

FLAGSTAR BANCORP INC
Form 10-Q
November 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission File Number: 001-16577

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

Michigan
(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)
(248) 312-2000

48098-2639
(Zip code)

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No .

As of November 3, 2015, 56,441,157 shares of the registrant's common stock, \$0.01 par value, were issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Flagstar Bancorp, Inc.

Consolidated Statements of Financial Condition

(In millions, except share data)

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and cash equivalents		
Cash	\$65	\$47
Interest-earning deposits	130	89
Total cash and cash equivalents	195	136
Investment securities available-for-sale	1,150	1,672
Investment securities held-to-maturity	1,108	—
Loans held-for-sale (\$2,164 and \$1,196 measured at fair value, respectively)	2,408	1,244
Loans with government guarantees	509	1,128
Loans held-for-investment, net		
Loans held-for-investment (\$132 and \$211 measured at fair value, respectively)	5,514	4,448
Less: allowance for loan losses	(197	) (297
Total loans held-for-investment, net	5,317	4,151
Mortgage servicing rights	294	258
Federal Home Loan Bank stock	113	155
Premises and equipment, net	243	238
Net deferred tax asset	372	442
Other assets	810	416
Total assets	\$12,519	\$9,840
Liabilities and Stockholders' Equity		
Deposits		
Noninterest bearing	\$1,749	\$1,209
Interest bearing	6,388	5,860
Total deposits	8,137	7,069
Federal Home Loan Bank advances (includes both short-term and long-term)	2,024	514
Long-term debt (\$32 and \$84 measured at fair value, respectively)	279	331
Representation and warranty reserve	45	53
Other liabilities (\$84 and \$82 measured at fair value, respectively)	530	500
Total liabilities	11,015	8,467
Stockholders' Equity		
Preferred stock \$0.01 par value, liquidation value \$1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding, respectively	267	267
Common stock \$0.01 par value, 70,000,000 shares authorized; 56,436,026 and 56,332,307 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,484	1,482
Accumulated other comprehensive income	12	8
Accumulated deficit	(260	) (385
Total stockholders' equity	1,504	1,373
Total liabilities and stockholders' equity	\$12,519	\$9,840

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

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

	Three Months Ended September		Nine Months Ended September		
	30,		30,		
	2015	2014	2015	2014	
Interest Income	(Unaudited)				
Loans	\$77	\$64	\$216	\$185	
Investment securities	14	11	43	28	
Interest-earning deposits and other	—	—	1	—	
Total interest income	91	75	260	213	
Interest Expense					
Deposits	10	8	30	21	
Federal Home Loan Bank advances	6	1	13	2	
Other	2	2	6	5	
Total interest expense	18	11	49	28	
Net interest income	73	64	211	185	
(Benefit) provision for loan losses	(1	) 8	(18	) 127
Net interest income after provision for loan losses	74	56	229	58	
Noninterest Income					
Net gain on loan sales	68	52	242	152	
Loan fees and charges	17	19	53	56	
Deposit fees and charges	7	6	19	16	
Loan administration income	8	6	19	19	
Net return on the mortgage servicing asset	12	1	19	22	
Net gain (loss) on sale of assets	1	5	(1	) 11
Representation and warranty benefit (provision)	6	(13) 13	(16)
Other noninterest income	9	9	9	3	
Total noninterest income	128	85	373	263	
Noninterest Expense					
Compensation and benefits	58	54	178	174	
Commissions	10	10	31	26	
Occupancy and equipment	20	20	60	60	
Asset resolution	—	14	13	43	
Federal insurance premiums	6	6	18	17	
Loan processing expense	14	10	40	26	
Legal and professional expense	10	15	27	40	
Other noninterest expense	13	50	40	53	
Total noninterest expense	131	179	407	439	
Income (loss) before income taxes	71	(38) 195	(118)
Provision (benefit) for income taxes	24	(10) 70	(38)
Net income (loss)	47	(28) 125	(80)
Preferred stock accretion	—	—	—	(1)
Net income (loss) from continuing operations	\$47	\$(28) \$125	\$(81)
Income (loss) per share					
Basic	\$0.70	\$(0.61) \$1.82	\$(1.79)
Diluted	\$0.69	\$(0.61) \$1.80	\$(1.79)
Weighted average shares outstanding					
Basic	56,436,026	56,249,300	56,419,354	56,224,850	

Diluted	57,207,503	56,249,300	57,050,789	56,224,850
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The accompanying notes are an integral part of these Consolidated Financial Statements.

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Flagstar Bancorp, Inc.

Consolidated Statements of Comprehensive Income (Loss)

(In millions)

	Three Months Ended September		
	30,		
	2015	2014	
	(Unaudited)		
Net income (loss)	\$47	\$(28))
Other comprehensive income (loss), net of tax			
Unrealized gain (loss) on investment securities available-for-sale			
Unrealized gain (loss) (net of (\$5) and \$4 tax effect, respectively)	9	(5))
Less: Reclassification of net loss on the sale (net of zero and zero tax effect, respectively)	—	(2))
Net change in unrealized gain (loss) on investment securities available-for-sale, net of tax	9	(7))
Unrealized (loss) on derivative instruments designated to cash flow hedges			
Unrealized (loss) (net of \$2 tax effect and zero respectively)	(5)) —	
Less: Reclassification of net loss on derivative instruments	—	—	
Net change in unrealized (loss) on derivative instruments, net of tax	(5)) —	
Other comprehensive income (loss), net of tax	4	(7))
Comprehensive income (loss)	\$51	\$(35))
	Nine Months Ended September		
	30,		
	2015	2014	
	(Unaudited)		
Net income (loss)	\$125	\$(80))
Other comprehensive income (loss), net of tax			
Unrealized gain on investment securities available-for-sale			
Unrealized gain (net of (\$5) and (\$1) tax effect, respectively)	9	11)
Less: Reclassification of net loss on the sale (net of zero and (\$4) tax effect, respectively)	—	(7))
Net change in unrealized gain on investment securities available-for-sale, net of tax	9	4)
Unrealized (loss) on derivative instruments designated to cash flow hedges			
Unrealized (loss) (net of \$2 tax effect and zero respectively)	(5)) —	
Less: Reclassification of net loss on derivative instruments	—	—	
Net change in unrealized (loss) on derivative instruments, net of tax	(5)) —	
Other comprehensive income, net of tax	4	4)
Comprehensive income (loss)	\$129	\$(76))

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

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Flagstar Bancorp, Inc.

Consolidated Statements of Stockholders' Equity

(In millions)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2013 (Unaudited)	\$266	\$1	\$1,479	\$ (5	) \$ (315	) \$1,426
Net loss	—	—	—	—	(80	) (80
Total other comprehensive income	—	—	—	4	—	4
Accretion of preferred stock	1	—	—	—	(1) —
Stock-based compensation	—	—	2	—	—	2
Balance at September 30, 2014	\$267	\$1	\$1,481	\$ (1	) \$ (396	) \$1,352
Balance at December 31, 2014 (Unaudited)	267	1	1,482	8	\$ (385	) \$1,373
Net income	—	—	—	—	125	125
Total other comprehensive income	—	—	—	4	—	4
Stock-based compensation	—	—	2	—	—	2
Balance at September 30, 2015	\$267	\$1	\$1,484	\$ 12	\$ (260	) \$1,504

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

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

	Nine Months Ended September 30,	
	2015 (Unaudited)	2014 (Unaudited) As Restated
Operating Activities		
Net income (loss)	\$ 125	\$(80)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
(Benefit) provision for loan losses	(18 )	) 127
Representation and warranty (benefit) provision	(13 )	) 16
Depreciation and amortization	17	18
Deferred income taxes	68	(35)
Net gain on loan and asset sales	(241 )	) (163)
Change in fair value and other non-cash changes	(231 )	) (150)
Other changes:		
Proceeds from sales of loans held-for-sale ("HFS")	15,247	12,610
Origination, premium paid and repurchase of loans, net of principal repayments	(22,180 )	) (18,225)
Increase in accrued interest receivable	(6 )	) (12)
Decrease (increase) in other assets, excludes purchase of other investments	155	(82)
Net charge-offs in representation and warranty reserve	(1 )	) (18)
Increase in other liabilities	11	35
Net cash used in operating activities	(7,067 )	) (5,959)
Investing Activities		
Proceeds from sale of available-for-sale securities, including loans that have been securitized	6,603	6,532
Collection of principal on investment securities available-for-sale ("AFS")	185	118
Purchase of investment securities available-for-sale and other	(783 )	) (756)
Collection of principal on investment securities held-to-maturity ("HTM")	38	—
Purchase of investment securities HTM	(10)) —
Proceeds received from the sale of held-for-investment loans ("HFI")	788	62
Origination and purchase of loans HFI, net of principal repayments	(2,249 )	) (623)
Purchase of bank owned life insurance	(175)) —
Proceeds from the disposition of repossessed assets	19	30
Redemption of Federal Home Loan Bank stock	42	—
Acquisitions of premises and equipment, net of proceeds	(28 )	) (26)
Proceeds from the sale of mortgage servicing rights	183	168
Net cash provided by investing activities	4,613	5,505
Financing Activities		
Net increase in deposit accounts	1,068	1,094
Proceeds from increases in Federal Home Loan Bank advances	22,235	13,633
Repayment of Federal Home Loan Bank advances	(20,725 )	) (14,471)
Repayment of long-term debt	(55 )	) (19)
Net (reduction) receipt of payments of loans serviced for others	(23 )	) 39
Net receipt of escrow payments	13	4
Net cash provided by financing activities	2,513	280
Net increase (decrease) in cash and cash equivalents	59	(174)

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Beginning cash and cash equivalents	136	281	
Ending cash and cash equivalents	\$195	\$107	
Supplemental disclosure of cash flow information			
Interest paid on deposits and other borrowings	\$42	\$23	
Income tax payments (refund)	\$3	\$(1)
Non-cash reclassification of investments AFS to HTM	\$1,136	\$—	
Non-cash reclassification of loans HFI to loans HFS	\$1,113	\$384	
Non-cash reclassification of loans HFS to loans HFI	\$30	\$15	
Non-cash reclassification of loans HFS to AFS securities	\$6,617	\$6,234	
Mortgage servicing rights resulting from sale or securitization of loans	\$220	\$198	
Non-cash reclassification of loans with government guarantee to other assets	\$373	\$—	

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

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Flagstar Bancorp, Inc.

Notes to the Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The accompanying financial statements of Flagstar Bancorp, Inc. ("Flagstar" or the "Company"), including its wholly owned principal subsidiary, Flagstar Bank, FSB (the "Bank"), have been prepared using U.S. generally accepted accounting principles ("GAAP") for interim financial statements.

These consolidated financial statements do not include all of the information and footnotes required by GAAP for a full year presentation and certain disclosures have been condensed or omitted in accordance with rules and regulations of the Securities and Exchange Commission. These interim financial statements are unaudited and include, in the opinion of the Company, all adjustments necessary for a fair presentation of the results for the periods indicated, which are not necessarily indicative of results which may be expected for the full year. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, which is available on the Company's website, at flagstar.com, and on the SEC website, at sec.gov. Certain prior period amounts have been reclassified to conform to the current period presentation.

