment rate, as a small institution, was determined based upon the Risk Category to which we are assigned. Our Risk Category was determined based on a combination of our Supervisory and Capital Group assignments.

Effective January 1, 2016, as a result of reporting assets of more than \$10 billion for four consecutive quarters, the Bank is classified as a large institution for deposit insurance assessment purposes. The assessment rate schedule for large financial institutions (i.e., financial institutions with at least \$10 billion in assets) is determined by use of a scorecard that combines a financial institution's Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity ("CAMELS") ratings with certain forward-looking financial information to measure the risk to the DIF. Pursuant to this scorecard method, two scores

(a performance score and a loss severity score) are combined and converted to an initial base assessment rate (also referred to as IBAR). The performance score measures a financial institution's financial performance and ability to withstand stress. The loss severity score measures the relative magnitude of potential losses to the FDIC in the event of the financial institution's failure. Total scores are converted pursuant to a predetermined formula into an initial base assessment rate, which is subject to adjustment based upon significant risk factors not captured in the scoreboard. Total assessment rates range from 2.5 basis points to 45 basis points for such large financial institutions.

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

#### Affiliate Transaction Restrictions

The Bank is subject to the affiliate and insider transaction rules applicable to member banks of the Federal Reserve as well as additional limitations imposed by the OCC. These provisions prohibit or limit the Bank from extending credit to, or entering into certain transactions with certain affiliates, principal stockholders, directors and executive officers of the banking institution and certain of its affiliates. The Dodd-Frank Act imposed further restrictions on transactions with certain affiliates and extension of credit to executive officers, directors and principal stockholders.

#### Incentive Compensation

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

The U.S. bank regulatory agencies review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of U.S. banks that are not "large, complex banking organizations." These reviews are tailored to each bank based on the scope and complexity of the bank's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives are included in reports of examination. Deficiencies are incorporated into the bank's supervisory ratings, which may affect the bank's ability to make acquisitions and take other actions. Enforcement actions will be taken against a bank if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the bank's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies. See the Supervisory Agreement discussion, in Item 1. Business for further discussion of the executive compensation notice requirements.

#### Federal Reserve

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

Federal Reserve regulations require federally chartered savings associations to maintain cash reserves against their transaction accounts (primarily NOW and demand deposit accounts). During 2016, a 3 percent reserve is to be maintained against aggregate transaction accounts between \$15 million and \$110 million (subject to adjustment by the Federal Reserve) plus a reserve of 10 percent (subject to adjustment by the Federal Reserve between 8 percent and 14 percent) against that portion of total transaction accounts in excess of \$110 million. For 2015, a 3 percent reserve will be required to be maintained against aggregate transaction accounts between \$14.5 million and \$103.6 million (subject to adjustment by the Federal Reserve) plus a reserve of 10 percent (subject to adjustment by the Federal Reserve between 8 percent and 14 percent) against that portion of total transaction accounts in excess of \$103.6 million.

Required reserves must be maintained in the form of vault cash, an account at a Federal Reserve Bank or a pass-through account as defined by the Federal Reserve. Pursuant to the Emergency Economic Stabilization Act of 2008, the Federal Reserve Banks pay interest on depository institutions' required and excess reserve balances. These interest rates are determined by the Federal Reserve, and currently both rates are 0.50 percent per annum.



#### Bank Secrecy Act ("BSA")

The BSA requires all financial institutions, including banks, to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. Under the BSA, an internal controls program should, at a minimum, include independent testing for compliance, designate an individual responsible for coordinating and monitoring day-to-day compliance and provide training for appropriate personnel. The BSA also includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting), as well as due diligence/know-your-customer documentation requirements. The Bank has established a global anti-money laundering program in order to comply with the BSA requirements and certain requirements under the Consent Order relating to its compliance with the BSA.

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

#### The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act")

The PATRIOT Act amended the BSA to include numerous provisions designed to detect and prevent the financing of international money laundering and terrorism. The PATRIOT Act mandates that U.S. financial institutions (and foreign financial institutions with U.S. operations) implement additional policies and procedures that meet certain minimum requirements and take heightened measures designed to address any or all of the following: customer identification programs, money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, currency crimes and cooperation between financial institutions and law enforcement authorities. Other required actions include terminating correspondent accounts for foreign "shell banks," obtaining information about the owners of foreign bank clients, and providing the name and address of the foreign bank's agent for service of process in the United States. Significant penalties and fines, as well as other supervisory orders may be imposed on a financial institution for non-compliance with these requirements. In addition, the U.S. bank regulatory agencies must consider the effectiveness of financial institutions engaging in a merger transaction in combating money laundering activities. The Bank has established policies and procedures intended to comply with the PATRIOT Act's provisions, the BSA, as well as other aspects of anti-money laundering legislation.

#### Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals, individuals, entities and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury's Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting certain persons and countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country or with a sanctioned person, including prohibitions against direct or indirect imports from and exports to a sanctioned country or person and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing

investment-related advice or assistance to, a sanctioned country or person; and (ii) a blocking of assets in which the sanctioned country or person have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

#### Consumer Protection Laws and Regulations

The Bank is subject to many federal consumer protection statutes and regulations, the examination and enforcement of which has become more pronounced since the passage of the Dodd-Frank Act and the creation of the CFPB. The CFPB has assumed the responsibility for the development and enforcement of the federal consumer protection statutes and regulations, such as the Electronic Fund Transfer Act, the Fair Credit Reporting Act, the Homeowners Protection Act, the Fair Debt Collection Practices Act, the Home Mortgage Disclosure Act, the Home Ownership and Equity Protection Act, the Secure and

Fair Enforcement for Mortgage Licensing Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Servicemembers' Civil Relief Act and the Truth in Saving Act. The Dodd-Frank Act gave the CFPB: (i) broad rule-making, supervisory, examination and enforcement authority in this area over financial institutions that have assets of more than \$10 billion, (ii) expanded data collecting powers for fair lending purposes for both small business and mortgage loans and (iii) authority to prevent unfair, deceptive and abusive practices. The consumer complaint function of the OCC also has been transferred to the CFPB. The Dodd-Frank Act also narrows the scope of federal preemption of state laws related to federally chartered financial institutions, including savings banks such as the Bank, which gives broader rights to state attorney generals to enforce certain consumer protection loans.

During 2015, the Bank was not subject to the CFPB's supervisory, examination and enforcement authority with respect to consumer protection laws and regulations because the Bank had reported assets of less than \$10 billion for four consecutive quarters. Instead, it was subject to the OCC's supervisory, examination and enforcement authority in this area. As of December 31, 2015, the total assets of the Bank have exceeded \$10 billion for four consecutive quarters, and as such, the Bank is again subject to the CFPB's supervisory, examination and enforcement authority with respect to consumer protection laws and regulations starting in January 2016.

In 2016 and future years, the Company anticipates that it will continue to be financially impacted by several meaningful regulatory changes. The most significant changes of which include:

**Amendments to the 2014 Regulations Related to Mortgage Origination and Servicing.** In January 2013, the CFPB issued a series of final rules related to mortgage loan origination and mortgage loan servicing. While these final rules amended existing regulations applicable to Flagstar, adjustments in our business operations necessary to comply with these rules have increased our overall regulatory compliance costs. In addition, the CFPB continues to modify and refine the new substantive requirements. In 2014, the CFPB issued final and proposed rules and guidance to amend and supplement its mortgage loan servicing rules. On July 8, 2014, the CFPB issued a final rule to clarify that the name of a deceased borrower's heir generally may be added to a mortgage without triggering the ability-to-repay rule. On August 19, 2014, the CFPB issued guidance that outlines what CFPB examiners will look for when mortgage servicing rights are transferred to ensure that mortgage servicers are fulfilling their obligations under the mortgage servicing rules and highlights regulatory requirements that may be implicated by a transfer of mortgage servicing rights. On October 22, 2014, the CFPB issued a final rule that provides a limited, post-consummation cure mechanism for loans that exceed the points and fees limit for Qualified Mortgages, but that meet the other requirements for being a Qualified Mortgage at consummation. In addition, on November 20, 2014, the CFPB proposed several amendments to certain mortgage servicing rules, including amendments that would require servicers to provide certain borrowers with foreclosure protections more than once over the life of the loan, clarify when a consumer is considered "delinquent," expand protections provided to certain borrowers during a servicing transfer and prevent wrongful disclosures. The CFPB is expected to continue to revise its rules related to mortgage loan origination and mortgage loan servicing, and additional rulemaking affecting the residential mortgage business is expected.

**The TILA-RESPA Integrated Disclosure Rule.** On November 20, 2013, the CFPB issued a final rule and official interpretation, which established integrated mortgage disclosure requirements for lenders and settlement agents in connection with most closed-end consumer credit transactions secured by real property. The final rule, commonly referred to as "TRID," became effective as to mortgage applications received on or after October 3, 2015 and combines certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under the Truth in Lending Act and the Real Estate Settlement Procedures Act. Among other things, the rule mandates the use of two new disclosure forms, a Loan Estimate form and a Closing Disclosure form, which replace existing disclosure forms and include additional content not required by the prior forms. In addition, the rule requires that the Closing Disclosure form be received by the borrower at least three business days before closing in most cases, limits the circumstances in which borrowers may be required to pay more for settlement services than the amount stated on

the Loan Estimate form and imposes certain recordkeeping requirements.

The Home Mortgage Disclosure Act (the "HMDA") and Updated Reporting Requirements. The HMDA grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes. Regulation C provides the mechanism for this collection and reporting of data, which has been applicable to closed-end consumer loans secured by a dwelling and which a financial institution originates, purchases, or for which it receives an application. On October 15, 2015, the CFPB issued a final rule amending Regulation C, expanding the amount of data to be gathered and reported as well as subjecting home equity lines of credit and reverse mortgages to these requirements. The new data gathering requirements will become effective on January 1, 2018 while the new reporting obligations will become

effective in 2019, although it is not yet clear how much of this new data will be made publicly available. We will continue to assess the impact to Flagstar as we update our procedures and system controls and as the CFPB provides additional guidance on how much of the data will be made publicly available.

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

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

In addition, many states also have predatory lending laws that may be applicable to the Bank.

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

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

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

In addition, the Bank is subject to regulatory guidelines establishing standards for safeguarding customer information. These regulations implement certain provisions of the GLBA. The guidelines describe the U.S. bank regulatory agencies expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of such records and protect against unauthorized access to, or use of, such records or information that could result in substantial harm or inconvenience to any customer.

**Fair Credit Reporting Act and the Fair and Accurate Credit Transactions Act ("FACT Act").** The Fair Credit Reporting Act, as amended by the FACT Act, requires financial firms to help deter identity theft, including developing appropriate fraud response programs, and gives consumers more control of their credit data. It also reauthorizes a federal ban on state laws that interfere with corporate credit granting and marketing practices. In connection with the FACT Act, U.S. bank regulatory agencies proposed rules that would prohibit an institution from using certain

information about a consumer it received from an affiliate to make a solicitation to the consumer, unless the consumer has been notified and given a chance to opt out of such solicitations. A consumer's election to opt out would be applicable for at least five years.

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

Truth In Lending Act (“TILA”). The TILA is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things. In addition, the TILA, through its

implementation of Regulation Z also provides a variety of substantive protections for consumers, including but not limited to the technical requirements of the new TILA RESPA Integrated Disclosure Rule. These protections also include the rules applicable to assessing a consumer's ability to repay as well as what constitutes a "qualified mortgage," the rules applicable to higher-priced mortgage loans, the strict requirements applicable to making a "High Cost Mortgage Loan," and rules restricting loan originator compensation. Regulation Z also impacts mortgage loan servicing, through rules applying to billing statements, interest rate adjustment notices, and the way in which payments are to be applied. Violations of these provisions can result in civil liability and/or administrative sanctions.