Note 2 – Investment Securities

As of September 30, 2015 and December 31, 2014, investment securities were comprised of the following.

	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
September 30, 2015				
Available-for-sale securities				
Agency	\$463	\$7	\$(1)	) \$469
Agency-collateralized mortgage obligations	657	11	—	668
Municipal obligations	13	—	—	13
Total available-for-sale securities	\$1,133	\$18	\$(1)	) \$1,150
Held-to-maturity securities				
Agency	\$445	\$4	\$—	\$449
Agency-collateralized mortgage obligations	663	6	—	669
Total held-to-maturity securities	\$1,108	\$10	\$—	\$1,118
December 31, 2014 (2)				
Available-for-sale securities				
Agency	\$925	\$6	\$(2)	) \$929
Agency-collateralized mortgage obligations	734	8	(1)	) 741
Municipal obligations	2	—	—	2
Total available-for-sale securities	\$1,661	\$14	\$(3)	) \$1,672

(1) Includes the investment securities that were transferred to held-to-maturity at fair value.

(2) The Company did not have any held-to-maturity securities at December 31, 2014.

Credit related declines in the available-for-sale and held-to-maturity securities are classified as other-than-temporary impairments ("OTTI") and are reported as a separate component of noninterest income within the Consolidated Statement of Operations. An impaired investment security is considered to be other than temporary if (1) the Company intends to sell the security; (2) it is more likely than not the Company will be required to sell the security

before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover all contractually required principal and interest payments.

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Available-for-sale securities

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

The Company purchased \$59 million and \$783 million of available-for-sale securities, which included agency securities, comprised of mortgage-backed securities, collateralized mortgage and municipal obligations during the three and nine months ended September 30, 2015, respectively. During the third quarter the Company subsequently transferred \$462 million of the securities purchased during 2015 to held-to-maturity investments. The Company purchased \$86 million and \$762 million of available-for-sale securities, which included agency securities, comprised of mortgage-backed securities and collateralized mortgage obligations during the three and nine months ended September 30, 2014, respectively.

Gains (losses) on sales of available-for-sale securities are reported in other noninterest income in the Consolidated Statements of Operations. During both the three and nine months ended September 30, 2015, there were no sales of available-for-sale securities except those related to loans that had been securitized for sale in the normal course of business, compared to \$255 million and \$314 million, respectively, in sales of available-for-sale securities, resulting in a gain of \$2 million and \$3 million during the three and nine months ended September 30, 2014, respectively.

Held-to-maturity securities

Investment securities held-to-maturity are carried at amortized cost and adjusted for amortization of premiums and accretion of discounts using the interest method.

During the third quarter 2015, the Company transferred \$1.1 billion of available-for-sale securities to held-to-maturity securities at a premium of \$8 million, reflecting the Company's intent and ability to hold those securities to maturity. Transfers of investment securities into the held-to-maturity category from the available-for-sale category are accounted for at fair value at the date of transfer. The related \$5 million of unrealized holding gain, net of tax, that was included in the transfer is retained in other comprehensive income (loss) and is being amortized as an adjustment to interest income over the remaining life of the securities. There were no gains or losses recognized as a result of this transfer. The Company did not classify investment securities as held-to-maturity at December 31, 2014.

The Company purchased \$10 million of held-to-maturity securities, which included agency-collateralized mortgage obligations during both the three and nine months ended September 30, 2015, respectively. During both the three and nine months ended September 30, 2015, there were \$25 million of maturities in held-to-maturity securities. The Company did not hold held-to-maturity securities for the three and nine months ended September 2014.

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

Type of Security	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
	Fair Value	Number of Securities	Unrealized Loss	Fair Value	Number of Securities	Unrealized Loss
September 30, 2015	(Dollars in millions)					
Available-for-sale securities						
Agency	\$8	2	\$—	\$87	7	\$(1)
Agency-collateralized mortgage obligations	—	—	—	42	3	—

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Held-to-maturity securities						
Agency	\$—	—	\$—	\$10	1	\$—
December 31, 2014						
Available-for-sale securities						
Agency	\$53	6	\$—	\$305	21	\$(2)
Agency-collateralized mortgage obligations	98	10	(1)	38	4	—

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The amortized cost and estimated fair value of securities at September 30, 2015, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Investment Securities Available-for-Sale				Investment Securities Held-to-maturity			
	Amortized Cost	Fair Value	Weighted-Average Yield		Amortized Cost	Fair Value	Weighted-Average Yield	
September 30, 2015	(Dollars in millions)				(Dollars in millions)			
Due in one year or less	\$—	\$—	—	%	\$—	\$—	—	%
Due after one year through five years	—	—	—	%	—	—	—	%
Due after five years through 10 years	13	13	4.60	%	69	69	2.43	%
Due after 10 years	1,120	1,137	2.50	%	1,039	1,049	2.44	%
Total	\$1,133	\$1,150			\$1,108	\$1,118		

Management evaluates its securities portfolio each quarter to determine if any security is considered to be other than temporarily impaired. In making this evaluation, management considers its ability and intent to hold securities to recover current market losses. The Company did not recognize any other than temporary impairment losses on its investment securities during the third quarter or nine months ended September 2015 and 2014.

Note 3 – Loans Held-for-Sale

The majority of our mortgage loans originated as loans held-for-sale are sold into the secondary market on a whole loan basis or by securitizing the loans into securities. At September 30, 2015 and December 31, 2014, loans held-for-sale totaled \$2.4 billion and \$1.2 billion, respectively. For the three and nine months ended September 30, 2015, the Company reported net gain on loan sales of \$68 million and \$242 million, respectively, compared to \$52 million and \$152 million net gain on loan sales during the three and nine months ended September 30, 2014, respectively.

At September 30, 2015 and December 31, 2014, \$243 million and \$48 million, respectively, of loans held-for-sale were recorded at lower of cost or fair value. The remainder of the loans in the portfolio are recorded at fair value as the Company elected the fair value option.

Note 4 – Loans with Government Guarantees

The majority of loans with government guarantees continue to be insured or guaranteed by the Federal Housing Administration. These loans earn interest at a rate based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent, which is not paid by the FHA until claimed.

At September 30, 2015, loans with government guarantees actually repurchased totaled \$509 million and were classified as loans with government guarantees. At December 31, 2014, loans with government guarantees actually repurchased totaled \$1.1 billion and were classified as loans with government guarantees.

The Company adopted ASU Update No. 2014-14, Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40) in the first quarter 2015 at which time repossessed assets and the associated claims were recorded separately from the associated loans. At September 30, 2015, repossessed assets and the associated claims recorded in other assets totaled \$231 million and at December 31, 2014 repossessed assets and the associated claims were \$373 million and included in loans with government guarantees.

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Note 5 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows.

	September 30, 2015	December 31, 2014
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	\$2,726	\$2,193
Second mortgage	140	149
HELOC	405	257
Other	32	31
Total consumer loans	3,303	2,630
Commercial loans		
Commercial real estate	707	620
Commercial and industrial	493	429
Warehouse lending	1,011	769
Total commercial loans	2,211	1,818
Total loans held-for-investment	5,514	4,448
Less allowance for loan losses	(197	) (297
Loans held-for-investment, net	\$5,317	\$4,151

During the third quarter 2015, the Company transferred interest-only residential first mortgage loans with unpaid principal balances totaling \$214 million to held-for-sale, which were subsequently sold in October 2015. In addition the Company transferred \$19 million of nonperforming first mortgage loans to held-for-sale, which were subsequently sold at a gain on sale of \$1 million during the third quarter 2015. A portion of the general allowance for loan losses associated with both of these loan sales was reduced, resulting in a \$16 million reduction in the general allowance.

During the second quarter 2015, the Company sold interest-only residential first mortgage loans with unpaid principal balances totaling \$386 million, along with \$70 million of nonperforming and troubled debt restructured first mortgage loans. A portion of the allowance for loan losses associated with these loans was reduced, resulting in a \$15 million reduction in allowance. Upon a change in the Company's intent, the loans were transferred to held-for-sale and subsequently sold resulting in a loss on sale of \$1 million during the three months ended June 30, 2015.

During the first quarter 2015, the Company re-measured the specifically identified reserve relating to the troubled debt restructured loans, resulting in a \$36 million reduction in reserve based on a change in expected future cash flows. During the first quarter 2015, the Company changed its intent to hold these loans for investment and instead decided to hold these loans for sale. The loans for which the intent changed had an approximate unpaid principal balance of \$331 million, including approximately \$291 million of troubled debt restructured residential first mortgage loans, and \$30 million in specifically identified reserves at the time this intent was changed. These loans were transferred to loans held-for-sale and subsequently sold resulting in a loss on sale of less than \$1 million during the first quarter 2015.

During the first quarter 2014, the Company sold nonperforming, troubled debt restructured residential first mortgage and residential first mortgage jumbo loans with unpaid principal balances totaling \$313 million. A portion of the allowance for loan losses associated with these loans was reduced, resulting in a \$2 million reduction in allowance. Upon a change in the Company's intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain on sale of \$1 million.

During the second quarter 2014, the Company sold nonperforming, troubled debt restructured residential first mortgage and residential first mortgage jumbo loans with unpaid principal balances totaling \$234 million. Upon a change in the Company's intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain on sale of \$4 million.

During the third quarter 2014, the Company sold nonperforming, troubled debt restructured residential first mortgage and residential first mortgage jumbo loans with unpaid principal balances totaling \$81 million. A portion of the allowance for loan losses associated with these loans was reduced, resulting in a \$5 million reduction in allowance. Upon a change in the Company's intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain on sale of \$5 million.

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During the first and second quarter of 2015, the Company purchased \$197 million of HELOC loans with a premium of \$7 million.

The Company has pledged certain loans held-for-investment, loans held-for-sale, and loans with government guarantees to collateralize lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the Federal Home Loan Bank of Indianapolis. At September 30, 2015 and December 31, 2014, the Company pledged \$5.2 billion and \$4.1 billion, respectively.

The allowance for loan losses by class of loan are summarized in the following table.

	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)								
Three Months Ended September 30, 2015								
Beginning balance allowance for loan losses	\$ 151	\$ 14	\$ 25	\$ 1	\$ 15	\$ 12	\$ 4	\$ 222
Charge-offs (1)	(21)	(1)	(1)	(1)	—	(3)	—	(27)
Recoveries	1	1	—	1	—	—	—	3
Provision (benefit)	(2)	(1)	(1)	—	(2)	5	—	(1)
Ending balance allowance for loan losses	\$ 129	\$ 13	\$ 23	\$ 1	\$ 13	\$ 14	\$ 4	\$ 197
Three Months Ended September 30, 2014								
Beginning balance allowance for loan losses	\$ 249	\$ 14	\$ 14	\$ 2	\$ 19	\$ 5	\$ 3	\$ 306
Charge-offs (1)	(12)	(1)	(1)	(1)	—	—	—	(15)
Recoveries	1	—	—	1	—	—	—	2
Provision (benefit)	2	(1)	6	—	2	—	(1)	8
Ending balance allowance for loan losses	\$ 240	\$ 12	\$ 19	\$ 2	\$ 21	\$ 5	\$ 2	\$ 301
Nine Months Ended September 30, 2015								
Beginning balance allowance for loan losses	\$ 234	\$ 12	\$ 19	\$ 1	\$ 17	\$ 11	\$ 3	\$ 297
Charge-offs (1)	(80)	(2)	(2)	(3)	—	(3)	—	(90)
Recoveries	3	1	—	2	2	—	—	8
Provision (benefit)	(28)	2	6	1	(6)	6	1	(18)
Ending balance allowance for loan losses	\$ 129	\$ 13	\$ 23	\$ 1	\$ 13	\$ 14	\$ 4	\$ 197

Nine Months Ended
September 30, 2014

Beginning balance allowance for loan losses	\$ 162	\$ 12	\$ 8	\$ 2	\$ 19	\$ 3	\$ 1	\$ 207
Charge-offs (1)	(29)	(3)	(5)	(2)	(2)	—	—	(41)
Recoveries	3	—	—	2	3	—	—	8
Provision (benefit)	104	3	16	—	1	2	1	127
Ending balance allowance for loan losses	\$ 240	\$ 12	\$ 19	\$ 2	\$ 21	\$ 5	\$ 2	\$ 301

Includes charge-offs of \$16 million and \$6 million related to the sale or transfer of loans during the three months (1)ended September 30, 2015 and September 30, 2014, respectively, and \$67 million and \$8 million related to the sale or transfer of loans during the nine months ended September 30, 2015 and September 30, 2014, respectively.

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The loans held-for-investment and allowance for loan losses by class of loan is summarized in the following table.

	Residential First Mortgage (Dollars in millions)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
September 30, 2015								
Loans held-for-investment								
Individually evaluated	\$77	\$29	\$3	\$—	\$—	\$3	\$—	\$112
Collectively evaluated (1)	2,642	66	322	32	707	490	1,011	5,270
Total loans	\$2,719	\$95	\$325	\$32	\$707	\$493	\$1,011	\$5,382
Allowance for loan losses								
Individually evaluated	\$21	\$7	\$1	\$—	\$—	\$—	\$—	\$29
Collectively evaluated (1)	108	6	22	1	13	14	4	168
Total allowance for loan losses	\$129	\$13	\$23	\$1	\$13	\$14	\$4	\$197
December 31, 2014								
Loans held-for-investment								
Individually evaluated	\$385	\$31	\$1	\$—	\$—	\$—	\$—	\$417
Collectively evaluated (1)	1,782	65	124	31	620	429	769	3,820
Total loans	\$2,167	\$96	\$125	\$31	\$620	\$429	\$769	\$4,237
Allowance for loan losses								
Individually evaluated	\$82	\$5	\$1	\$—	\$—	\$—	\$—	\$88
Collectively evaluated (1)	152	7	18	1	17	11	3	209
Total allowance for loan losses	\$234	\$12	\$19	\$1	\$17	\$11	\$3	\$297

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

The allowance for loan losses, other than for loans that have been identified for individual evaluation for impairment, is determined on a loan pool basis by grouping loan types with similar risk characteristics to determine the Company's best estimate of incurred losses. Management evaluates the results of the allowance for loan losses model and makes qualitative adjustments to the results of the model when it is determined that model results do not reflect all losses inherent in the loan portfolios due to changes in recent economic trends and conditions, or other relevant factors.

For those loans not individually evaluated for impairment, management has categorized the commercial and consumer loans into portfolios with common risk characteristics.

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The following table sets forth the loans held-for-investment aging analysis as of September 30, 2015 and December 31, 2014, of past due and current loans.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due (1)	Total Past Due	Current	Total Investment Loans
(Dollars in millions)						
September 30, 2015						
Consumer loans						
Residential first mortgage	\$8	\$5	\$51	\$64	\$2,662	\$2,726
Second mortgage	1	—	1	2	138	140
HELOC	4	3	7	14	391	405
Other	—	—	1	1	31	32
Total consumer loans	13	8	60	81	3,222	3,303
Commercial loans						
Commercial real estate	—	—	—	—	707	707
Commercial and industrial	—	—	3	3	490	493
Warehouse lending	—	—	—	—	1,011	1,011
Total commercial loans	—	—	3	3	2,208	2,211
Total loans (2)	\$13	\$8	\$63	\$84	\$5,430	\$5,514
December 31, 2014						
Consumer loans						
Residential first mortgage	\$29	\$8	\$115	\$152	\$2,041	\$2,193
Second mortgage	1	1	2	4	145	149
HELOC	4	1	3	8	249	257
Other	—	—	—	—	31	31
Total consumer loans	34	10	120	164	2,466	2,630
Commercial loans						
Commercial real estate	—	—	—	—	620	620
Commercial and industrial	—	—	—	—	429	429
Warehouse lending	—	—	—	—	769	769
Total commercial loans	—	—	—	—	1,818	1,818
Total loans (2)	\$34	\$10	\$120	\$164	\$4,284	\$4,448

(1) Includes performing nonaccrual loans that are less than 90 days delinquent and for which interest can not be accrued.

(2) Includes \$9 million and \$5 million of loans 90 days or greater past due accounted for under the fair value option at September 30, 2015 and December 31, 2014, respectively.

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 the Company becomes aware of information indicating that collection of principal and interest is in doubt. When a loan is placed on nonaccrual status, the accrued interest income is reversed. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Loans held-for-investment and loans held-for-sale on which interest accruals have been discontinued totaled approximately \$77 million and \$135 million at September 30, 2015 and December 31, 2014, respectively, and \$122 million at September 30, 2014. Interest income is recognized on impaired loans using a modified cost recovery method. Interest that would have been accrued on impaired loans totaled approximately \$1 million and \$4 million during the three and nine months ended September 30, 2015, respectively, and \$2 million and \$4 million during the three and nine months ended September 30, 2014, respectively. At September 30, 2015 and December 31, 2014, the

Company had no loans 90 days past due and still accruing.

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Troubled Debt Restructuring

The Company may modify certain loans in both consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. The Company has programs designed to assist borrowers by extending payment dates or reducing the borrower's contractual payments. All loan modifications are made on a case-by-case basis. The Company's standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. TDRs result in those instances in which a borrower demonstrates financial difficulty and for which a concession has been granted, which includes reductions of interest rate, extensions of amortization period, principal and/or interest forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. These loans are classified as nonperforming TDRs if the loan was nonperforming prior to the restructuring, or based upon the results of a collateral credit evaluation. Such loans will continue on nonaccrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months, after which they will begin to accrue interest.

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

	TDRs		
	Performing	Nonperforming	Total
September 30, 2015	(Dollars in millions)		
Consumer loans			
Residential first mortgage	\$41	\$20	\$61
Second mortgage	34	1	35
HELOC	22	5	27
Total consumer loans	97	26	123
Commercial loans			
Commercial real estate	—	—	—
Commercial and industrial	—	—	—
Total commercial loans	—	—	—
Total TDRs (1)(2)	\$97	\$26	\$123
December 31, 2014			
Consumer loans			
Residential first mortgage	\$306	\$44	\$350
Second mortgage	35	1	36
HELOC	20	1	21
Total consumer loans	361	46	407
Commercial loans			
Commercial real estate	1	—	1
Total TDRs (1)(2)	\$362	\$46	\$408

(1) The allowance for loan losses on consumer TDR loans totaled \$16 million and \$81 million at September 30, 2015 and December 31, 2014, respectively.

(2) Includes \$31 million and \$30 million of TDR loans accounted for under the fair value option at September 30, 2015 and December 31, 2014, respectively.

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, but may give rise to potential incremental losses. The Company measures impairment using the discounted cash flow method for performing TDRs and measures impairment based on collateral values for re-defaulted TDRs.

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The following table provides a summary of newly modified TDRs and TDR loans that subsequently defaulted in the previous 12 months during the three and nine months ended September 30, 2015 and 2014. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when they are greater than 90 days past due.

	Number of Accounts	Pre-Modification Unpaid Principal Balance (Dollars in millions)	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
Three Months Ended September 30, 2015				
Residential first mortgages	48	\$13	\$14	\$—
Second mortgages	15	1	1	—
HELOC (2)	46	4	4	—
Total TDR loans	109	\$18	\$19	\$—
Three Months Ended September 30, 2014				
Residential first mortgages	36	\$11	\$11	\$1
Second mortgages	85	3	3	—
HELOC (2)	4	—	—	—
Total TDR loans	125	\$14	\$14	\$1
Nine Months Ended September 30, 2015				
Residential first mortgages	239	\$66	\$65	\$(1)
Second mortgages	83	4	3	—
HELOC (2)	204	12	11	—
Consumer	3	—	—	—
Total TDR loans	529	\$82	\$79	\$(1)
Nine Months Ended September 30, 2014				
Residential first mortgages	107	\$31	\$30	\$2
Second mortgages	291	9	9	—
HELOC (2)	19	1	—	—
Total TDR loans	417	\$41	\$39	\$2
TDRs that subsequently defaulted in previous 12 months				
	Number of Accounts		Unpaid Principal Balance	Increase in Allowance at Subsequent Default
Three Months Ended September 30, 2015				
Residential first mortgages	1		\$—	\$—
Total TDR loans	1		\$—	\$—
Three Months Ended September 30, 2014				
Second mortgages	2		\$—	\$—
Total TDR loans	2		\$—	\$—
Nine Months Ended September 30, 2015				
Residential first mortgages	1		\$—	\$—
Second mortgages	1		—	—
Total TDR loans	2		\$—	\$—

Nine Months Ended September 30, 2014

Residential first mortgages	2	\$—	\$—
Second mortgages	15	—	—
HELOC (2)	5	—	—
Total TDR loans	22	\$—	\$—

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

(2) HELOC post-modification unpaid principal balance reflects write downs.