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

Real Estate Settlement Procedures Act ("RESPA"). Lenders are required by RESPA to provide borrowers with disclosures regarding the nature and cost of real estate settlements. While many of these requirements are now spelled out under the Truth in Lending Act's Regulation Z pursuant to the TILA RESPA Integrated Disclosure Rule, RESPA and its Regulation X continue to impact mortgage servicing compliance through several rules, including but not limited to those applicable to handling borrower requests for information and notices of error, force placed insurance, loss mitigation and foreclosure, and the transfer of servicing. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Violations of RESPA may result in civil liability or administrative sanctions.

Servicemembers' Civil Relief Act (the "SCRA"). The SCRA applies to all debts incurred prior to commencement of active military service (including credit card and other open-end debt) and limits the amount of interest, including service and renewal charges and any other fees or charges (other than bona fide insurance) that is related to the obligation or liability.

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

#### Community Reinvestment Act ("CRA")

The CRA, as implemented by OCC regulations, requires the OCC to evaluate how federal savings associations have helped to meet the credit needs of the communities they serve, including low to moderate income neighborhoods, while maintaining safe and sound banking practices. The evaluation rates an institution based on its actual performance in meeting community needs. In particular, the current evaluation system focuses on three tests: (i) a lending test, to evaluate the institution's record of making loans in its service areas (ii) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing, and programs benefiting low- or moderate-income individuals and businesses; and (iii) a service test, to evaluate the institution's delivery of services through its branches, ATMs and other offices. The OCC assigns one of four possible ratings to an institution's CRA performance and is required to make public an institution's rating and written evaluation. The four possible ratings of meeting community credit needs are outstanding, satisfactory, needs to improve and substantial non-compliance.

An institution's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities, including, but not limited to, engaging in acquisitions and mergers. CRA ratings are also considered in evaluating applications to open a branch.

## Regulatory Reform

The Dodd-Frank Act requires the federal financial regulatory agencies to adopt rules that prohibit banks and affiliates from engaging in proprietary trading and investing in and sponsoring certain "covered funds," including hedge funds and private equity funds. The statutory provision is commonly called the "Volcker Rule." The final rules implementing the Volcker Rule, as drafted by a variety of federal financial regulatory agencies, were issued December 10, 2013. The final rules extend the conformance period to July 21, 2015. Pursuant to the requirements of the Volcker Rule, we have established a standard compliance program based on the size and complexity of our operations. The standard compliance program includes written policies and procedures that document and limit our risk mitigating hedging and market-making related activities; a system of internal controls to monitor compliance; a management framework that provides a clear accountability for compliance including appropriate management review of limits; incentive compensation; and other matters identified as requiring attention; independent testing and audits; training; and recordkeeping requirements.



We expect to incur ongoing operational and system costs for ongoing compliance with the multitude of new laws and regulations. Furthermore, there may be additional federal or state laws enacted during this period that place additional obligations on servicers of residential loans.

#### Stress Testing Requirements

The U.S. federal banking agencies, including the OCC and the Federal Reserve, issued final rules implementing provisions of the Dodd-Frank Act that require banking organizations, including savings associations and savings and loan holding companies, with total consolidated assets of more than \$10 billion but less than \$50 billion to conduct annual company-run stress tests, report the results to their primary federal regulator and the Federal Reserve and publish a summary of the results. Each Dodd-Frank Act Stress Test, or DFAST, must be conducted using certain scenarios (baseline, adverse and severely adverse), which the OCC and Federal Reserve will publish by February 15 of each year. Banking organizations are required to use the scenarios to calculate, for each quarter-end within a nine-quarter planning horizon, the impact of such scenarios on revenues, losses, loan loss reserves and regulatory capital levels and ratios, taking into account all relevant exposures and activities. The rules also require each banking organization to establish and maintain a system of controls, oversight and documentation, including policies and procedures, designed to ensure that the DFAST procedures used by the banking organization are effective in meeting the requirements of the rules.

#### Limitation on Capital Distributions

Under the Supervisory Agreement, we shall not declare or pay any cash dividends or other capital distributions or purchase, repurchase, or redeem, or commit to purchase, repurchase, or redeem any equity stock without the prior written nonobjection of the Federal Reserve. The Company does not currently pay dividends on the capital stock.

OCC regulations impose limitations upon certain capital distributions by savings associations, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital.

The OCC regulates all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. A subsidiary of a savings and loan holding company, such as the Bank, must file a notice or application with the OCC at least 30 days prior to each proposed capital distribution. Whether an application is required is based on a number of factors including whether the institution qualifies for expedited treatment under the OCC rules and regulations or if the total amount of all capital distributions (including each proposed capital distribution) for the applicable calendar year exceeds net income for that year to date plus the retained net income for the preceding two years. Under the Consent Order, the Bank may not pay a dividend or make a capital distribution if it is not in compliance with its approved capital plan or would not remain in compliance after making the dividend or capital distribution, and the Bank must receive OCC approval under the generally applicable application or notice requirements. In addition, as a subsidiary of a savings and loan holding company, the Bank must receive approval from the Federal Reserve Bank ("FRB") before declaring any dividends. Additional restrictions on dividends apply if the Bank fails the QTL test.

The Bank may not pay dividends to us if, after paying those dividends, it would fail to meet the required minimum levels under risk-based capital guidelines and the minimum leverage and tangible capital ratio requirements or if the dividend would violate a prohibition contained in any statute, regulation or agreement. Under the Federal Deposit Insurance Act ("FDIA") an insured depository institution such as the Bank is prohibited from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become "undercapitalized" (as such term is used in the FDIA). Payment of dividends by the Bank also may be restricted at any

time at the discretion of the OCC if it deems the payment to constitute an unsafe and unsound banking practice.

#### Commercial Real Estate Lending

Lending operations that involve concentrations of commercial real estate loans are subject to enhanced scrutiny by federal banking regulators. Regulators have advised financial institutions of the risks posed by commercial real estate lending concentrations. Such loans generally include land development, construction loans and loans secured by multifamily property and nonfarm, nonresidential real property where the primary source of repayment is derived from rental income associated with the property. Interagency guidance prescribes the following guidelines for examiners to help identify institutions that are potentially exposed to concentration risk and may warrant greater supervisory scrutiny:

Total reported loans for construction, land development and other land represent 100 percent or more of the institution's total capital, or  
Total commercial real estate loans represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50 percent or more during the prior 36 months.

#### Loans to One Borrower

Under the Home Owners Loan Act ("HOLA"), savings associations are generally subject to the national bank limits on loans to one borrower. Generally, savings associations may not make a loan or extend credit to a single or related group of borrowers in excess of 15 percent of the institution's unimpaired capital and surplus (as defined by HOLA). Additional amounts may be loaned if such loans or extensions of credit are secured by readily-marketable collateral, but in no case may they be in excess of an additional 10 percent of unimpaired capital and surplus.

#### Regulatory Enforcement

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

#### Assessments

In its normal course of business, the OCC charges assessments to savings associations to fund its operations. The general assessment is paid on a semi-annual basis and is generally based on an institution's total assets, with a surcharge for an institution with a composite rating of 3, 4 or 5 in its most recent safety and soundness examination. Our expense for these assessments totaled \$3 million for each of the years ending December 31, 2015 and 2014.

#### Federal Home Loan Bank System

The primary purpose of the Federal Home Loan Banks ("FHLBs") is to act as a central credit facility and provide loans to their respective members, such as the Bank, in the form of collateralized advances for making housing loans as well as for affordable housing and community development lending. The FHLBs are generally able to make advances to their member institutions at interest rates that are lower than the members could otherwise obtain. The Federal Housing Finance Agency, a government agency, is generally responsible for regulating the FHLB system. The FHLB system consists of 12 regional FHLBs, each being federally chartered, but privately owned, by their respective member institutions. The Bank is currently a member of the FHLB of Indianapolis, and as such, is required to purchase and hold shares of capital stock in that FHLB in an amount as required by that FHLB's capital plan and minimum capital requirements. At December 31, 2015, we held 169,881,300 shares of FHLB stock with a value of \$170 million.

## Environmental Regulation

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

### Anti-Tying Restrictions

Under HOLA, the Bank is prohibited from engaging in certain tying or reciprocity arrangements with its customers. In general, the Bank may not extend credit, lease, sell property, or furnish any services or fix or vary the consideration for these on the condition that: (i) the customer obtain or provide some additional credit, property, or services from or to the Bank, us or the Bank's or our subsidiaries or (ii) the customer may not obtain some other credit, property, or services from a competitor, except in each case to the extent reasonable conditions are imposed to assure the soundness of the credit extended. Certain arrangements are permissible. For example, the Bank may offer more favorable terms if a customer obtains two or more traditional bank products.

### Competition

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

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

### Additional Information

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

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

## ITEM 1A. RISK FACTORS

Our financial condition and results of operations may be adversely affected by various factors, many of which are beyond our control. In addition to the factors identified elsewhere in this Report, the most significant risk factors affecting our business include those set forth below. The below description of risk factors is not exhaustive, and readers should not consider the description of such risk factors to be a complete set of all potential risks that could affect us.

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

Economic and general market conditions may adversely affect our business.

Our business and results of operations are affected by the financial markets and general economic, market, political and social conditions, including factors such as the level and volatility of short-term and long-term interest rates, inflation, home prices, unemployment and under-employment levels, bankruptcies, household income, consumer spending, fluctuations in both debt and equity capital markets and currencies, liquidity of the financial markets, the availability and cost of capital and credit, investor sentiment and confidence in the financial markets, political risks and the sustainability of economic growth. Continued economic challenges include under-employment, declines in energy prices, the ongoing low interest rate environment, restrained growth in consumer demand, the strengthening of the U.S. Dollar versus other currencies, and continued risk in the consumer and commercial real estate markets. Deterioration of any of these conditions could adversely affect our consumer and commercial businesses, our level of charge-offs and provision for credit losses, our capital levels and liquidity, and our results of operations.

Our business and results of operations are also affected by domestic and international fiscal and monetary policy. For example, the recent rate increase by the Federal Reserve impacts our cost of funds for investing and lending activities. Central bank actions can also affect the value of financial instruments and other assets, such as debt securities and mortgage servicing rights ("MSRs"), and their policies can affect our borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in fiscal and monetary policies are beyond our control and difficult to predict but could have an adverse impact on our capital requirements and the costs of running our business.

Further, any deterioration in the mortgage market may also reduce the number of new mortgages that we originate, increase the costs of servicing mortgages without a corresponding increase in servicing fees or adversely affect our ability to sell mortgage loans originated by us. Any such event could adversely affect our business, financial condition and results of operations.

Changes in interest rates could lead to lower mortgage origination volume, which could adversely affect our business, financial condition and results of operations.

In 2015, approximately 60 percent of our revenue was derived from the origination of residential mortgages. The residential real estate mortgage lending business is sensitive to interest rates, and lower interest rates generally increase that business, while higher interest rates generally cause that business to decrease. Therefore, our performance is typically correlated to fluctuations in interest rates. Historically, mortgage origination volumes and sales for the Bank and for other financial institutions have widened and narrowed in response to these and other factors. During portions of 2015, the interest rate environment was quite favorable for mortgage loan originations, particularly refinancing activity. There is no guarantee that these conditions will persist, and a change in these conditions could have a material adverse effect on our operating results.

In addition, increasing long-term interest rates may decrease our mortgage loan originations. Generally, the volume of mortgage loan originations is inversely related to the long-term interest rate curve. During periods of low long-term

interest rates, a significant number of our customers may elect accelerated prepayments as they seek to refinance their mortgages (i.e., pay off their existing higher rate mortgage loans with new mortgage loans obtained at lower interest rates). Our profitability levels and those of others in the mortgage industry have generally been strongest during periods of low and/or declining interest rates.

Changes in interest rates could adversely affect our held-for-investment mortgage loan portfolio, our mortgage related assets, our financial condition and results of operations.

Changes in interest rates may affect the average life of our mortgage loans and mortgage related securities. Decreases in interest rates can trigger an increase in prepayments of our mortgage loans and mortgage-related securities, as borrowers refinance to reduce their own borrowing costs. As prepayment speeds on mortgage related securities increase, any premium

amortization would increase on a prospective basis. Any immediate adjustments required under the application of the interest method of income recognition may also result in lower net interest income. On the other hand, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate mortgage loans. Additionally, there were wider spreads between short- and long-term interest rates during portions of 2015, resulting in higher profit margins on loan sales than in prior periods.

Changes in interest rates could adversely affect our results of operations and financial condition, including on our net interest margin and the value of our investment assets.

Our results of operations and financial condition could be significantly affected by changes in interest rates. Our financial results depend substantially on net interest income, which is the difference between the interest income that we earn on interest-earning assets and the interest expense we pay on interest-bearing liabilities. While we have modeled rising interest rate scenarios using historic data and such scenarios result in an increase in our net interest income, our interest-bearing liabilities may reprice or mature more quickly than modeled, thus resulting in a decrease in our net interest income.

Changes in interest rates also affect the value of our variable rate loans held-for-sale, loans held-for-investment and investment securities. Generally, the value of our investment securities fluctuates inversely with changes in interest rates. Decreases in the fair value of our investment securities, therefore, could have an adverse effect on our stockholders' equity or our earnings if the decrease in fair value is deemed to be other than temporary.

At December 31, 2015 we had \$296 million of MSR which we manage using certain derivative strategies which may be ineffective.

We invest in MSRs to support mortgage strategies and to deploy capital at acceptable returns. Our MSRs are sensitive to interest rate volatility and are highly susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve, among other factors. In addition, when interest rates fluctuate, repricing risks arise from the timing difference in the maturity and/or repricing of assets, liabilities and off-balance sheet positions. While such repricing mismatches are fundamental to our business, they can expose us to fluctuations in income and economic value, in particular as interest rates vary. We utilize derivatives and other fair value assets as part of our overall hedging strategy to manage the impact of changes in the fair value of the MSRs, but these risk management strategies do not completely eliminate repricing risk. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of revenues produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may differ from actual subsequent experience. In addition, our hedging strategies rely on assumptions and projections regarding assets and general market factors, many of which are outside of our control. If one or more of these assumptions and projections proves to be incorrect or our hedging strategies may not adequately mitigate the impact of changes in interest rates or prepayment speeds, and as a result we may incur losses that would adversely impact earnings.

At December 31, 2015, our MSR was \$296 million or 20.6 percent of Tier 1 Capital. We may be unable to effectively manage our MSR concentration risk which could impact capital under Basel III, which when fully phased-in will require any MSR balance exceeding 10 percent of our Common Equity Tier 1 (CET1) capital deduction threshold.

As of January 1, 2015, we are subject to new rules relating to capital standards requirements, including requirements contemplated by Section 171 of the Dodd-Frank Act as well as certain standards initially adopted by the Basel Committee on Banking Supervision, which standards are commonly referred to as Basel III. Basel III established a new qualifying criteria for regulatory capital, including new limitations on the inclusion of deferred tax assets and mortgage servicing rights. Basel III limits the inclusion of MSRs and deferred tax assets to 10 percent of Common Equity Tier 1 (as defined in the Basel III final framework, "CET1"), individually, and 15 percent of CET1, in the



aggregate. We have established a plan to reduce these assets before the Basel III full implementation date of March 31, 2018 and are taking other actions to reduce our book balance by that date. However, no assurances can be given that we will be able to do so, or that we will be successful in selling these assets at their current fair value. If implemented today, we would experience another 263 basis points reduction in Tier 1 Capital (to risk weighted assets) and 149 basis points reduction in the leverage ratio (Tier 1 Capital to adjusted average assets). The application of more stringent capital requirements could, among other things, result in lower returns on invested capital and result in regulatory actions if we were to be unable to comply with such requirements. See Note 22 of the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for additional information regarding Basel III.

At December 31, 2015 our allowance for loan and lease losses was \$187 million, covering 3.0 percent of total loans held-for-investment. Our estimate of the inherent losses are imperfect, the portfolio is relatively new and we are using underwriting standards which have not been in place for a long period of time.

Our estimate of the allowance for loan and lease losses of \$187 million at December 31, 2015, may not be adequate to cover actual credit losses, and future provisions for credit losses could adversely affect our business, financial condition, results of operations, cash flows and prospects. Our allowance for loan losses is based on prior experience as well as an evaluation of the risks incurred in the current portfolio. The determination of an appropriate level of loan loss allowance is an inherently subjective process that requires significant management judgment including estimates of loss and the loss emergence period. We make various assumptions, estimates and judgments about the collectability of our loan portfolio including but not limited to the creditworthiness of our borrowers and the value of real estate or other collateral backing the repayment of loans. New information regarding existing loans, identification of additional problem loans, failure of borrowers and guarantors to perform in accordance with the terms of their loans, and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. Moreover, our regulators, as part of their supervisory function, periodically review our allowance for loan losses. Our regulators, who have access to broader industry data that we do not have, may recommend or require us to change our allowance for loan losses, based on their judgment, which may be different from that of our management or other regulators. Any increase in our loan losses could have an adverse effect on our earnings and financial condition.

Concentration of loans held-for-investment in certain geographic locations may increase risk.

Our mortgage loan portfolio is geographically concentrated in certain states, including California, Michigan, Florida, and Texas, which is approximately 60 percent of the portfolio. In addition, approximately 90 percent of our commercial real estate loans are in Michigan or are repayable by borrowers who have significant operations in Michigan. This concentration has made, and will continue to make, our loan portfolio particularly susceptible to downturns in the general economy and the real estate and mortgage markets. Michigan and California have had significant volatility in housing prices in the recent past. Adverse conditions beyond our control, including unemployment, inflation, recession, natural disasters, declining property values, municipal bankruptcies and other factors in these markets could increase default rates in our loan portfolio and could reduce our ability to generate new loans and otherwise negatively affect our financial results.

In 2015, we continued to grow our portfolio of commercial real estate and commercial industrial loans, which generally expose us to a greater risk of nonpayment and loss than residential real estate loans due to the more complex nature of underwriting associated with commercial loans. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Also, many of our borrowers have more than one commercial loan outstanding. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a residential real estate loan.

Liquidity is essential to our business and our ability to borrow funds, maintain or increase deposits or raise capital at commercially reasonable terms or at all may adversely affect our liquidity and earnings.

We require substantial liquidity to meet our deposit and debt obligations as they come due, fund our operations and for potential unforeseen liabilities or losses, including without limitation those that could be incurred in connection with the settlement of litigation, regulatory proceedings or other matters. Our access to liquidity could be impaired by our inability to access the capital markets or unforeseen outflows of deposits. Our access to external sources of financing, including deposits, as well as the cost of that financing, is dependent on various factors including regulatory restrictions. A number of factors could make funding more difficult, more expensive or unavailable on any terms, including, but not limited to, declining financial results and losses, material changes to operating margins, financial

leverage on an absolute or relative to peers, changes within the organization, specific events that impact our financial condition or reputation, disruptions in the capital markets, specific events that adversely impact the financial services industry, counterparty availability, changes affecting assets, the corporate and regulatory structure, balance sheet and capital structure, geographic and business diversification, interest rate fluctuations, market share and competitive position, general economic conditions and the legal, regulatory, accounting and tax environments governing funding transactions. Many of these factors are beyond our control. The material deterioration in any one or a combination of these factors could result in a downgrade of our credit or servicer standing with counterparties or a decline in our reputation within the marketplace and could result in higher cash outflows requiring additional access to liquidity, having a limited ability to borrow funds, maintain or increase deposits (including custodial deposits for our agency servicing portfolio) or to raise capital on commercially reasonable terms or at all.

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

In addition, we previously provided notice to the U.S. Treasury exercising our contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding. Also, under the terms of our indenture agreements related to the trust preferred securities ("TPS"), we deferred interest payments since 2012 and may do so for up to 20 consecutive quarters without default or penalty. If we intend to resume interest or dividend payments on either or both the preferred stock and the trust preferred securities and do not have adequate financing at the Holding Company this would require a dividend from the Bank to the Holding Company, which could adversely affect the business, financial condition and results of operations of the Bank. Please see "Regulatory Risk Factors," for additional risk factors on the risk of default of the TPS.

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

A total of \$4,301 million of assets and \$110 million of liabilities are carried on our Consolidated Statements of Financial Condition at fair value, including our MSR, loans held-for-sale, certain loans held-for-investment, available-for-sale investment securities, derivatives, certain long-term debt and the future obligations arising from our settlement with the Department of Justice ("DOJ"). Generally, for assets that are reported at fair value, we use quoted market prices when available. In certain cases, observable market prices and data may not be readily available or their availability may be diminished due to market conditions. In such cases, we use internally developed financial models that utilize observable market data inputs as well as asset specific collateral data and market inputs for interest rates to estimate the fair value of certain of these assets and liabilities. These valuation models rely to some degree on management's assumptions, estimates and judgment, which are inherently uncertain. We cannot be certain that the models or the underlying assumptions will prove to be predictive and remain so over time, and therefore, actual results may differ from our models and assumptions. Different assumptions could result in significant declines in valuation, which in turn could result in significant declines or increases in the dollar amount of assets or increases in the liabilities we report on our Consolidated Statements of Financial Condition. In addition, sudden illiquidity in markets or declines in prices of certain loans and securities may make it more difficult to value certain balance sheet items, which may lead to the possibility that such valuations will be subject to further change or adjustment. If assumptions or estimates underlying our Consolidated Statements of Financial Condition are incorrect, we may experience material losses.

#### Regulatory Risk

We and the Bank remain subject to the restrictions and conditions of the Consent Orders with the OCC and CFPB, and Supervisory Agreement with the Federal Reserve. Failure to comply with the Consent Orders or Supervisory Agreement could result in further enforcement action against us.

There is no guarantee that the Bank will be able to fully comply with the Consent Orders. In the event that we are in material non-compliance with the terms of the Consent Orders, the CFPB and OCC have the authority to subject the Bank to additional corrective actions. Moreover, they could initiate further enforcement actions against the Bank, seek an injunction requiring the Bank and its officers and directors to comply with the Consent Orders and seek civil money penalties against us and our officers and directors. Any failure by the Bank to comply with the terms of the Consent Orders or additional actions could adversely affect our business, financial condition and results of operations. In addition, the Bank's competitors may not be subject to similar actions, which could limit our ability to compete effectively. These corrective actions could negatively impact the Bank's operations and financial performance. See the Consent Order discussions in Item 1. Business, herein, for further details.