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The following table presents impaired loans and the associated allowance:

	September 30, 2015			December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars in millions)						
With no related allowance recorded						
Consumer loans						
Residential first mortgage loans	\$6	\$6	\$—	\$63	\$78	\$—
Second mortgage	—	—	—	1	6	—
HELOC	—	—	—	—	1	—
Commercial loans						
Commercial and industrial	3	6	—	—	—	—
	\$9	\$12	\$—	\$64	\$85	\$—
With an allowance recorded						
Consumer loans						
Residential first mortgage	\$70	\$71	\$22	\$321	\$326	\$82
Second mortgage	29	29	7	29	29	6
HELOC	3	3	1	1	1	1
	\$102	\$103	\$30	\$351	\$356	\$89
Total						
Consumer loans						
Residential first mortgage	\$76	\$77	\$22	\$384	\$404	\$82
Second mortgage	29	29	7	30	35	6
HELOC	3	3	1	1	2	1
Commercial loans						
Commercial and industrial	3	6	—	—	—	—
Total impaired loans	\$111	\$115	\$30	\$415	\$441	\$89

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015		2014		2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(Dollars in millions)								
Consumer loans								
Residential first mortgage	\$96	\$ 1	\$406	\$ 3	\$172	\$ 4	\$408	\$ 8
Second mortgage	29	—	30	—	30	—	28	1
HELOC	15	—	1	—	6	—	1	—
Commercial loans								
Commercial real estate	—	—	—	—	—	—	1	—
Commercial and industrial	2	—	—	—	1	—	—	—
Total impaired loans	\$142	\$ 1	\$437	\$ 3	\$209	\$ 4	\$438	\$ 9

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Credit Quality

The Company utilizes an internal risk rating system in accordance with the Rating Credit Risk booklet of the Comptroller's Handbook, April 2011 and the Uniform Retail Credit classification and Account Management Policy issued June 20, 2000 by the Federal Financial Institution Examination Council (FFIEC) which is applied to all consumer and commercial loans. Commercial credits are classified using a risk-based approach by assigning a risk rating individually to each loan. Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship. Descriptions of the Company's internal risk ratings as they relate to credit quality follow the ratings used by the U.S. bank regulatory agencies as listed below.

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

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

Special mention. Assets identified as special mention possess credit deficiencies or potential weaknesses deserving management's close attention. Special mention assets have a potential weakness or pose an unwarranted financial risk that, if not corrected, could weaken the assets and increase risk in the future. Special mention assets are criticized, but do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Assets identified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. For HELOC loans and other consumer loans, the Company evaluates credit quality based on the aging and status of payment activity and includes all nonperforming loans.

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

Commercial Loans

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

based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship.

Consumer Loans

The same rating principles are used for consumer and commercial loans, but the principles are applied differently for consumer loans. Consumer loans consists of open and closed end loans extended to individuals for household, family, and other personal expenditures, and includes consumer loans, loans to individuals secured by their personal residence, including first mortgage, home equity, and home improvement loans. Because consumer loans are usually relatively small-balance, homogeneous exposures, consumer loans are rated primarily on payment performance. Payment performance is a proxy for the strength of repayment capacity and loans are generally classified based on their payment status rather than by an individual review of each loan.

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In accordance with regulatory guidance, the Company assigns risk ratings to consumer loans in the following manner:

- Consumer loans are classified as Watch once the loan becomes 60 days past due.
- Open and closed-end consumer loans 90 days or more past due are classified Substandard.

Commercial Credit Loans	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial	
September 30, 2015	(Dollars in millions)				
Grade					
Pass	\$659	\$445	\$921	\$2,025	
Watch	43	19	76	138	
Special mention	5	7	11	23	
Substandard	—	19	3	22	
Doubtful	—	3	—	3	
Total loans	\$707	\$493	\$1,011	\$2,211	
December 31, 2014					
Pass	\$578	\$398	\$650	\$1,626	
Watch	29	10	119	158	
Special mention	2	—	—	2	
Substandard	11	21	—	32	
Total loans	\$620	\$429	\$769	\$1,818	
Consumer Credit Loans	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Total
September 30, 2015	(Dollars in millions)				
Grade					
Pass	\$2,625	\$104	\$374	\$ 32	\$3,135
Watch	44	34	24	—	102
Substandard	57	2	7	—	66
Total loans	\$2,726	\$140	\$405	\$ 32	\$3,303
December 31, 2014					
Pass	\$1,764	\$111	\$233	\$ 31	\$2,139
Watch	314	36	21	—	371
Substandard	115	2	3	—	120
Total loans	\$2,193	\$149	\$257	\$ 31	\$2,630

Note 6 – Variable Interest Entities ("VIEs")

Due to the Assured Settlement Agreement in 2013, the Company became the primary beneficiary and reconsolidated the FSTAR 2005-1 and the FSTAR 2006-2 HELOC securitization trust's assets and liabilities. The Company had elected the fair value option for these assets and liabilities.

In June 2015, the Company executed a clean-up call of the FSTAR 2005-1 long-term debt associated with the HELOC securitization trust. The transaction resulted in a cash payment of \$24 million to the debt bondholders. After payment of the debt, the FSTAR 2005-1 HELOC securitization trust has been dissolved as of second quarter 2015. The Company initiated the clean-up call process with respect to the 2006-2 HELOC securitization trust, which the Company expects to complete in the fourth quarter 2015.

The Company continues to consolidate the VIE, which consists of the HELOC securitization trust formed in 2006. The Company has determined the trust is a VIE and has concluded that the Company is the primary beneficiary of this trust because it has the power to direct the activities of the entity that most significantly affect the entity's economic performance and has either the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits

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from the entity that could potentially be significant to the VIE. The beneficial owners of the trust can look only to the assets of the securitization trust for satisfaction of the debt issued by the securitization trust.

The following table provides a summary of the classifications of consolidated VIE assets and liabilities included in the Consolidated Financial Statements.

	2005-1	2006-2	Total
September 30, 2015	(Dollars in millions)		
HELOC Securitizations			
Assets			
Loans held-for-investment	\$—	\$57	\$57
Liabilities			
Long-term debt	\$—	\$32	\$32
December 31, 2014	(Dollars in millions)		
HELOC Securitizations			
Assets			
Loans held-for-investment	\$63	\$69	\$132
Liabilities			
Long-term debt	\$42	\$42	\$84

The economic performance of the VIE is most significantly impacted by the performance of the underlying loans. The principal risks to which the entities were exposed include credit risk and interest-rate risk.

FSTAR 2007-1 mortgage securitization trust is an unconsolidated VIE. The Company has a continuing involvement, but is not the primary beneficiary and de-recognized the assets upon transfer. In accordance with the settlement agreement with MBIA, there is no further recourse to the Company related to FSTAR 2007-1. At September 30, 2015 and December 31, 2014, the FSTAR 2007-1 mortgage securitization trust included 3,215 loans and 3,624 loans, respectively, with an aggregate principal balance of \$124 million and \$141 million, respectively.

Note 7 – Mortgage Servicing Rights

The Company has investments in mortgage servicing rights ("MSRs") to support mortgage strategies and to deploy capital at acceptable returns. The Company also utilizes derivatives as economic hedges to offset changes in the fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. The Company's portfolio of MSRs is highly sensitive to movements in interest rates. The primary risk associated with MSRs is the potential change in value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates or government intervention. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. There is also a risk of valuation decline due to higher than expected increases in default rates, which the Company does not believe can be effectively hedged. See Note 8 of the Notes to the Consolidated Financial Statements, herein, for additional information regarding the instruments utilized to hedge the risks of MSRs.

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Changes in the carrying value of residential first mortgage MSR, accounted for at fair value, were as follows.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Balance at beginning of period	\$317	\$289	\$258	\$285
Additions from loans sold with servicing retained	74	79	220	199
Reductions from sales	(73	) (68	) (144	) (161
Changes in fair value due to (1)				
Decrease in MSR due to pay-offs, pay-downs and run-off	(9	) (10	) (34	) (22
Changes in valuation inputs or assumptions (2)	(15	) (5	) (6	) (16
Fair value of MSR at end of period	\$294	\$285	\$294	\$285

(1) Changes in fair value are included within net return on mortgage servicing asset on the Consolidated Statements of Operations.

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

See Note 17 of the Notes to the Consolidated Financial Statements, herein, for additional fair value disclosures relating to mortgage servicing rights.

The following table summarizes income and fees associated with the mortgage servicing asset.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Income on mortgage servicing asset				
Servicing fees, ancillary income and late fees (1)	\$18	\$17	\$52	\$50
Fair value adjustments (2)	(24	) (15	) (38	) (38
Gain on hedging activity (3)	15	—	10	10
Net transaction costs	3	(1	) (5) —
Total income on mortgage servicing asset, included in net return on mortgage servicing asset	\$12	\$1	\$19	\$22

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

(2) Includes a \$2 million gain related to the sale of MSR during the nine months ended September 30, 2015.

(3) Changes in the derivatives utilized as economic hedges to offset changes in fair value of the MSR.

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

The following table summarizes income and fees associated with the mortgage loans subserviced.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(Dollars in millions)			
Income on mortgage loans subserviced				

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Servicing fees, ancillary income and late fees (1)	\$8	\$7	\$24	\$21
Other servicing charges	—	(1) (5) (2
Total income on mortgage loans subserviced, included in loan administration	\$8	\$6	\$19	\$19

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

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

	September 30, 2015			December 31, 2014		
	Actual	Fair value due to 10% adverse change	Fair value due to 20% adverse change	Actual	Fair value due to 10% adverse change	Fair value due to 20% adverse change
Option adjusted spread	8.68	% \$285	\$276	8.88	% \$250	\$243
Constant prepayment rate	13.27	% 283	272	14.98	% 253	245
Weighted average cost to service per loan	\$73.48	290	286	\$74.49	258	255

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

Note 8 – Derivative Financial Instruments

Derivative financial instruments are recorded at fair value in other assets and other liabilities on the Consolidated Statements of Financial Condition after taking into account the effects of legally enforceable bilateral collateral and master netting agreements. The Company is exposed to non-performance risk by the counterparties to its various derivative financial instruments. The Company believes that the credit risk inherent in all its derivative contracts is minimal based on credit standards and the netting and collateral provisions of the interest rate swap agreements.

Derivatives not designated as hedging instruments: The Company maintains a derivative portfolio of interest rate swaps, futures and forward commitments used to manage exposure to changes in interest rates, MSR asset values and to meet the needs of customers. The Company also enters into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Market risk on interest rate lock commitments and mortgage loans held-for-sale is managed using corresponding forward sale commitments.

Changes in fair value of derivatives not designated as hedging instruments are recognized in the Consolidated Statements of Income.

Derivatives designated as hedging instruments: The Company uses interest rate swaps to hedge the forecasted cash flows from its underlying variable-rate Federal Home Loan Bank (FHLB) advances in a qualifying cash flow hedge accounting relationship. Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income on the Consolidated Statement of Financial Condition and reclassified into interest expense in the same period in which the hedge transaction is realized into earnings. At September 30, 2015, the Company had \$5 million (net-of-tax) of realized and unrealized losses on derivatives classified as cash flow hedges recorded in other comprehensive income (loss), compared to zero at December 31, 2014. The estimated amount to be reclassified from other comprehensive income into earnings during the remainder of 2015 and the next 12 months represents gains of less than \$1 million (net-of-tax) and \$3 million of losses (net-of-tax), respectively. All cash flow hedges were highly effective as of September 30, 2015.

Derivatives that are designated in hedging relationships are evaluated for effectiveness using regression analysis at the time they are designated and throughout the hedge period. Cash flows and the profit impact associated with designated hedges are reported in the same category as the underlying hedged item.