We also remain subject to the Supervisory Agreement, which requires that we take certain actions to address issues identified by the OTS. The Supervisory Agreement is enforced by the Federal Reserve as the successor regulator to the OTS with respect to savings and loan holding companies. The Supervisory Agreement requires that we submit a capital plan; receive written non-objection before declaring or paying any dividend or other capital distribution, incurring or renewing any debt and engaging in affiliate transactions (with limited exceptions); comply with applicable regulatory requirements before making certain severance and indemnification payments; and provide notice prior to changes in directors and certain executive officers or entering into, renewing, extending or revising compensation or benefits agreements of such directors or executive officers, with such changes being subject to Federal Reserve approval. While we believe that we have taken numerous steps to comply with, and intend to comply with in the future, the requirements of the Supervisory Agreement, failure to comply with the Supervisory Agreement in the time frames provided, or at all, could result in additional enforcement orders or penalties, which could include further restrictions on us, assessment of civil money penalties on us, as well as our directors, officers and other affiliated parties and removal of one or more officers and/or directors. Any failure by us to comply with the terms of the Supervisory Agreement or additional actions by the Federal Reserve could adversely affect our business, financial condition and results of operations. Moreover, our competitors may not be subject to similar actions, which could limit our ability to compete effectively. See the Supervisory Agreement discussion in Item 1. Business, herein, for further details.

Expanded regulatory oversight over our business could significantly increase our risks and costs associated with complying with current and future regulations, which could adversely affect our financial condition and results of operations.

As noted in "Item 1 - Business - Regulation and Supervision," we are subject to a wide variety of banking, consumer protection and securities laws, regulations and supervisory expectations and numerous regulatory and enforcement authorities. As a result of and in addition to new legislation aimed at regulatory reform, such as the Dodd-Frank Act, and the increased capital requirements introduced by the Basel III final rules, the regulatory agencies generally are taking a more stringent approach to supervising and regulating financial institutions and financial products and services over which they exercise their respective supervisory authorities. We, the Bank and our products and services all remain subject to greater supervisory scrutiny and enhanced supervisory requirements and expectations. We expect to continue to face greater supervisory scrutiny and enhanced supervisory requirements in the foreseeable future.

As a result of increasing scrutiny and regulation of the banking industry and consumer practices, we may face a greater number or wider scope of examinations, investigations, enforcement actions and litigation, thereby increasing our costs associated with responding to or defending such actions, as well as potentially resulting in costs associated with fines, penalties, settlements or judgments. In addition, increased regulatory inquiries and investigations, as well as any additional legislative or regulatory developments affecting our businesses, and any required changes to our operations resulting from these developments, could reduce our revenue, limit the products or services that we offer or increase the costs thereof, impose additional compliance costs, harm our reputation or otherwise adversely affect our businesses. Some of these laws may provide a private right of action that a consumer or class of consumers may seek to pursue to enforce these laws and regulations.

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

The Dodd-Frank Act has significantly changed the bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act and its implementing regulations have increased and may continue to increase our operating and compliance costs and our interest expense. In addition, compliance obligations have exposed us and will continue to expose us to additional noncompliance risk and could divert management's focus from our business operations. Furthermore, the combined

effect of numerous rulemakings by multiple governmental agencies and regulators, and the potential conflicts or inconsistencies among such rules, present challenges and risks to our business and operations.

The CFPB has broad and unique rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers, including prohibitions against unfair, deceptive or abusive practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service including regulations related to the origination and servicing of residential mortgages. The concept of what may be considered to be an "abusive" practice is new under the law. The CFPB has also finalized a number of significant rules and guidance that impact nearly every aspect of the life cycle of a residential mortgage. The CFPB continues to revise these rules and propose new rules. Effective in 2016, the Bank is again subject to the CFPB's supervisory, examination and enforcement authority with respect to consumer protection laws and regulations, due to reporting assets of more than \$10 billion for four consecutive quarters. As a result, we could incur increased costs, potential litigation or be materially limited or restricted in our business, product offerings or services in the future.

We are highly dependent on the Agencies to sell mortgage loans and any changes in these entities or their current roles could adversely affect our business, financial condition and results of operations.

We sell approximately 70 percent of our mortgage loans to Fannie Mae and Freddie Mac. The future roles of Fannie Mae and Freddie Mac remain in conservatorship and a path forward is unclear. These roles could be reduced, modified or eliminated and the nature of their guarantees could be limited or eliminated relative to historical measurements.

The elimination or modification of the traditional roles of Fannie Mae or Freddie Mac could adversely affect our business, financial condition and results of operations. Furthermore, any discontinuation of, or significant reduction in, the operation of these agencies, any significant adverse change in the level of activity of these agencies in the primary or secondary mortgage markets or in the underwriting criteria of these agencies could materially and adversely affect our business, financial condition and results of operations.

Changes in the servicing or origination guidelines required by the Agencies could adversely affect our business, financial condition and results of operations.

We are required to follow specific guidelines that impact the way that we service and originate agency loans, including guidelines with respect to credit standards for mortgage loans, our staffing levels and other servicing practices, the servicing and ancillary fees that we may charge, our modification standards and procedures and the amount of non-reimbursable advances.

We cannot negotiate these terms with the Agencies and they are subject to change at any time. A significant change in these guidelines that has the effect of decreasing the fees we charge or requires us to expend additional resources in providing mortgage services could decrease our revenues or increase our costs, which would adversely affect our business, financial condition and results of operations.

In addition, changes in the nature or extent of the guarantees provided by Fannie Mae and Freddie Mac or the insurance provided by the FHA could also have broad adverse market implications. The fees that we are required to pay to the Agencies for these guarantees have changed significantly over time and any future increases in these fees would adversely affect our business, financial condition and results of operations.

We depend upon having FDIC insurance to raise deposit funding at reasonable rates. Increases in deposit insurance premiums and special FDIC assessments will adversely affect our earnings.

The Dodd-Frank Act required the FDIC to substantially revise its regulations for determining the amount of an institution's deposit insurance premiums. The FDIC has defined the deposit insurance assessment base for an insured depository institution as average consolidated total assets during the assessment period, minus average tangible equity. Our assessment rate is determined by use of a scorecard that combines a financial institution's Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity ("CAMELS") ratings with certain forward-looking financial information. The FDIC may determine that we present a higher risk to the DIF than other banks due to certain factors. These factors include significant risks relating to interest rates, loan portfolio and geographic concentration, concentration of high credit risk loans, increased loan losses, regulatory compliance (including under existing agreements with regulators such as the Consent Order and Supervisory Agreement), existing and future litigation and other factors. As a result, we could be subject to higher deposit insurance premiums and special assessments in the future that could adversely affect our earnings. The Bank's deposit insurance premiums and special assessments in the future also may be higher than competing banks may be required to pay.



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

As a holding company with no significant assets other than the capital stock of the Bank, our ability to service our debt or preferred stock obligations, including interest payments on debentures underlying the trust preferred securities and dividend payments on the preferred shares, is dependent upon available cash on hand and the receipt of dividends from the Bank on such capital stock. The declaration and payment of dividends by the Bank on all classes of its capital stock is subject to the discretion of the Bank's board of directors and to applicable regulatory and legal limitations, including receiving approval from the OCC, compliance with the approved capital plan submitted pursuant to the Consent Order and receiving approval from the Federal Reserve. If the Bank does not make dividend payments to us, we may not be able to service our debt or preferred stock obligations, which could have a material adverse effect on our financial condition and results of operations.

At December 31, 2015, we had accumulated deferrals for 16 consecutive quarters of interest payments due on our TPS totaling \$27 million of deferred interest. We are only allowed up to 20 consecutive quarters of deferral after which we will be in default. If we default and are unable, or not allowed, to make the required payments, TPS holders could file to put the Holding Company into bankruptcy.

We exercised our contractual right in 2012 to defer interest payments with respect to our TPS. Under the terms of the related indentures, we may only defer interest payments for up to 20 consecutive quarters without default or penalty. As of December 31, 2015 we had deferred interest payments for 16 consecutive quarters, with the cumulative amount in arrears as of December 31, 2015 totaling \$27 million. If we do not pay all deferred amounts then due by the end of the 20<sup>th</sup> quarter, i.e., by December 31, 2016, and resume current interest payments, we will be in default. There can be no assurances that we will be able, or allowed, to pay off these deferred amounts and resume making current interest payments by that time. If we default and do not cure the default through such payments, TPS holders could file to put the Holding Company into bankruptcy.

### Operational Risk

A failure of our information technology systems, or those of our key third party vendors or service providers, could cause operational losses and damage our reputation.

Our businesses are increasingly dependent on our ability to process, record and monitor a large number of complex transactions and data. If our internal financial, accounting, or other information technology systems fail, we may be unable to conduct business for a period of time, which may impact our financial results if that interruption is sustained. In addition, our reputation with our customers or counterparties may suffer, which could have a further, long-term impact on our financial results.

Also, because we conduct part of our business over the Internet and outsource a significant number of our critical functions to third parties, our operations depend on our third-party service providers to maintain and operate their own technology systems. To the extent these third parties' systems fail, we may be unable to conduct business or provide certain services, and we may face financial and reputational losses as a result.

We collect, store and transfer our customers' personally identifiable information, and any compromise to the security of that information may have meaningful consequences for us.

Data breaches are of a particular concern as in the processing of consumer transactions, our businesses receive, transmit and store a large volume of personally identifiable information and other user data. There are a myriad of federal, state and international laws regarding privacy and the storing, sharing, use, disclosure and protection of personally identifiable information and user data.

We have policies and processes in place that are intended to meet the requirements of those laws, including security systems in place to prevent unauthorized access to that information. Nevertheless, those processes and systems may be inadequate. Also, to the extent we rely upon third parties to handle personally identifiable data on our behalf, we may be responsible if such data is compromised while in the custody and control of those third parties.

Privacy laws are still evolving, and many local jurisdictions have laws that differ from federal law. At times, we may also be governed by privacy laws outside the U.S., with which we are less familiar. If we fail to comply with applicable privacy policies or federal, state or international laws and regulations or any compromise of security that results in the unauthorized release of personally identifiable information or other user data, those events could damage the reputation of our business, and discourage potential users from utilizing our products and services. In addition, we may have to bear the cost of mitigating identity theft concerns, and may additionally be subject to fines or legal

proceedings by governmental agencies or consumers. Any of these events could adversely affect our business, financial condition and results of operations.

We may be terminated as a servicer or subservicer or incur costs, liabilities, fines and other sanctions if we fail to satisfy our servicing obligations, including our obligations with respect to mortgage loan foreclosure actions.

We act as servicer and subservicer for mortgage loans owned by third parties, which is approximately 10 percent of our revenue and \$1.2 billion of our average deposits. In such capacities for those loans, we have certain contractual obligations, including foreclosing on defaulted mortgage loans or, to the extent applicable, considering alternatives to foreclosure. If we commit a material breach of our obligations as servicer, we may be subject to termination if the breach is not cured within a specified period of time following notice, causing us to lose servicing income.

For certain investors and/or certain transactions, we may be contractually obligated to repurchase a mortgage loan or reimburse the investor for credit losses incurred on the loan as a remedy for servicing errors with respect to the loan. If we have increased repurchase obligations because of claims for which we did not satisfy our obligations as a servicer, or increased loss severity on such repurchases, we may have a significant reduction to noninterest income or increase to noninterest expense. We may incur significant costs if we are required to, or if we elect to, re-execute or re-file documents or take other action in our capacity as a servicer in connection with pending or completed foreclosures. We may incur litigation costs if the validity of a foreclosure action is challenged by a borrower. If a court were to overturn a foreclosure because of errors or deficiencies in the foreclosure process, we may have liability to the borrower and/or to any title insurer of the property sold in foreclosure if the required process was not followed. These costs and liabilities may not be legally or otherwise reimbursable to us.