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The gains/(losses), by hedge designation, recorded in income for the periods ended September 30 were as follows:

Location of Gain/(Loss)		Three Months Ended		Nine Months Ended	
		September 30, 2015	2014	September 30, 2015	2014
(Dollars in millions)					
Derivatives not designated as					
hedging instruments:					
U.S. Treasury and euro dollars futures	Net return on mortgage servicing asset	\$3	\$—	\$6	\$6
Swap futures	Net return on mortgage servicing asset	10	—	2	—
Mortgage backed securities forwards	Net return on mortgage servicing asset	2	—	2	4
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	(24	) (1	) (4	) (8
Rate lock commitments	Other noninterest income	1	—	(1) —
Interest rate swaps	Other noninterest income	2	1	2	2
Total derivative (loss) gain		\$(6) \$—	\$7	\$4

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The notional amount, estimated fair value and maturity of our derivative financial instruments were as follows:

	Notional Amount	Fair Value	Expiration Dates
	(Dollars in millions)		
September 30, 2015			
Derivatives designated as hedging instruments:			
Liabilities (2)			
Interest rate swaps on FHLB advances	\$225	\$8	2025
Derivatives not designated as hedging instruments:			
Assets (1)			
U.S. Treasury and euro dollar futures	\$232	\$2	2015-2019
Mortgage backed securities forwards	173	2	2015
Swap futures	179	3	2028-2045
Rate lock commitments	4,234	44	2015
Forward agency and loan sales	69	1	2015
Interest rate swaps and swaptions	769	15	2016-2033
Total derivative assets	\$5,656	\$67	
Liabilities (2)			
U.S. Treasury and euro dollar futures	\$1,793	\$2	2015-2020
Mortgage backed securities forwards	10	—	2015
Swap futures	26	1	2022
Rate lock commitments	41	—	2015
Forward agency and loan sales	4,150	29	2015
Interest rate swaps	399	10	2016-2025
Total derivative liabilities	\$6,419	\$42	
December 31, 2014			
Derivatives not designated as hedging instruments:			
Assets (1)			
Mortgage servicing rights			
U.S. Treasury and euro dollar futures	\$2,530	\$7	2015-2020
Mortgage backed securities forwards	161	2	2015
Rate lock commitments	2,604	31	2015
Forward agency and loan sales	194	—	2015
Interest rate swaps	355	6	2015-2021
Total derivative assets	\$5,844	\$46	
Liabilities (2)			
Mortgage servicing rights			
U.S. Treasury and euro dollar futures	\$687	\$1	2015-2020
Rate lock commitments	22	—	2015
Forward agency and loan sales	2,789	13	2015
Interest rate swaps	367	6	2015-2021
Total derivative liabilities	\$3,865	\$20	

(1) Derivative assets are included in other assets on the Consolidated Statements of Financial Condition.

(2) Derivatives liabilities are included in other liabilities on the Consolidated Statements of Financial Condition.

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The following tables present the derivatives subject to a master netting arrangement.

	Gross Amount	Gross Amounts Offset in the Statement of Financial Position	Net Amount Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral	Gross Amounts Not Offset in the Statement of Financial Position	Net Amount (1)
(Dollars in millions)							
September 30, 2015							
Derivatives designated as hedging instruments:							
Liabilities							
Interest Rate Swaps on FHLB advances	\$—	\$—	\$—	\$—	\$ (8	)	\$ 8
Derivatives not designated as hedging instruments:							
Assets							
Swap futures	\$ 6	\$—	\$ 6	\$—	\$ 3		\$ 3
U.S. Treasury swap and euro dollar futures	—	2	(2	)	(2)	—
Mortgage backed securities forwards	37	—	37	—	35		2
Interest rate swaps and swaptions	17	—	17	—	2		15
Total derivative assets	\$ 60	\$ 2	\$ 58	\$—	\$ 38		\$ 20
Liabilities							
Swap Futures	\$ 1	\$—	\$ 1	\$—	\$—		\$ 1
Interest rate swaps and swaptions	18	—	18	—	8		10
Total derivative liabilities	\$ 19	\$—	\$ 19	\$—	\$ 8		\$ 11
December 31, 2014							
Derivatives not designated as hedging instruments:							
Assets							
U.S. Treasury swap and euro dollar futures	\$ 18	\$ 1	\$ 17	\$—	\$ 10		\$ 7
Mortgage backed securities forwards	26	—	26	—	24		2
Interest rate swaps	8	—	8	—	2		6
Total derivative assets	\$ 52	\$ 1	\$ 51	\$—	\$ 36		\$ 15
Liabilities							
Interest rate swaps	\$ 6	\$—	\$ 6	\$—	\$—		\$ 6

(1) Includes gross amounts for items not netted in the Company's Consolidated Statements of Financial Condition.

The Company pledged a total of \$48 million of cash collateral to counterparties and had an obligation to return cash of \$10 million at September 30, 2015 for derivative activities. The Company pledged a total of \$36 million of investment securities and cash collateral to counterparties at December 31, 2014 for derivative activities. The net cash pledged is restricted and is included in other assets on the Consolidated Statements of Financial Condition.

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Note 9 – Federal Home Loan Bank Advances

The portfolio of Federal Home Loan Bank advances includes short-term fixed rate advances and long-term fixed rate advances. The following is a breakdown of the advances outstanding.

	September 30, 2015		December 31, 2014		
	Amount	Rate	Amount	Rate	
	(Dollars in millions)				
Short-term fixed rate term advances	\$824	0.18	% \$214	0.26	%
LIBOR adjustable advances long-term	225	0.46	% —	—	%
Long-term fixed rate term advances	975	1.54	% 300	1.36	%
Total	\$2,024	0.86	% \$514	0.90	%

At September 30, 2015, the Company had the authority and approval from the Federal Home Loan Bank to utilize a line of credit of up to \$7.0 billion and the Company may access that line to the extent that collateral is provided. At September 30, 2015, the Company had \$2.0 billion of advances outstanding and an additional \$1.6 billion of collateralized borrowing capacity available at Federal Home Loan Bank. The advances can be collateralized by non-delinquent single-family residential first mortgage loans, loans with government guarantees, certain other loans and investment securities. At September 30, 2015, \$225 million of the outstanding advances were adjustable rate based on the three month LIBOR index. Interest rates on these advances reset every three months and the advances may be prepaid without penalty, with notification at scheduled three month intervals after an initial 12 month lockout period.

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2015	2014	2015	2014	
	(Dollars in millions)				
Maximum outstanding at any month end	\$2,127	\$1,000	\$2,198	\$1,300	
Average outstanding balance	1,795	998	1,597	995	
Average remaining borrowing capacity	1,738	2,026	1,711	1,832	
Weighted-average interest rate	1.17	% 0.23	% 1.05	% 0.23	%

The following outlines the Company's Federal Home Loan Bank advance final maturity dates as of September 30, 2015.

	September 30, 2015 (Dollars in millions)
2015	\$824
2016	175
2017	50
2018	125
Thereafter	850
Total	\$2,024

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Note 10 – Long-Term Debt

The Company sponsored nine trust subsidiaries, including the consolidated VIEs, which issued trust preferred securities to third-party investors and loaned the proceeds to the Company in the form of junior subordinated notes included in long-term debt. The notes held by each trust are the sole assets of that trust. Distributions on the trust preferred securities of each trust are payable quarterly at a rate equal to the interest being earned by the trust on the notes held by these trusts.

The following table presents the carrying value on each junior subordinated note and VIE, along with the related interest rates of the long-term debt as of the dates indicated.

	September 30, 2015 (Dollars in millions)		December 31, 2014			
Trust Preferred Securities						
Floating Three Month LIBOR						
Plus 3.25%, matures 2032	\$26	3.58	%	\$26	3.50	%
Plus 3.25%, matures 2033	26	3.54	%	26	3.48	%
Plus 3.25%, matures 2033	26	3.53	%	26	3.51	%
Plus 2.00%, matures 2035	26	2.29	%	26	2.23	%
Plus 2.00%, matures 2035	26	2.29	%	26	2.23	%
Plus 1.75%, matures 2035	51	2.09	%	51	1.99	%
Plus 1.50%, matures 2035	25	1.79	%	25	1.73	%
Plus 1.45%, matures 2037	25	1.79	%	25	1.69	%
Plus 2.50%, matures 2037	16	2.84	%	16	2.74	%
Subtotal	\$247			\$247		
Notes associated with consolidated VIEs						
Floating One Month LIBOR						
Plus 0.46% (1), matures 2018 (3)	—			42		
Plus 0.16% (2), matures 2019 (4)	32			42		
Total long-term debt	\$279			\$331		

(1) The Note accrued interest at a rate equal to the least of (i) one month LIBOR plus 0.46 percent (ii) the net weighted average coupon, and (iii) 16.00 percent.

The interest rate for the notes may adjust monthly and will be subject to (i) a cap based on the weighted average of (2) the loan rates on the mortgage loans, minus the rates at which certain fees and expenses of the issuing entity are calculated and minus any required spread and adjusted for actual days and (ii) a fixed cap of 16.00 percent.

(3) In June 2015, the Company exercised a clean-up of the outstanding debt. The par value for the debt was \$43 million at December 31, 2014.

(4) The par value for the debt was \$33 million and \$45 million, respectively, at September 30, 2015 and December 31, 2014.

At September 30, 2015 and December 31, 2014 the three month LIBOR interest rate was 0.33 percent and 0.26 percent, respectively. At September 30, 2015 the one month LIBOR interest rate was 0.19 percent, compared to 0.17 percent at December 31, 2014.

Trust Preferred Securities

The trust preferred securities outstanding are callable by the Company are junior subordinated notes. The interest is payable quarterly; however, the Company may defer interest payments for up to 20 quarters without default or penalty. In January 2012, the Company exercised its contractual rights to defer interest payments with respect to trust preferred securities. The payments are periodically evaluated and will be reinstated when appropriate, subject to the

provisions of the Company's Supervisory Agreement and Consent Order. At September 30, 2015, the Company has deferred for 15 quarters and has \$26 million accrued for these deferred interest payments.

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Notes Associated with Consolidated VIEs

As previously discussed in Note 6 of the Notes to the Consolidated Financial Statements, herein, the Company determined it was the primary beneficiary of VIEs associated with HELOC securitizations and such VIEs proceeds from the HELOC assets are therefore consolidated in the Consolidated Financial Statements. The assets in the securitization trust are utilized to repay the outstanding debt of the securitization trust. The Company has elected the fair value option for the debt and changes in fair value are recorded to "other noninterest income" on the Consolidated Statements of Operations. Fair value is estimated using quantitative models which incorporate observable and, in some instances, unobservable inputs including security prices, interest rate yield curves, option volatility, currency, commodity or equity rates, and correlations between these inputs. The Company also considers the impact of its own observable credit spreads in the secondary bond markets in determining the discount rate used to value these liabilities. See Note 17 of the Notes to the Consolidated Financial Statements, herein, for additional recurring fair value disclosures.

The final legal maturity of the long-term debt associated with the VIE is June 2019; however, this debt agreement has a contractual provision that allows for a clean-up call of the debt when less than 10 percent of the balance remains outstanding. The Company initiated the clean-up call process with respect to the 2006-2 HELOC securitization trust, which the Company expects to complete in the fourth quarter 2015.

Note 11 - Representation and Warranty Reserve

The following table shows the activity impacting the representation and warranty reserve.

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2014	2014	2014
	(Dollars in millions)			
Balance, beginning of period	\$48	\$50	\$53	\$54
Provision				
Charged to gain on sale for current loan sales	2	2	6	5
Charged to representation and warranty reserve - change in estimate	(6	) 13	(13	) 16
Total	(4	) 15	(7	) 21
Charge-offs, net	1	(8	) (1	) (18
Balance, end of period	\$45	\$57	\$45	\$57

At the time a loan is sold, an estimate of the fair value of such loss associated with the mortgage loans is recorded in the representation and warranty reserve in the Consolidated Statements of Financial Condition and charged against the net gain on loan sales in the Consolidated Statements of Operations. Subsequent to the sale, the liability is re-measured on an ongoing basis based on an estimate of probable future losses. Changes in the estimate are recorded in the representation and warranty provision on the Consolidated Statements of Operations.

Note 12 – Stockholders' Equity

Preferred Stock and Other Warrants

On January 30, 2009, the Company sold to the U.S. Treasury 266,657 shares of Series C fixed rate cumulative non-convertible perpetual preferred stock ("Series C Preferred Stock") and a warrant to purchase up to approximately 1 million shares of Common Stock at an exercise price of \$62.00 per share (the "Warrant") for \$267 million. The Series C Preferred Stock qualifies as Tier 1 capital and currently pays cumulative dividends quarterly at a rate of 9

percent per annum. The Warrant is exercisable through 2019.

In 2013 the U.S. Treasury sold the Series C Preferred Stock and Warrants which are now held by unrelated third-party investors and are no longer held by the U.S. government under the TARP Capital Purchase Program. The warrants are valued utilizing the equity method.

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Preferred stock with a par value of \$0.01 and a liquidation value of \$1,000 and additional paid in capital attributable to preferred stock at September 30, 2015 is summarized as follows.

	Rate	Earliest Redemption Date	Shares Outstanding	Preferred Shares (Dollars in millions)	Additional Paid in Capital
Series C Preferred Stock	9.0	% 1/31/2012	266,657	\$—	\$267

At September 30, 2015, the Company has deferred \$79 million of dividend payments on the Series C Preferred Stock.

Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss) for investment securities available-for-sale, investment securities held-to-maturity and cash flow hedges.

	Held-to-Maturity Securities (Dollars in millions)	Available-for-Sale Securities	Cash Flow Hedges
Accumulated other comprehensive income (loss)			
Balance at December 31, 2014, net of tax	\$—	\$ 8	\$—
Net unrealized loss, net of tax	—	9	(5)
Transfer of net unrealized loss from AFS to HTM	5	(5) —
Balance at September 30, 2015, net of tax (1)	\$5	\$ 12	\$(5)
Balance at December 31, 2013, net of tax	\$—	\$(5)	\$—
Net unrealized gain, net of tax	—	4	—
Balance at September 30, 2014, net of tax (1)	\$—	\$(1)	\$—

(1) For the periods ended September 30, 2015 and 2014, there were no reclassifications out of accumulated other comprehensive income (loss) into earnings.

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Note 13 – Earnings (Loss) Per Share

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

The following table sets forth the computation of basic and diluted (loss) earnings per share of common stock.

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014		2014	
	(Dollars in millions, except share data)			
Net income (loss)	\$47	\$(28	) \$125	\$(80
Less: preferred stock dividend/accretion	—	—	—	(1
Net income (loss) from continuing operations	47	(28	) 125	(81
Deferred cumulative preferred stock dividends	(8	) (7	) (22	) (19
Net income (loss) applicable to common stock	\$39	\$(35	) \$103	\$(100
Weighted average shares				
Weighted average common shares outstanding	56,436,026	56,249,300	56,419,354	56,224,850
Effect of dilutive securities				
Warrants (1)	339,478	—	290,840	—
Stock-based awards	431,999	—	340,595	—
Weighted average diluted common shares	57,207,503	56,249,300	57,050,789	56,224,850
Earnings (loss) per common share				
Net income (loss) applicable to common stock	\$0.70	\$(0.61	) \$1.82	\$(1.79
Effect of dilutive securities				
Warrants	—	—	(0.01) —
Stock-based awards	(0.01	) —	(0.01) —
Diluted earnings (loss) per share	\$0.69	\$(0.61	) \$1.80	\$(1.79

(1) Includes the May warrants at an exercise price of \$10.00 per share and a fair value of \$8 million at September 30, 2015.

The three and nine months ended September 30, 2014 diluted loss per share calculation excludes all common stock equivalents, including 248,089 and 273,407 shares pertaining to stock based awards, respectively, and 303,026 and 326,102 shares pertaining to warrants, respectively. The inclusion of these securities would be anti-dilutive.

Under the terms of the Series C Preferred Stock the Company may defer dividend payments. The Company elected to defer dividend payments beginning with the February 2012 dividend. Although not included in quarterly net income (loss) from continuing operations, the deferral still impacts net income (loss) applicable to common stock for the purpose of calculating earnings per share, as shown above. The cumulative amount in arrears as of September 30, 2015 is \$79 million.

Note 14 – Income Taxes

The provision for income taxes in interim periods requires the Company to make a best estimate of the effective tax rate expected to be applicable for the full year. This estimated effective tax rate is then applied to interim consolidated pre-tax operating income to determine the interim provision for income taxes.

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	Three Months Ended September		Nine Months Ended September	
	30, 2015	2014	30, 2015	2014
	(Dollars in millions)			
Provision (benefit) for income taxes	\$24	\$(10)) \$70	\$(38)
Effective tax provision (benefit) rate	34.4	%(27.2))% 36.0	%(32.3)

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As of each reporting date, the Company considers both positive and negative evidence including any annual limitations to the realization of the Company's net operating loss carryforwards that could impact the view with regard to realization of deferred tax assets. The Company continues to believe it is more likely than not that the benefit for federal deferred tax assets will be realized. The Company continues to believe it is more likely than not that the benefit for certain state deferred tax assets will not be realized. In recognition of this risk, the Company continues to provide a partial valuation allowance on the deferred tax assets relating to state deferred tax assets.

The Company believes that it is unlikely that the unrecognized tax benefits will change by a material amount during the next 12 months. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense.

Note 15 — Regulatory Matters

Regulatory Capital

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that could have a material effect on the Consolidated Financial Statements. On January 1, 2015, the Basel III rules became effective and include transition provisions through 2018. Under Basel III, Total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of common equity Tier 1 capital and additional Tier 1 capital.

To be categorized as "well capitalized," the Company and the Bank must maintain minimum tangible capital, Tier 1 capital, common equity Tier 1, and total capital ratios as set forth in the table below. The Company and the Bank are considered "well capitalized" at both September 30, 2015 and December 31, 2014. There have been no conditions or events that management believes have changed the Company's or the Bank's category.

The following table shows the regulatory capital ratios as of the dates indicated.

Bancorp	Actual		For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions		
	Amount (Dollars in millions)	Ratio	Amount	Ratio	Amount	Ratio	
September 30, 2015 (1)							
Tangible capital (to tangible assets)	\$ 1,393	11.65	% N/A	N/A	N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,393	11.65	% \$ 478	4.0	% \$ 598	5.0	%
Common equity Tier 1 capital (to RWA)	1,024	14.93	% 309	4.5	% 446	6.5	%
Tier 1 capital (to risk-weighted assets)	1,393	20.32	% 411	6.0	% 549	8.0	%
Total capital (to risk-weighted assets)	1,483	21.64	% 549	8.0	% 686	10.0	%
December 31, 2014							
Tangible capital (to tangible assets)	\$ 1,184	12.59	% N/A	N/A	N/A	N/A	
	1,184	12.59	% \$ 376	4.0	% \$ 470	5.0	%

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Tier 1 capital (to adjusted tangible assets)

Tier 1 capital (to risk-weighted assets)	1,184	22.81	% 208	4.0	% 311	6.0	%
Total capital (to risk-weighted assets)	1,252	24.12	% 415	8.0	% 519	10.0	%

N/A - Not applicable

On January 1, 2015, the Basel III rules became effective, subject to transition provisions primarily related to (1) regulatory deductions and adjustments impacting common equity Tier 1 capital and Tier 1 capital. The Company and the Bank reported under Basel I (which included the Market Risk Final Rules) at December 31, 2014.

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Bank	Actual		For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions		
	Amount (Dollars in millions)	Ratio	Amount	Ratio	Amount	Ratio	
September 30, 2015 (1)							
Tangible capital (to tangible assets)	\$1,426	11.91	% N/A	N/A	N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,426	11.91	% \$479	4.0	% \$599	5.0	%
Common equity tier 1 capital (to RWA)	1,426	20.75	% 309	4.5	% 447	6.5	%
Tier 1 capital (to risk-weighted assets)	1,426	20.75	% 412	6.0	% 550	8.0	%
Total capital (to risk-weighted assets)	1,516	22.05	% 550	8.0	% 687	10.0	%
December 31, 2014							
Tangible capital (to tangible assets)	\$1,167	12.43	% N/A	N/A	N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,167	12.43	% \$376	4.0	% \$470	5.0	%
Tier 1 capital (to risk-weighted assets)	1,167	22.54	% 207	4.0	% 311	6.0	%
Total capital (to risk-weighted assets)	1,235	23.85	% 414	8.0	% 518	10.0	%

On January 1, 2015, the Basel III rules became effective, subject to transition provisions primarily related to (1) regulatory deductions and adjustments impacting common equity Tier 1 capital and Tier 1 capital. The Company and the Bank reported under Basel I (which included the Market Risk Final Rules) at December 31, 2014.

Note 16 – Legal Proceedings, Contingencies and Commitments

Legal Proceedings

The Company and its subsidiaries are subject to various pending or threatened legal proceedings arising out of the normal course of business operations. In addition, the Bank is routinely named in civil actions throughout the country by borrowers and former borrowers relating to the origination, purchase, sale, and servicing of mortgage loans. From time to time, governmental agencies also conduct investigations or examinations of various mortgage-related practices of the Bank. In the course of such investigations or examinations, the Bank cooperates with such agencies and provides information as requested.

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

Management does not believe that the amount of any reasonably possible losses in excess of any amounts accrued with respect to ongoing proceedings or any other known claims, including the matters described below, will be material to the Company's financial statements, or that the ultimate outcome of these actions will have a material adverse effect on its financial condition, results of operations or cash flows.

DOJ litigation settlement

Per the February 2012 DOJ litigation settlement, the Company is required to make future additional payments contingent upon the occurrence of certain future events. The Company elected the fair value option to account for this liability and uses a weighted average discounted cash flow model to measure fair value. The fair value of the DOJ litigation settlement liability was \$84 million and \$82 million at September 30, 2015 and December 31, 2014, respectively. The undiscounted amount of the DOJ litigation settlement liability remains at \$118 million at September 30, 2015.