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

When mortgage loans are sold by us, we make customary representations and warranties to purchasers, guarantors and insurers, including the Agencies, about the mortgage loans, and the manner in which they were originated. We have made, and will continue to make, such representations and warranties in connection with the sale of loans. Whole loan sale agreements require us to repurchase or substitute mortgage loans, or indemnify buyers against losses, in the event we breach these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of early payment default of the borrower on a mortgage loan or we may be required to pay fees. We also are subject to litigation relating to these representations and warranties and the costs of such litigation may be significant. With respect to loans that are originated through our broker or correspondent channels, the remedies we have available against the originating broker or correspondent, if any, may not be as broad as the remedies available to purchasers, guarantors and insurers of mortgage loans against us. In addition, we also face further risk that the originating broker or correspondent, if any, may not have financial capacity to perform remedies that otherwise may be available. Therefore, if a purchaser, guarantor or insurer enforces its remedies against us, we may not be able to recover losses from the originating broker or correspondent. If repurchase and indemnity demands increase and such demands are valid claims, the liquidity, results of operations and financial condition may also be adversely affected.

Our representation and warranty reserve for losses at December 31, 2015 is \$40 million. This may not be adequate to cover losses for loans that we have sold or securitized into the secondary market which we may be subsequently required to repurchase, pay fines or fees, or indemnify purchasers and insurers because of violations of customary representations and warranties. In addition, our regulators, as part of their supervisory function, periodically review our representation and warranty reserve for losses. Our regulators may recommend or require us to increase our reserve, based on their judgment, which may be different from that of our management. Any increase in our loan losses could have an adverse effect on our earnings and financial condition.

We utilize third party mortgage originators over whom we have less control which may expose us to risk.

We rely on third party mortgage originators to make and document the mortgage loans we purchase. While we perform investigations on the mortgage companies with whom we do business and review the loan files and loan documents we purchase to attempt to detect any irregularities or legal noncompliance, we have less control over these originators than employees of the Bank. Our ability to control the third party mortgage originators could have an adverse impact on our business. In addition, these arrangements with third party mortgage originators and the fees payable by us to such third parties could be subject to additional regulatory scrutiny and restrictions in the future.

Our mortgage volume may be impacted by our use of third party mortgage originators.

Approximately 95 percent of our residential first mortgage volume depends upon the use of third party mortgage originators, who are not our employees. These third parties originate mortgages and provide services to many different banks and other entities. Accordingly, they may have relationships with or loyalties to such banks and other parties that are different from those they have with or to us. Failure to maintain good relations with such third party mortgage originators could have a negative impact on our market share which would negatively impact our net income.

Due to increasing regulatory scrutiny, our third party mortgage originators could choose or be required to either reduce the scope of their business or exit the mortgage origination business altogether. This could lead to a decrease in our mortgage volume.

Our financial results fluctuate as a result of the cyclical nature of our business and seasonality, which may adversely affect our business, financial condition and results of operations and make it difficult to predict our future performance.

Our mortgage origination business is subject to the cyclical and seasonal trends of the real estate market. Cyclicity in our industry could lead to periods of strong growth in the mortgage and real estate markets followed by periods of sharp declines and losses in such markets. One of the primary influences on our mortgage business is the aggregate demand for mortgage loans in our market areas, which is affected by prevailing interest rates. If we are unable to respond to the cyclicity of our industry by appropriately adjusting our operations, headcount and overhead, our business, financial condition and results of operations could be adversely affected.

In addition, seasonal trends have historically reflected the general patterns of residential and commercial real estate sales, which typically peak in the spring and summer seasons. Although in recent periods the broader cyclical trends in the mortgage and real estate markets have disrupted the customary historical seasonal trends, such seasonal trends could resume in the future, which could cause our quarterly operating results to fluctuate and make it difficult to predict our future operating performance. Furthermore, Basel III also provides for a countercyclical capital buffer to induce banking organizations to hold capital in excess of regulatory minimums.

While we recently reversed the valuation allowance for our deferred tax assets, we may not be able to realize these assets or may have to establish a valuation allowance in the future, which could adversely affect our operating results.

Management assesses the valuation allowance recorded against deferred tax assets at each reporting period and currently has no valuation allowance related to federal deferred tax assets and a valuation of allowance of \$22 million related to state taxes. The determination of whether a valuation allowance for deferred tax assets is appropriate is subject to considerable judgment and requires an evaluation of all available positive and negative evidence. The evaluation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns and future profitability. Our accounting for deferred taxes represents our best estimate as described in Note 21 to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein. Changes in our current estimates, due to unanticipated events or otherwise, could have a material effect on our financial condition and results of operations.

#### General Risk Factors

MP Thrift, an entity managed and controlled by MatlinPatterson, owns 63.1 percent of our common stock and has significant influence over us, including control over decisions that require the approval of stockholders, whether or not such decisions are in the best interests of other stockholders.

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

Additionally, our ability to use our deferred tax assets to offset future taxable income may be significantly limited if we experience an "ownership change" as defined for U.S. federal income tax purposes. Section 382 of the Internal Revenue Code imposes restrictions on the use of a corporation's net operating losses, certain recognized built-in losses,

and other carryovers after an ownership change occurs. As we have a controlling stockholder, any stock offering in isolation or when combined with other ownership changes, could cause us to experience an ownership change. If an ownership change were to occur, we believe it could cause us to permanently lose the ability to realize a portion of our net operating losses ("NOL") related deferred tax asset, resulting in reduction to total stockholders' equity.

We are subject to a number of legal or regulatory proceedings, therefore making them difficult to predict.

At any given time, we are defending ourselves against a number of legal and regulatory investigating and proceedings. Proceedings or actions brought against us may result in judgments, settlements, fines, penalties, injunctions, business improvement orders, consent orders, supervisory agreements, restrictions on our business activities or other results adverse to

us, which could materially and negatively affect our businesses. If such claims and other matters are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact customer demand for those products and services. In addition, some of the laws and regulations to which we are subject may provide a private right of action that a consumer or class of consumers may pursue to enforce these laws and regulations. We also have been, and may continue to be in the future, subject to stockholder derivative actions, which could seek significant damages or other relief. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations. Moreover, claims asserted against us can be highly complicated and slow to develop, making the outcome of such proceedings difficult to predict or estimate early in the process. As a participant in the financial services industry, it is likely that we will continue to experience a high level of litigation and regulatory scrutiny and investigations relating to our business and operations. The results of these legal and regulatory proceedings could lead to significant monetary damages or penalties, restrictions on the way in which we conduct our business, or reputational harm.

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

For a further discussion of the unpredictability of legal proceedings and description of certain of our pending legal proceedings, see Note 23 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein.

#### Other Risk Factors

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

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

#### ITEM 2. PROPERTIES

At December 31, 2015, through our headquarters located in Troy, Michigan, totaling approximately 373,210 square feet with approximately 80 percent capacity. We also operate a regional office in Jackson, Michigan, 99 branches in Michigan and 10 retail centers in nine states (Michigan, Arizona, Connecticut, Florida, Kentucky, Missouri, New York, North Carolina and Ohio). We also maintain five wholesale lending offices, one underwriting office and one commercial lending office. Our banking centers consist of 76 free-standing office buildings, two in-store banking centers and 21 centers in buildings in which there are other tenants, typically strip malls.

As of December 31, 2015, we owned buildings and land for 73 of our offices (including our headquarters) and lease the remaining 42 offices. The offices that we lease have lease expiration dates ranging from 2016 to 2023.



ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is party to legal proceedings incident to its business. See Note 23 of the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, which is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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## PART II

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

Our common stock trades on the NYSE under the trading symbol FBC. At December 31, 2015, there were 56,483,258 shares of our common stock outstanding held by approximately 14,514 stockholders of record. The following table shows the high and low sale prices for our common stock during each calendar quarter during 2015 and 2014.

Quarter Ending	Highest Sale Price	Lowest Sale Price
December 31, 2015	\$24.95	\$20.60
September 30, 2015	21.01	17.83
June 30, 2015	19.44	14.61
March 31, 2015	16.50	14.10
December 31, 2014	\$16.78	\$14.42
September 30, 2014	19.25	16.26
June 30, 2014	21.83	16.43
March 31, 2014	22.57	19.57

## Dividends

We have not paid dividends on our common stock since the fourth quarter 2007. The amount and nature of any dividends declared on our common stock in the future will be determined by our board of directors. We are generally prohibited from making any dividend payments on stock except pursuant to the prior non-objection of the Federal Reserve as set forth in the Supervisory Agreement. In addition, we are prohibited from paying dividends on our common stock so long as we have deferred and unpaid dividends on our preferred stock issues and deferred and unpaid interest on our trust preferred securities.

On January 27, 2012, we provided notice to the U.S. Treasury exercising our contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding. The cumulative amount in arrears as of December 31, 2015 is \$86 million.

In addition, our principal sources of funds are cash dividends paid by the Bank to us and other subsidiaries, investment income and borrowings. Federal laws and regulations limit the amount of dividends or other capital distributions that the Bank may pay us. The Bank has an internal practice to remain "well-capitalized" under OCC capital adequacy regulations as discussed above. The Bank must seek prior approval from the OCC at least 30 days before it may make a dividend payment or other capital distribution to us.

## Equity Compensation Plan Information

The following table sets forth certain information with respect to securities to be issued under our equity compensation plans as of December 31, 2015.

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (1)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders (2)	445,528	\$ 80.00	437,402
Equity compensation plans not approved by security holders (3)	907,741	—	—
Total	1,353,269	\$ 80.00	437,402

Weighted average exercise price is calculated including restricted stock units, which for this purpose are treated as (1) having an exercise price of zero. If calculated solely for options and stock appreciation rights that have an exercise price, the weighted exercise price of outstanding options, warrants and rights at December 31, 2015 was \$80.00.

(2) See Note 20 of the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for additional information regarding the 2006 Equity Incentive Plan (the "2006 Plan").

If the 2016 Flagstar Bancorp, Inc. Stock and Incentive Plan (the "2016 Plan") is approved by shareholders, these (3) shares will remain in the 2006 Plan, and will not be available for equity awards pursuant to the terms of the proposed 2016 Plan.

## Sale of Unregistered Securities

We made no unregistered sales of our equity securities during the fiscal year ended December 31, 2015.

## Issuer Purchases of Equity Securities

We made no purchases of equity securities during the fiscal year ended December 31, 2015.