At September 30, 2015 and December 31, 2014, the Company's total liability for contingent liabilities was \$85 million and \$86 million, respectively, including the legal proceedings and fair value liability relating to the DOJ litigation settlement.

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Commitments

A summary of the contractual amount of significant commitments is as follows.

	September 30, 2015	December 31, 2014
	(Dollars in millions)	
Commitments to extend credit		
Mortgage loans interest-rate lock commitments	\$4,314	\$2,172
HELOC commitments	133	88
Other consumer commitments	25	7
Warehouse loan commitments	1,046	827
Standby and commercial letters of credit	14	10
Commercial and industrial commitments	297	276
Other commercial commitments	447	169

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

The Company enters into mortgage interest-rate lock commitments with its customers. These commitments are considered to be derivative instruments and changes in the fair value of these commitments are recorded in the Consolidated Statements of Financial Condition in other assets. Further discussion on derivative instruments is included in Note 8 - Derivative Financial Instruments.

The Company has unfunded commitments under its contractual arrangement with the HELOC securitization trust to fund future advances on the underlying HELOC. Refer to further discussion of this issue as presented in Note 6 of the Notes to the Consolidated Financial Statements, herein.

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

Warehouse loan commitments are lines of credit provided to mortgage originators to fund loans they originate and then sell. The proceeds of the sale of the loan is used to repay the draw on the line used to fund the loan.

Standby and commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party.

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

These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the Consolidated Statements of Financial Condition. The Company's exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company utilizes the same credit policies in making commitments and conditional obligations as it does for balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract.

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The Company maintains a reserve for letters of credit which is included in other liabilities, which represents the estimate for probable credit losses inherent in unfunded commitments to extend credit. Unfunded commitments to extend credit include unfunded loans with available balances, new commitments to lend that are not yet funded, and standby and commercial letters of credit. The balance of \$2 million and \$1 million for September 30, 2015 and December 31, 2014, respectively, is reflected in other liabilities on the Consolidated Statements of Financial Condition.

Note 17 – Fair Value Measurements

The Company utilizes fair value measurements to record certain assets and liabilities at fair value.

Valuation Hierarchy

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

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

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

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

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

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

Assets

Investment securities available-for-sale. These securities are comprised of U.S. government sponsored agencies and municipal obligations. The Company measures fair value using prices obtained from pricing services. A review is performed on the security prices received from the pricing services, which includes discussion and analysis of the inputs used by the pricing services to value our securities and comparisons to independent pricing. Where possible, fair values are generated using market inputs including quoted prices (the closing price in an exchange market), bid prices (the price at which a buyer stands ready to purchase), and other market information. For fixed income securities that are not actively traded, the pricing services use alternative methods to determine fair value for the securities, including quotes for similar fixed-income securities, matrix pricing, discounted cash flow using benchmark curves or other factors to determine fair value. Investment securities are classified within level 2 of the valuation hierarchy.

Loans held-for-sale. The Company generally estimates the fair value of loans held-for-sale based on quoted market prices for securities backed by similar types of loans. Where quoted market prices were available, such market prices were utilized as estimates for fair values. Otherwise, the fair value of loans was computed by discounting cash flows

using observable inputs inclusive of interest rates, prepayment speeds and loss assumptions for similar collateral. These loans are classified as level 2.

Loans held-for-investment. Loans held-for-investment are generally recorded at amortized cost. Such loans are not recorded at fair value on a recurring basis. However, from time to time, a loan becomes impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as impaired, the fair value of the impaired loan is estimated using one of several methods, including collateral value less costs to sell, market value of similar debt, or discounted cash flows. The fair value of the underlying collateral is determined, where possible, using market prices derived from appraisals or market evaluations which are considered a non-recurring level 3 valuation. Fair value may also be measured using the present value of expected cash flows discounted at the loan's effective interest rate.

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Loans held-for-investment that are recorded at fair value on a recurring basis are loans that were previously recorded as loans held-for-sale but subsequently transferred to the held-for-investment category. As the Company elected the fair value option for the held-for-sale loans, they continue to be reported at fair value and measured consistent with the level 2 methodology for loans held-for-sale. Certain HELOC loans associated with the previous FSTAR 2005-1 and the current FSTAR 2006-2 securitization trusts have been recorded in the Consolidated Financial Statement as loans held-for-investment at fair value. The Company records these loans as a recurring level 3 valuation. Also included in loans held-for-investment are the second mortgage loans associated with the previous FSTAR 2006-1 mortgage securitization trust. The loans are carried at fair value and valued using a discounted estimated net future cash flow model and are classified within the level 3 valuation hierarchy as the model utilizes significant inputs which are unobservable. See Note 6 - Variable Interest Entities ("VIEs") for additional information.

Repossessed assets. Repossessed assets are measured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the repossessed asset. The fair value of repossessed assets, upon initial recognition, are estimated using level 3 inputs based on appraisals or evaluations. The significant unobservable inputs used in the level 3 fair value measurements of the Company's impaired loans and repossessed assets primarily relate to internal valuations or analysis.

Mortgage Servicing Rights ("MSRs"). The current market for MSRs is not sufficiently liquid to provide participants with quoted market prices. Therefore, the Company uses an option-adjusted spread valuation approach to determine the fair value of MSRs. This approach consists of projecting servicing cash flows under multiple interest rate scenarios and discounting these cash flows using risk-adjusted discount rates. The key assumptions used in the valuation of MSRs include mortgage prepayment speeds and discount rates. Management obtains third-party valuations of the MSR portfolio on a quarterly basis from independent valuation experts to assess the reasonableness of the fair value calculated by its internal valuation model. In certain circumstances, based on the probability of the completion of a sale of MSRs pursuant to a bona-fide purchase offer, the Company considers 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. Due to the nature of the valuation inputs, MSRs are classified within level 3 of the valuation hierarchy.

Other investments. The fair value of the reverse repurchase agreement is determined by cost, which approximates the fair value due to its short term nature. The reverse repurchase agreement is guaranteed by a third party and secured by level 2 government and agency securities which are unobservable by the Company, which are held by a third party. In case of default, the Company would receive the collateral from the third party. The reverse repurchase agreement is included in other assets on the Consolidated Statements of Financial Condition.

Derivative financial instruments. Certain classes of derivative contracts are listed on an exchange and are actively traded, and they are therefore classified within level 1 of the valuation hierarchy. These include U.S. Treasury futures and U.S. Treasury options. The Company's forward loan sale commitments, swap futures and interest rate swaps are valued based on quoted prices for similar assets in an active market with inputs that are observable and are classified within level 2 of the valuation hierarchy. Rate lock commitments are valued using internal models with significant unobservable market parameters and therefore are classified within level 3 of the valuation hierarchy. The Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. The derivatives are reported in either other assets or other liabilities on the Consolidated Statements of Financial Condition.

Liabilities

Warrants. Warrant liabilities are valued using a binomial lattice model and are classified within level 2 of the valuation hierarchy. Significant observable inputs include expected volatility, a risk free rate and an expected life. Warrant liabilities are reported in "other liabilities" on the Consolidated Statements of Financial Condition.

Long-term debt. The Company records the long-term debt associated with the previous FSTAR 2005-1 and the current FSTAR 2006-2 HELOC securitization trusts at fair value. The fair value of the debt is estimated using quantitative models which incorporate observable and, in some instances, unobservable inputs including security prices, interest rate yield curves, option volatility, currency, commodity or equity rates and correlations between these inputs. The Company also considers the impact of its own credit spreads in determining the discount rate used to value these liabilities. The credit spread is determined by reference to observable spreads in the secondary bond markets, which are considered to be level 3. The Company records this debt as a recurring level 3 valuation.

Litigation settlement. Upon settlement of the DOJ litigation settlement, we elected the fair value option to account for the liability representing the remaining future payments. As of September 30, 2015 the fair value totaled \$84 million, using a

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discount rate of 7.6 percent for which we use a discounted cash flow model to determine the current fair value. The model utilizes our forecast and considers multiple scenarios including possible outcomes that impact the timing of the additional payments which are discounted using a risk free rate adjusted for nonperformance 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.

The liability is classified within level 3 of the valuation hierarchy as the projections of earnings and growth rate and other assumptions are unobservable inputs which affect the estimated timing of the cash flow payments. The Company considers factors which could affect those projections from the perspective of a market participant, which is incorporated into the assessment of fair value. The litigation settlement is included in other liabilities on the Consolidated Statements of Financial Condition and changes in the fair value of the litigation settlement will be recorded each quarter in other noninterest expense on the Consolidated Statements of Operations.

Assets and liabilities measured at fair value on a recurring basis

The following tables present the financial instruments carried at fair value as of September 30, 2015 and December 31, 2014, by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy (as described above).

	Level 1	Level 2	Level 3	Total Fair Value
September 30, 2015	(Dollars in millions)			
Investment securities available-for-sale				
Agency	\$—	\$469	\$—	\$469
Agency-collateralized mortgage obligations	—	668	—	668
Municipal obligations	—	13	—	13
Loans held-for-sale				
Residential first mortgage loans	—	2,164	—	2,164
Loans held-for-investment				
Residential first mortgage loans	—	7	—	7
Second mortgage loans	—	—	45	45
HELOC loans	—	—	80	80
Mortgage servicing rights	—	—	294	294
Derivative assets				
Rate lock commitments	—	—	44	44
Swap futures	—	3	—	3
U.S. Treasury and euro dollar futures	2	—	—	2
Forward agency and loans sales	—	1	—	1
Mortgage backed securities forwards	2	—	—	2
Interest rate swaps and swaptions	—	15	—	15
Total derivative assets	4	19	44	67
Other investments	—	—	100	100
Total assets at fair value	\$4	\$3,340	\$563	\$3,907
Derivative liabilities				
U.S. Treasury and euro dollar futures	\$(2	) \$—	\$—	\$(2)
Forward agency and loans sales	—	(29	) —	(29)
Interest rate swap on FHLB advances	(8	) —	—	(8)
Swap futures	—	(1) —	(1)
Interest rate swaps	—	(10) —	(10)
Total derivative liabilities	(10) (40) —	(50)

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Warrant liabilities	—	(8) —	(8)
Long-term debt	—	—	(32) (32)
DOJ litigation settlement	—	—	(84) (84)
Total liabilities at fair value	\$(10) \$(48) \$(116) \$(174)

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	Level 1	Level 2	Level 3	Total Fair Value
December 31, 2014	(Dollars in millions)			
Investment securities available-for-sale				
Agency	\$—	\$929	\$—	\$929
Agency-collateralized mortgage obligations	—	741	—	741
Municipal obligations	—	—	2	2
Loans held-for-sale				
Residential first mortgage loans	—	1,196	—	1,196
Loans held-for-investment				
Residential first mortgage loans	—	26	—	26
Second mortgage loans	—	—	53	53
HELOC loans	—	—	132	132
Mortgage servicing rights	—	—	258	258
Derivative assets				
U.S. Treasury and euro dollar futures	7	—	—	7
Rate lock commitments	—	—	31	31
Mortgage backed securities forwards	2	—	—	2
Interest rate swaps	—	6	—	6
Total derivative assets	9	6	31	46
Other investments	—	—	100	100
Total assets at fair value	\$9	\$2,898	\$576	\$3,483
Derivative liabilities				
Forward agency and loan sales	\$—	\$(13	) \$—	\$(13
U.S. Treasury and euro dollar futures	(1	) —	—	(1
Interest rate swaps	—	(6	) —	(6
Total derivative liabilities	(1	) (19	) —	(20
Warrant liabilities	—	(6	) —	(6
Long-term debt	—	—	(84	) (84
DOJ litigation settlement	—	—	(82	) (82
Total liabilities at fair value	\$(1	) \$(25	) \$(166	) \$(192

The Company had no transfers of assets or liabilities recorded at fair value between fair value levels during the three and nine months ended September 30, 2015.