Performance Graph

CUMULATIVE TOTAL STOCKHOLDER RETURN  
 COMPARED WITH PERFORMANCE OF SELECTED INDICES  
 DECEMBER 31, 2010 THROUGH DECEMBER 31, 2015

	Nasdaq Financial	Nasdaq Bank	S&P Small Cap 600	Russell 2000	Flagstar Bancorp
December 31, 2010	100	100	100	100	100
December 31, 2011	87	88	100	95	31
December 31, 2012	99	101	115	108	119
December 31, 2013	137	141	160	148	120
December 31, 2014	140	145	167	154	97
December 31, 2015	145	154	162	145	142

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## ITEM 6. SELECTED FINANCIAL DATA

	For the Years Ended December 31,					
	2015	2014	2013	2012	2011	
	(In millions, except share data and percentages)					
Summary of Consolidated Statements of Operations						
Interest income	\$355	\$286	\$330	\$481	\$465	
Interest expense	68	39	144	184	220	
Net interest income	287	247	186	297	245	
(Benefit) provision for loan losses	(19)	) 132	70	276	177	
Net interest income after provision for loan losses	306	115	116	21	68	
Noninterest income	470	361	653	1,021	386	
Noninterest expense	536	579	918	989	635	
Income before income taxes provision	240	(103)	) (149)	) 53	(181)	)
Provision for income taxes (1)	82	(34)	) (416)	) (16)	) 1	)
Net income (loss)	158	(69)	) 267	69	(182)	)
Preferred stock dividends/accretion	—	(1)	) (6)	) (6)	) (17)	)
Net income (loss) from continuing operations	\$158	\$(70)	) \$261	\$63	\$(199)	)
Income (loss) per share:						
Basic (2)	\$2.27	\$(1.72)	) \$4.40	\$0.88	\$(3.62)	)
Diluted (2)	\$2.24	\$(1.72)	) \$4.37	\$0.87	\$(3.62)	)
Weighted average shares outstanding:						
Basic (2)	56,426,977	56,246,528	56,063,282	55,762,196	55,434,296	
Diluted (2)	57,164,523	56,246,528	56,518,181	56,193,515	55,434,296	
Mortgage loans originated (3)	\$29,402	\$24,608	\$37,482	\$53,587	\$26,613	
Mortgage loans sold and securitized	\$26,307	\$24,407	\$39,075	\$53,094	\$27,451	
Interest rate spread	2.58	% 2.80	% 1.50	% 1.96	% 1.85	%
Net interest margin	2.74	% 2.91	% 1.72	% 2.26	% 2.07	%
Average interest-earning assets	\$10,436	\$8,440	\$10,882	\$13,104	\$11,804	
Average interest paying liabilities	\$8,305	\$6,780	\$9,338	\$10,786	\$10,539	
Average stockholders' equity	\$1,486	\$1,406	\$1,239	\$1,192	\$1,186	
Return (loss) on average assets	1.32	% (0.71)	)% 2.08	% 0.43	% (1.49)	)%
Return (loss) on average equity	10.63	% (4.97)	)% 21.09	% 5.26	% (16.78)	)%
Efficiency ratio	70.9	% 95.4	% 109.4	% 75.1	% 100.6	%
Equity/assets ratio (average for the period)	12.43	% 14.22	% 9.87	% 8.10	% 8.88	%
Net charge-offs to average LHFI	1.85	% 1.07	% 4.00	% 4.43	% 2.14	%

(1) The effective tax rate was 34.2 percent, 32.9 percent, 29.7 percent, 0.6 percent, and 0.6 percent for the years ended December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

(2) For the year ended December 31, 2011, the amounts have been restated for one-for-ten stock split announced September 27, 2012 and began trading on October 11, 2012.

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



	December 31,					
	2015	2014	2013	2012	2011	
	(In millions, except per share data and percentages)					
<b>Summary of Consolidated Statements of Financial Condition</b>						
Total assets	\$13,715	\$9,840	\$9,407	\$14,082	\$13,637	
Loans receivable, net	\$9,226	\$6,523	\$6,637	\$10,914	\$10,421	
Mortgage servicing rights	\$296	\$258	\$285	\$711	\$511	
Total deposits	\$7,935	\$7,069	\$6,140	\$8,294	\$7,690	
Federal Home Loan Bank advances	\$3,541	\$514	\$988	\$3,180	\$3,953	
Long-term debt	\$247	\$331	\$353	\$247	\$249	
Stockholders' equity (1)	\$1,529	\$1,373	\$1,426	\$1,159	\$1,080	
Book value per common share (2)	\$22.33	\$19.64	\$20.66	\$16.12	\$14.80	
Number of common shares outstanding (thousands) (2)	56,483	56,332	56,138	55,863	55,578	
Ratio of allowance for loan losses to LHF (3)	3.00	% 7.01	% 5.42	% 5.61	% 4.52	%
Ratio of nonperforming assets to total assets	0.61	% 1.41	% 1.94	% 3.70	% 4.42	%
Equity-to-assets ratio	11.14	% 13.95	% 15.16	% 8.53	% 7.92	%
Common equity-to-assets ratio	9.20	% 11.24	% 12.33	% 6.38	% 6.05	%
Tier 1 capital ratio (to adjusted total assets) (4)	11.79	% 12.43	% 13.97	% 9.26	% 8.95	%
Common equity Tier 1 capital ratio (to risk-weighted assets) (4)	19.42	% N/A	N/A	N/A	N/A	
Total risk-based capital ratio (to risk-weighted assets) (4)	20.71	% 23.85	% 28.11	% 17.18	% 16.64	%
Number of banking centers	99	107	111	111	111	
Number of FTE employees	2,713	2,739	3,253	3,662	3,136	

(1) Includes preferred stock totaling \$267 million, \$267 million, \$266 million, \$260 million, and \$255 million at December 31, 2015 through 2011, respectively.

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

(3) Excludes loans carried under the fair value option

(4) 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.

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

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The following is an analysis of our financial condition and results of operations. You should read this item in conjunction with our Consolidated Financial Statements and related notes filed with this report in Part II, Item 8. Financial Statements and Supplementary Data and the description of our business filed here within Part I, Item I. Business.

## Overview

We are a Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. At December 31, 2015, our total assets were \$14 billion, making us the largest bank headquartered in Michigan and one of the top 10 largest savings banks in the United States. We have three major operating segments: Mortgage Originations, Mortgage Servicing, and Community Banking. Through these lines of business, we emphasize the delivery of a complete set of mortgage and banking products and services and are distinguished by local delivery, customer service and product pricing.

## Critical Accounting Policies

Our Consolidated Financial Statements are prepared in accordance with U.S. GAAP and reflect general practices within our industry. Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements. Some of our significant accounting policies require complex judgments and estimates to determine values of assets and liabilities. The more judgmental, uncertain and complex estimates are further discussed below. These estimates are based on information available to management as of the date of the Consolidated Financial Statements. Accordingly, as this information changes, future financial statements could reflect different estimates or judgments.

## Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses that are inherent in our loans held-for-investment portfolio but which have not yet been realized as of the date of our Consolidated Statements of Financial Condition. We establish an allowance when (a) available information indicates that it is probable that a loss has occurred and (b) the amount of the loss can be reasonably estimated. We believe that the accounting estimates related to the allowance for loan losses are critical because they require us to make larger subjective and complex judgments about the effect of matters that are inherently uncertain. As a result, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses. Our methodology for assessing the adequacy of the allowance involves a significant amount of judgment. Although management believes its process for estimating the allowance for loan losses adequately considers all of the factors that could potentially result in loan losses, the process also includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provision for loan losses could be required that could adversely affect operations or our financial position in future periods.

Consumer loans. Impaired residential loans include loan modifications considered to be TDRs as well as all nonperforming loans. The allowance related to nonperforming residential mortgage loans, including re-defaulted TDRs and certain other severely past due loans, is based on the underlying collateral value obtained through appraisals or broker's price opinions, updated at least semi-annually, less management's estimates of cost to sell. The allowance attributed to TDRs performing under the terms of their modification is based on the present value of the expected future cash flows discounted at the loan's original effective interest rate as these loans are not considered to be collateral dependent.

For those loans not individually evaluated for impairment, management has sub-divided the consumer loans into homogeneous portfolios for which the allowance for loan losses is determined on a collective basis primarily utilizing

a historical loss model based on common risk characteristics that include a qualitative factor component.

Our historical loss model is based upon management's qualitative assessment and utilizes a loss emergence period that represents the average amount of time between when the loss event first occurs and when the specific loan is charged-off. The time period starts when the borrower first begins to experience financial difficulty and continues until the actual loss is recorded. The loss emergence period is variable and may change based on changes in underlying economic conditions or market factors. For portfolios that do not have adequate loss experience and purchased portfolios, we utilize peer loss data in determining the allowance for loan losses.

Management assigns qualitative factors to each loan portfolio segment in the consumer portfolio based on consideration of the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality

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statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, changes in concentrations of credit, and other internal or external factor changes. These factors are used to reflect changes in the collectability of the portfolio not captured by the historical loss model. As such, the qualitative factors supplement actual loss experience based on management's judgment to estimate the loss within the loan portfolios.

For all classes within the consumer and commercial loan portfolio, loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due (or nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt.

Commercial loans. Nonperforming commercial and commercial real estate loans are considered to be impaired and have a specific allowance based on the underlying collateral's appraised value, less management's estimates of costs to sell. 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. Appraisals are updated at least annually but may be obtained more frequently if changes to the property or market conditions warrant.

For those loans not individually evaluated for impairment, the allowance for loan losses is determined on a collective basis utilizing a historical loss model and utilizes a loss emergence period that represents the average amount of time between when the loss event first occurs and when the specific loan is charged-off. The time period starts when the borrower first begins to experience financial difficulty and continues until the actual loss is recorded. The loss emergence period is variable and may change based on changes in underlying economic conditions or market factors. The historical loss model represents management's best estimate of inherent loss within the commercial loan portfolio sub-divided into homogeneous portfolios based on common risk characteristics.

The commercial loan portfolio is segmented into two primary groups: (1) Special Assets Group ("SAG") loans which represent all loans risk rated substandard or worse, and (2) all other commercial loans risk rated special mention or better, which are further subdivided into commercial real estate, commercial and industrial, and warehouse. Due to the changes in our strategy and to changes in underwriting and origination practices and controls related to that strategy, management determined the aforementioned segmentation better reflected the dynamics in the commercial loan portfolios. The loss rates attributed to the SAG portfolio are based on historical losses of the Bank's own commercial loan portfolio. Due to the absence of a sufficient loss history over the brief period of time that loans in the non-SAG portfolios have been outstanding, we have used peer loss data from publicly available information provided by bank regulators (adjusting for our qualitative factors) instead of our own historical losses.

Management assigns qualitative factors for each loan segment in the portfolio in consideration of the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, changes in concentrations of credit, and changes in other external factors. These factors are used to reflect changes in the collectability of the portfolio not captured by the historical loss rates. As such, the qualitative factors supplement actual loss experience and allow us to better estimate the loss within the loan portfolios based upon market and other indicators.

#### Accounting for Income Taxes

Net deferred tax assets, reported as a component of other assets on the Consolidated Statements of Financial Condition, represent the net decrease in taxes expected to be paid in the future because of NOL, tax credit carryforwards and the future reversals of temporary differences in the bases of assets and liabilities as measured by tax

laws versus their bases as reported in the financial statements. NOL and tax credit carryforwards result in reductions to future tax liabilities, and many of these attributes can expire if not utilized within certain periods. We consider the need for valuation allowances to reduce net deferred tax assets to the amounts that we estimate are more-likely-than-not to be realized. While we have established some valuation allowances for certain state deferred tax assets, we have concluded that no valuation allowance was necessary with respect to all U.S. federal deferred tax assets, including NOL and tax credit carryforwards. Management's conclusion is supported by future forecasts of taxable income and historical experience adjusted for items considered to not be reflective of the Company's ability to generate future earnings. Significant changes to our estimates, such as a substantial worsening of the mortgage origination market, a rapid decline in home prices or an economic recession, could lead management to reassess its valuation allowance conclusions or other internal factors which may cause a substantial change to our financial results. See Note 21 to the Consolidated Financial Statements for additional information.

## Representation and Warranty Reserve

When we sell mortgage loans we make customary representations and warranties to the purchasers about various characteristics of each loan and how it was originated. The estimate of the liability for obligations under representations and warranties relating to transfers of residential mortgage loans is dependent on a variety of factors. These factors include actual defaults, estimated future defaults, historical loss experience, other economic conditions, estimated probability that we will receive a repurchase request, including consideration of whether presentation thresholds will be met and estimated probability that we will be required to repurchase a loan. The estimate of the liability for obligations under representations and warranties is based upon currently available information, historical experience, significant judgment and a number of other factors, including those set forth above, that are subject to change. Changes to any one of these factors or the framework applied by the GSEs could significantly impact the estimate of our liability. The representations and warranties provision may vary significantly each period as the methodology used to estimate the expense continues to be refined based on the level and type of repurchase requests presented, defects identified, the latest experience gained on repurchase requests, and other relevant facts and circumstances.

## Fair Value Measurements

A portion of our assets and liabilities are carried at fair value on the Consolidated Statements of Financial Condition, with changes in fair value recorded either through earnings or other comprehensive income (loss) in accordance with applicable accounting principles generally accepted in the United States.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is based on quoted market prices in an active market, or if market prices are not available, is estimated using models employing techniques such as matrix pricing or discounting expected cash flows. The significant assumptions used in the models, which include assumptions for interest rates, discount rates, prepayments and credit losses, are independently verified against observable market data where possible. Where observable market data is not available, the estimate of fair value becomes more subjective and involves a high degree of judgment. In this circumstance, fair value is estimated based on management's judgment regarding the value that market participants would assign to the asset or liability. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, which could significantly affect the results of current or future values.

**Level 3 Financial Instruments.** Level 3 valuations are based upon financial models using primarily unobservable inputs. These unobservable inputs reflect estimates of assumptions that market participants would use in pricing the asset or liability. The unobservable inputs are developed based on the best information available in the circumstances, which might include our financial data such as internally developed pricing models and discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment. Fair value measurement and disclosure guidance differentiates between those assets and liabilities required to be carried at fair value at every reporting period ("recurring") and those assets and liabilities that are only required to be adjusted to fair value under certain circumstances ("nonrecurring").

At December 31, 2015 and 2014, Level 3 assets recorded at fair value on a recurring basis totaled \$428 million and \$576 million, or 3.1 percent and 5.9 percent of total assets, respectively, and consisted primarily of loans held-for-investment, MSRs and mortgage rate lock commitments. At December 31, 2015 and 2014, there were \$84 million and \$166 million Level 3 liabilities recorded at fair value on a recurring basis, respectively, which primarily consisted of long-term debt and the DOJ litigation settlement.

At December 31, 2015 and 2014, Level 3 assets recorded at fair value on a nonrecurring basis were \$59 million and \$93 million, respectively, and there were no Level 3 liabilities recorded at fair value on a nonrecurring basis at December 31, 2015 and 2014. The Level 3 assets recorded at fair value on a nonrecurring basis were 0.4 percent and 0.9 percent of total assets at December 31, 2015 and December 31, 2014, respectively, and consisted of residential first mortgage and commercial real estate impaired loans held-for-investment and repossessed assets.

**Mortgage Servicing Rights.** When we sell mortgage loans in the secondary market, we frequently retain the right to continue to service these loans and earn a servicing fee. At the time the loan is sold on a servicing retained basis, we record the MSR as an asset at its fair value. Determining the fair value of MSRs involves a calculation of the present value of a set of market driven and MSR specific cash flows. MSRs do not trade in an active market with readily observable market prices.

However, the market price of MSR is generally a function of demand and interest rates. When mortgage interest rates decline, mortgage loan prepayments are expected to increase due to increased refinances. If this happens, the income stream from a MSR portfolio is expected to decline and the fair value of the portfolio will decline. Similarly, when mortgage interest rates increase, mortgage loan prepayments tend to slow and therefore the value of the MSR tends to increase. Accordingly, we must make assumptions about future interest rates and other market conditions in order to estimate the current fair value of our MSR portfolio. In certain circumstances, based on the probability of the completion of a sale of MSRs pursuant to a bona-fide purchase offer, we consider the bid price of that offer and identifiable transaction costs in comparison to the calculated fair value and may adjust the estimate of fair value to reflect the terms of the pending transaction. See Notes 1, 10 and 24 of the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for additional information and a sensitivity analysis of our MSR fair values. On an ongoing basis, we compare our fair value estimates based on both unobservable inputs and market inputs, where available, to report the various assumptions. On a quarterly basis, our MSR valuation is compared to two independent valuations performed by third parties. See Note 24 of the Consolidated Financial Statements for an interest rate sensitivity analysis on the MSRs.

DOJ litigation settlement. Upon the DOJ litigation settlement, we elected the fair value option to account for the liability representing the remaining future payments. As of December 31, 2015 the remaining future payments totaled \$118 million for which we use a discounted cash flow model to determine the current fair value. The model utilizes our forecast and considers multiple scenarios and possible outcomes that impact the timing of the additional payments, which are discounted using a risk free rate adjusted for non-performance risk that represents our credit risk. These scenarios are probability weighted and consider the view of an independent market participant to estimate the most likely fair value of the liability. As of December 31, 2015 and 2014, the liability was \$84 million and \$82 million, respectively. Refer to Note 1 of the Notes to Consolidated Financial Statements, herein for a further discussion of the DOJ liability.

Refer to Note 24 of the Notes to Consolidated Financial Statements, herein for a further discussion of fair value measurements.

#### Accounting and Reporting Developments

See Note 1 to the Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on our Consolidated Financial Statements.

## Summary of Operations

	For the Years Ended December 31,			
	2015	2014	2013	
	(Dollars in millions)			
Net interest income	\$287	\$247	\$186	
Provision (benefit) for loan losses	(19	) 132	70	
Total noninterest income	470	361	653	
Total noninterest expense	536	579	918	
Provision (benefit) for income taxes	82	(34	) (416	)
Preferred stock accretion	—	(1	) (6	)
Net income (loss)	\$158	\$(70	) \$261	
Income (loss) per share:				
Basic	\$2.27	\$(1.72	) \$4.40	
Diluted	\$2.24	\$(1.72	) \$4.37	

Our net income for the year ended December 31, 2015 was \$158 million (\$2.24 per diluted share), compared to a net loss of \$70 million (\$1.72 loss per diluted share) for the year ended December 31, 2014. During the year ended December 31, 2015, we had strong mortgage revenue with little commensurate expense increases. In addition, we significantly de-risked the balance sheet through the sales of approximately \$1.0 billion loans and grew assets which drove an overall improvement in portfolio quality.

Net interest income increased \$40 million for the year ended December 31, 2015 as compared to the same period in 2014, primarily due to strong growth in average interest-earning assets, partially offset by a decrease in the net interest margin due to a significant portion of the interest earning asset growth being in relatively lower spread mortgage loans which were funded with higher cost/longer tenured liabilities.

Our provision for loan losses improved by \$151 million for the year ended December 31, 2015 as compared to the same period in 2014. In 2014, we recorded a \$132 million provision that was primarily driven by two changes in estimates (described further in the prior year comparison): the evaluation of current data related to the loss emergence period on our residential mortgage loan portfolio and the evaluation of the enhanced risk associated with payment resets relating to interest-only loans. In 2015, we sold 90 percent of our interest-only loans at prices that were favorable as compared to the continuing reset risk associated with us continuing to hold these loans which was recorded consistent with the incurred loss methodology. This action along with the sale of \$444 million TDR, nonperforming and jumbo loans resulted in a \$69 million reduction to the allowance for loan losses which along with an overall improvement in portfolio quality was the primary driver of the \$19 million net benefit reported in 2015 being partially offset by a \$1.9 billion increase in volume of average loans held-for-investment due to the origination of residential first mortgages and increased commercial lending.

Noninterest income increased \$109 million for the year ended December 31, 2015 as compared to the same period in 2014, primarily due to an \$82 million increase in net gain on loan sales due to higher origination volumes and a \$29 million benefit in the representation and warranty provision.

Noninterest expense decreased \$43 million for the year ended December 31, 2015 as compared to the same period in 2014, primarily due to lower asset resolution expense, a decrease in legal and professional expenses and the CFPB penalty in 2014. These items were partially offset by increases in expenses related to the DOJ settlement valuation, loan processing, warrant expense, compensation and benefits and commissions.



Income tax provision increased \$116 million for the year ended December 31, 2015 as compared to the same period in 2014, primarily due to higher pre-tax book income.

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The following table presents on a consolidated basis interest income from average assets and liabilities, expressed in dollars and yields.

	For the Years Ended December 31,											
	2015			2014			2013					
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate			
	(Dollars in millions)											
<b>Interest-Earning Assets</b>												
Loans held-for-sale	\$2,188	\$85	3.90 %	\$1,534	\$65	4.24 %	\$2,499	\$89	3.55 %			
Loans with government guarantees	633	18	2.86 %	1,216	29	2.39 %	1,477	48	3.26 %			
<b>Loans held-for-investment</b>												
Consumer loans (1)	3,083	114	3.68 %	2,681	103	3.85 %	3,113	123	3.95 %			
Commercial loans (1)	1,993	78	3.88 %	1,294	49	3.70 %	1,215	54	4.37 %			
Loans held-for-investment	5,076	192	3.76 %	3,975	152	3.80 %	4,328	177	4.07 %			
Investment securities	2,305	59	2.55 %	1,496	39	2.61 %	474	12	2.51 %			
Interest-bearing deposits	234	1	0.50 %	219	1	0.25 %	2,104	5	0.25 %			
Total interest-earning assets	10,436	\$355	3.39 %	8,440	\$286	3.38 %	10,882	\$331	3.03 %			
Other assets	1,520			1,446			1,673					
Total assets	\$11,956			\$9,886			\$12,555					
<b>Interest-Bearing Liabilities</b>												
<b>Retail deposits</b>												
Demand deposits	\$429	\$1	0.14 %	\$422	\$1	0.14 %	\$397	\$1	0.19 %			
Savings deposits	3,693	30	0.82 %	3,139	18	0.61 %	2,729	20	0.63 %			
Money market deposits	258	1	0.31 %	266	1	0.20 %	335	1	0.25 %			
Certificate of deposits	787	6	0.77 %	915	6	0.73 %	2,055	18	0.89 %			
Total retail deposits	5,167	38	0.73 %	4,742	26	0.57 %	5,516	40	0.67 %			
<b>Government deposits</b>												
Demand deposits	257	1	0.39 %	182	1	0.38 %	96	—	0.43 %			
Savings deposits	405	2	0.52 %	320	2	0.51 %	203	1	0.35 %			
Certificate of deposits	358	1	0.39 %	349	1	0.33 %	360	2	0.41 %			
Total government deposits	1,020	4	0.44 %	851	4	0.41 %	659	3	0.39 %			
Total deposits	6,187	42	0.68 %	5,593	30	0.54 %	6,175	43	0.69 %			
<b>Federal Home Loan Bank advances</b>												
Other	1,811	19	1.00 %	939	2	0.23 %	2,915	95	3.22 %			
Other	307	7	2.42 %	248	7	2.72 %	247	7	2.68 %			
Total interest-bearing liabilities	8,305	68	0.82 %	6,780	39	0.58 %	9,337	145	1.53 %			
<b>Noninterest-bearing deposits (2)</b>												
Other liabilities	1,690			1,141			1,197					
Stockholders' equity	475			559			782					
Total liabilities and stockholders' equity	1,486			1,406			1,239					
Total liabilities and stockholders' equity	\$11,956			\$9,886			\$12,555					
Net interest-earning assets	\$2,131			\$1,660			\$1,545					
Net interest income		\$287			\$247			\$186				
Interest rate spread (3)			2.58 %			2.80 %			1.50 %			
Net interest margin (4)			2.74 %			2.91 %			1.72 %			

Ratio of average interest-earning assets to interest-bearing liabilities	125.7 %	124.5 %	116.5 %
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- (1) Consumer loans include: residential first mortgage, second mortgage, HELOC and other consumer loans.
- (1) Commercial loans include: commercial real estate, commercial and industrial, and warehouse lines.
- (2) Includes noninterest-bearing company controlled deposits that arise due to the servicing of loans for others.
- (3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.
- (4) Net interest margin is net interest income divided by average interest-earning assets.

## Net Interest Income

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

### 2015 Compared to 2014

Net interest income increased \$40 million for the year ended December 31, 2015, compared to the same period in 2014, primarily due to strong growth in interest-earning assets, partially offset by a decrease in the net interest margin.

Our net interest margin for the year ended December 31, 2015 was 2.74 percent, as compared to 2.91 percent for the year ended December 31, 2014. The decrease from 2014 was primarily driven by a significant portion of the interest earning asset growth being in relatively lower spread mortgage loans which were funded with higher cost/longer tenured liabilities .

Interest income increased \$69 million for the year ended December 31, 2015, compared to the same period in 2014, primarily driven by higher average loans held-for-sale, loans held-for-investment and investment securities, partially offset by a decrease in loans with government guarantees. Average warehouse loans increased \$431 million for the year ended December 31, 2015 to \$877 million, compared to \$446 million for the year ended December 31, 2014, primarily due to higher line utilization and new accounts. Average HELOC loans increased \$225 million for the year ended December 31, 2015 to \$347 million, compared to \$122 million for the year ended December 31, 2014, resulting from the acquisitions of loan portfolios in 2015. Average residential first mortgage loans increased \$195 million for the year ended December 31, 2015 to \$2,561 million, compared to \$2,366 million for the year ended December 31, 2014, primarily due to retained loan production from our mortgage origination business. Average commercial real estate loans increased \$153 million for the year ended December 31, 2015 to \$679 million, compared to \$526 million for the year ended December 31, 2014. Average commercial and industrial loans increased \$116 million for the year ended December 31, 2015 to \$438 million, compared to \$322 million for the year ended December 31, 2014, in line with our strategy to grow interest-earning assets.

Interest expense increased \$29 million for the year ended December 31, 2015, compared to the same period in 2014, primarily due to increased Federal Home Loan Bank advances and interest-bearing deposits. Average interest-bearing deposits were \$6.2 billion during the year ended December 31, 2015, increasing \$0.6 billion or 10.6 percent, compared to the year ended December 31, 2014. Retail deposits increased \$0.4 billion, led by growth in savings deposits. Average Federal Home Loan Bank advances were \$1.8 billion for the year ended December 31, 2015, an increase of \$0.9 billion compared to the year ended December 31, 2014. Throughout 2015, we replaced certain short-term advances with longer term advances primarily to match- fund our longer duration asset growth which resulted in slightly higher cost debt.

### 2014 Compared to 2013

Net interest income increased \$61 million for the year ended December 31, 2014, compared to the same period in 2013, primarily due to the prepayment of higher cost long-term Federal Home Loan Bank advances at the end of 2013 and lower interest earning asset and interest bearing liability levels. The overall cost of funds decreased to 0.58 percent for the year ended December 31, 2014, as compared to 1.53 percent for the year ended December 31, 2013. Net interest income represented 40.6 percent of our total revenue during the year ended December 31, 2014, compared to 22.2 percent for the year ended December 31, 2013.

Our net interest margin for the year ended December 31, 2014 was 2.91 percent, as compared to 1.72 percent for the year ended December 31, 2013. The increase was driven primarily by the replacement of high cost long term Federal Home Loan Bank advances with lower cost funds and increased interest income resulting from higher average loan balances.

Interest income decreased \$45 million for the year ended December 31, 2014, compared to the same period in 2013, primarily due to lower average balances in our mortgage loans available-for-sale and warehouse loans held-for-investment portfolios. Lower asset levels in these portfolios were primarily due to a decrease in mortgage industry originations during the year ended December 31, 2014, as compared to the year ended December 31, 2013.

Interest expense decreased \$105 million for the year ended December 31, 2014, compared to the same period in 2013, primarily due to a decrease of \$2.6 billion in average interest-bearing liabilities. This decline was the result of a \$2.0 billion decrease in average Federal Home Loan Bank advances and a \$0.6 billion decrease in the average balance of deposits.

## Rate/Volume Analysis

The following tables present the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities 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). The rate/volume variances are allocated to variances due to rate.

	For the Years Ended December 31,					
	2015 Versus 2014 Increase			2014 Versus 2013 Increase		
	(Decrease) Due to:					
	Rate	Volume	Total	Rate	Volume	Total
(Dollars in millions)						
<b>Interest-Earning Assets</b>						
Loans held-for-sale	\$(8	) \$28	\$20	\$11	\$(35	) \$(24
Loans with government guarantees	3	(14	) (11	) (11	) (8	) (19
Loans held-for-investment						
Consumer loans (1)	(5	) 16	11	(3	) (17	) (20
Commercial loans (2)	3	26	29	(8	) 3	(5
Total loans held-for-investment	(2	) 42	40	(11	) (14	) (25
Investment securities	(1	) 21	20	1	26	27
Interest-earning deposits	—	—	—	—	(5	) (5
Total interest-earning assets	\$(8	) \$77	\$69	\$(10	) \$(36	) \$(46
<b>Interest-Bearing Liabilities</b>						
<b>Retail deposits</b>						
Savings deposits	\$8	\$4	\$12	\$(1	) \$3	\$2
Certificate of deposits	—	—	—	(2	) (10	) (12
Total retail deposits	8	4	12	(3	) (7	) (10
<b>Government deposits</b>						
Savings deposits	—	—	—	—	1	1
Total government deposits	—	—	—	—	1	1
Wholesale deposits	—	—	—	—	(3	) (3
Total deposits	8	4	12	(3	) (9	) (12
Federal Home Loan Bank advances	15	2	17	(29	) (64	) (93
Total interest-bearing liabilities	\$23	\$6	\$29	\$(32	) \$(73	) \$(105
Change in net interest income	\$(31	) \$71	\$40	\$22	\$37	\$59

(1) Consumer loans include residential first mortgage, second mortgage, HELOC and other consumer loans.

(2) Commercial loans include: commercial real estate, commercial and industrial, and warehouse lending.

## Provision for Loan Losses

### 2015 Compared to 2014

The provision for loan losses decreased \$151 million for the year ended December 31, 2015, as compared to the year ended December 31, 2014. In 2014, we recorded a \$132 million provision that was primarily driven by two changes in estimates (described further in the prior year comparison): the evaluation of current data related to the loss emergence period on our residential mortgage loan portfolio and the evaluation of the enhanced risk associated with payment resets relating to interest-only loans. In 2015, we sold 90 percent of our interest-only loans at prices that were favorable as compared to the continuing reset risk associated with us continuing to hold these loans which was recorded consistent with the incurred loss methodology. This action along with the sale of \$444 million TDR, nonperforming and jumbo loans resulted in a \$69 million reduction to the allowance for loan losses which along with an overall improvement in portfolio quality was the primary driver of the \$19 million net benefit reported in 2015 being partially offset by a \$1.9 billion increase in volume of average loans held-for-investment due to the origination of residential first mortgages and increased commercial lending.

Net charge-offs for the year ended December 31, 2015 totaled \$91 million, compared to \$42 million for the year ended December 31, 2014. The increase was primarily due to the charge-off of allowance relating to loans sold or transferred to held-for-sale during the year ended December 31, 2015. We sought to de-risk the balance sheet by selling lower performing or interest-only loans. As a percentage of the average loans held-for-investment, annualized net charge-offs for the year ended December 31, 2015 increased to 1.85 percent from 1.07 percent for the year ended December 31, 2014. During the year ended December 31, 2015 and 2014, the annualized net charge-offs as a percentage of the average loans held-for-investment were 0.45 percent and 0.77 percent, respectively, excluding the charge-offs related to the loan sales or transfers of \$69 million and \$11 million, respectively.

### 2014 Compared to 2013

The provision for loan losses increased \$61 million for the year ended December 31, 2014, as compared to the year ended December 31, 2013. The increase was primarily driven by two changes in estimates: the loss emergence period related to the portfolio of residential loans and the evaluation of the risk associated with payment resets relating to the interest-only loans.

The loss emergence period is an assumption within our model and represents the average amount of time between when the loss event first occurs and when the specific loan is charged-off. The time period starts when the borrower first begins to experience financial difficulty and continues until the actual loss becomes visible to us. We analyzed our recent data including early stage delinquency, the increase in charge-offs for the first quarter 2014, continued emergence of nonperforming loans and our assessment of the time from first delinquency to charge-off. As a result, we qualitatively determined that our estimate of the average loss emergence period has lengthened. This change resulted in a \$37 million increase to the allowance for loan loss that reflected our updated estimate of probable losses inherent in the portfolio as of December 31, 2014.

In addition, during the first quarter 2014, certain loans in our interest-only residential first mortgage and HELOC loan portfolios began to reset. At the point of reset, the borrower's monthly payment increases upon inclusion of the amortization of principal and may also increase as a result of increases in interest rates. The payment reset increases could give rise to a "payment shock" as in a sudden and significant increase in the borrower's monthly payment. For instance, as of November 30, 2014 we estimated an average payment shock for borrowers with resets in 2015 of approximately 101 percent (i.e. their total monthly payments increase by 101 percent). The extent of the payment shock increased the likelihood that a borrower could default. Data we reviewed through December 31, 2014 indicated that interest-only loan modifications and defaults were greater than our previous estimates while in addition

refinancing levels were below our previous estimates. These conditions resulted in a \$59 million increase to the allowance for loan loss as of December 31, 2014.

Data we reviewed through December 31, 2014 indicated that actual modifications and defaults in the interest-only portfolio were greater than we had estimated at December 31, 2013. Additionally, we noted that these loans were refinancing at levels below those previously estimated. We believe that the combination of these two factors indicated an increase in future delinquencies and charge-offs; therefore, the allowance for loan losses was increased to \$297 million at December 31, 2014 from \$207 million at December 31, 2013. These allowance amounts included approximately \$112 million at December 31, 2014 and \$52 million at December 31, 2013 related to certain interest-only loans included in our residential first mortgage and HELOC loan held-for-investment portfolios which increased due to both the change in the average loss emergence period and in our qualitative assessment of the reset risk.



Net charge-offs for the year ended December 31, 2014 totaled \$42 million, compared to \$168 million for the year ended December 31, 2013. As a percentage of the average loans held-for-investment, net charge-offs for the year ended December 31, 2014 decreased to 1.07 percent from 4.00 percent for the year ended December 31, 2013. The decrease was primarily due to lower net credit losses on loan sales, lower levels of nonperforming loans, and lower loss severity due to continuing improvement in underlying collateral values.

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

#### Noninterest Income

The following table sets forth the components of our noninterest income.

	For the Years Ended December 31,		
	2015	2014	2013
	(Dollars in millions)		
Net gain on loan sales	\$288	\$206	\$402
Loan fees and charges	67	73	104
Deposit fees and charges	25	22	21
Loan administration income	26	24	6
Net return on mortgage servicing asset	28	24	91
Net gain on sale of assets	(1	) 12	2
Net impairment loss			