The Company utilized US Treasury future, forward agency and loan sales and interest rate swaps to manage the risk associated with mortgage servicing rights and rate lock commitments. The assets and/or liabilities transferred are valued at the end of the period. Gains and losses for individual lines in the tables do not reflect the effect of the Company's risk management activities related to such level 3 instruments.

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Fair value measurements using significant unobservable inputs

The tables below include a roll forward of the Consolidated Statement of Financial Condition amounts for the three and nine months ended September 30, 2015 and 2014 (including the change in fair value) for financial instruments classified by the Company within level 3 of the valuation hierarchy.

Three Months Ended September 30, 2015	Balance at Beginning of Period	Recorded in		Recorded		Purchases / Sales	Settlements	Transfer In (Out)	Balance at End of Period	Changes in Unrealized Gains / (Losses) Held at End of Period
		Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Total Unrealized Gains / (Losses)					
Assets										
(Dollars in millions)										
Loans										
held-for-investment										
Second mortgage loans	\$48	\$—	\$—	\$—	\$—	\$—	\$ (3)	\$—	\$45	\$—
HELOC loans	93	2	—	—	—	—	(15)	—	80	1
Mortgage servicing rights	317	(24)	—	—	74	(73)	—	—	294	(14)
Other investments	100	—	—	—	—	—	—	—	100	—
Totals	\$558	\$(22)	\$—	\$—	\$ 74	\$(73)	\$(18)	\$—	\$519	\$(13)
Liabilities										
Long-term debt	\$(36)	\$—	\$—	\$—	\$—	\$—	\$ 4	\$—	\$(32)	\$—
DOJ litigation settlement	(84)	—	—	—	—	—	—	—	(84)	—
Totals	\$(120)	\$—	\$—	\$—	\$—	\$—	\$ 4	\$—	\$(116)	\$—
Derivative financial instruments (net)										
Rate lock commitments	\$30	\$53	\$—	\$—	\$ 81	\$(104)	\$(16)	\$—	\$44	\$ 14
Three Months Ended September 30, 2014										
Assets										
Investment securities available-for-sale										
Municipal obligation	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$4	\$4	\$—
Loans										
held-for-investment										
Second mortgage loans	\$59	\$1	\$—	\$—	\$—	\$—	\$ (4)	\$—	\$56	\$ 1
HELOC loans	147	(1)	1	—	—	—	(7)	—	140	(8)
Mortgage servicing rights	289	(13)	—	—	79	(70)	—	—	285	(5)
Totals	\$495	\$(13)	\$1	\$—	\$ 79	\$(70)	\$(11)	\$4	\$485	\$(12)

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Liabilities										
Long-term debt	\$ (98)	\$ —	\$ (2)	\$ —	\$ —	\$ —	\$ 8	\$ —	\$ (92)	\$ —
DOJ litigation settlement	(78)	(2)	—	—	—	—	—	—	(80)	(2)
Totals	\$ (176)	\$ (2)	\$ (2)	\$ —	\$ —	\$ —	\$ 8	\$ —	\$ (172)	\$ (2)
Derivative financial instruments (net)										
Rate lock commitments	\$51	\$10	\$—	\$—	\$66	\$ (85)	\$ (15)	\$—	\$27	\$1

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Nine Months Ended September 30, 2015	Balance at Beginning of Period	Recorded in Earnings		Recorded in OCI		Purchases / Originations	Sales	Settlements	Transfer at In (Out)	Balance at End of Period	Changes In Unrealized Held at End of Period
		Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Total Unrealized Gains / (Losses)						
Assets											
Investment securities available-for-sale											
Municipal obligations	\$2	\$—	\$—	\$—	\$—	\$—	\$—	\$ (2)	\$—	\$—	\$—
Loans held-for-investment											
Second mortgage loans	53	2	1	—	—	—	—	(11)	—	45	1
HELOC loans	132	(4)	—	—	—	—	—	(48)	—	80	4
Mortgage servicing rights	258	(40)	—	—	220	(144)	—	—	—	294	(3)
Other investments	100	—	—	—	—	—	—	—	—	100	—
Totals	\$545	\$(42)	\$1	\$—	\$ 220	\$(144)	\$(61)	\$—	\$—	\$519	\$ 2
Liabilities											
Long-term debt	\$(84)	\$—	\$(3)	\$—	\$—	\$24	\$ 31	\$—	\$—	\$(32)	\$—
DOJ litigation	(82)	(2)	—	—	—	—	—	—	—	(84)	(2)
Totals	\$(166)	\$(2)	\$(3)	\$—	\$—	\$24	\$ 31	\$—	\$—	\$(116)	\$(2)
Derivative financial instruments (net)											
Rate lock commitments	\$31	\$60	\$—	\$—	\$ 272	\$(276)	\$(43)	\$—	\$—	\$44	\$ 30
Nine Months Ended September 30, 2014											
Assets											
Investment securities available-for-sale											
Municipal obligation	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$4	\$4	\$4	\$—
Loans held-for-investment											
Second mortgage loans	\$65	\$2	\$1	\$—	\$—	\$—	\$—	\$(12)	\$—	\$56	\$ 2
HELOC loans	155	(1)	1	—	—	—	—	(15)	—	140	(16)
Mortgage servicing rights	285	(37)	—	—	198	(161)	—	—	—	285	(11)
Totals	\$505	\$(36)	\$2	\$—	\$ 198	\$(161)	\$(27)	\$4	\$4	\$485	\$(25)
Liabilities											
Long-term debt	\$(106)	\$—	\$(5)	\$—	\$—	\$—	\$ 19	\$—	\$—	\$(92)	\$—
DOJ litigation	(93)	13	—	—	—	—	—	—	—	(80)	13
Totals	\$(199)	\$13	\$(5)	\$—	\$—	\$—	\$ 19	\$—	\$—	\$(172)	\$ 13

Derivative financial
instruments (net)

Rate lock commitments	\$10	\$110	\$—	\$—	\$203	\$(244)	\$(52)	\$—	\$27	\$24
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The following tables present the quantitative information about recurring level 3 fair value financial instruments and the fair value measurements as of September 30, 2015 and December 31, 2014.

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
September 30, 2015 (Dollars in millions)				
Assets				
Second mortgage loans	\$45	Discounted cash flows	Discount rate Prepay rate - 12 month historical average CDR rate - 12 month historical average	7.2% - 10.8% (9.0%) 15.4% - 23.2% (19.3%) 2.6% - 3.9% (3.3%)
HELOC loans	\$80	Discounted cash flows	Loss severity on defaulted balance Weighted average discount rate	24.4% - 36.7% (30.6%) 6.9% - 10.3% (8.6%)
Mortgage servicing rights	\$294	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service per loan	7.0% - 10.4% (8.7%) 10.8% - 15.6% (13.3%) \$59 - \$88 (\$73)
Liabilities				
Long-term debt	\$(32)	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Weighted average life Asset growth rate	7.2% - 10.8% (9.0%) 18.4% - 27.6% (23.0%) 0.2 - 0.4 (0.3) 4.4% - 6.6% (5.5%)
DOJ litigation settlement	\$(84)	Discounted cash flows	MSR growth rate Return on assets (ROA) improvement Peer group ROA	0.9% - 1.4% (1.2%) 0.02% - 0.04% (0.03%) 0.5% - 0.8% (0.7%)
Derivative financial instruments				
Rate lock commitments	\$44	Consensus pricing	Origination pull-through rate	65.3% - 97.9% (81.6%)
December 31, 2014 (Dollars in millions)				
Assets				
Second mortgage loans	\$53	Discounted cash flows	Discount rate Prepay rate - 12 month historical average CDR rate - 12 month historical average	7.2% - 10.8% (9.0%) 11.3% - 17.0% (14.2%) 2.4% - 3.6% (3.0%)
HELOC loans	\$132	Discounted cash flows	Yield Weighted average life (CPR) Weighted average life (CDR) Discount loss severity	8.0% - 12.0% (10.0%) 7.2% - 10.8% (9.0%) 6.6% - 9.9% (8.3%) 60.2% - 90.2% (75.2%)
Mortgage servicing rights	\$258	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service	7.1% - 10.7% (8.9%) 12.2% - 17.1% (15.0%)

Liabilities			per loan	\$67 - \$88 (\$78)
Long-term debt	\$(84)	) Discounted cash flows	Discount rate	6.4% - 9.6% (8.0%)
			Prepay rate - 3 month historical average	16.0% - 24.0% (20.0%)
			Weighted average life	0.5 - 0.7 (0.6)
DOJ litigation settlement	\$(82)	) Discounted cash flows	Asset growth rate	4.4% - 6.6% (5.5%)
			MSR growth rate	0.9% - 1.4% (1.2%)
			Return on assets (ROA) improvement	0.02% - 0.04% (0.03%)
			Peer group ROA	0.5% - 0.8% (0.7%)
Derivative financial instruments				
Rate lock commitments	\$31	) Consensus pricing	Origination pull-through rate	66.2% - 99.3% (82.7%)

Recurring Significant Unobservable Inputs

The significant unobservable inputs used in the fair value measurement of the second mortgage loans are discount rates, prepayment rates, and default rates. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases in prepay rates in isolation result in a higher fair value and increases (decreases) in default rates in isolation result in a (higher) lower fair value.

At September 30, 2015, the significant unobservable inputs used in the fair value measurement of the HELOC loans are the loss severity on defaulted loans and the weighted average discount rate. For the HELOC loans, increases (decreases) in the loss severity on defaulted balance, in isolation, would result in a lower (higher) fair value measurement; increases

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(decreases) in the weighted average discount rate, in isolation, would lower (higher) fair value measurement. For the debt carried at fair value (liability), increases (decreases) in the discount rate in isolation would result in a lower (higher) fair value measurement; increases (decreases) in prepayment rates in isolation results in a shorter (longer) weighted average life and ultimately a higher (lower) fair value measurement. In June 2015, the Company executed a clean-up call of the FSTAR 2005-1 long-term debt associated with the HELOC securitization trust. After payment of the debt, the FSTAR 2005-1 HELOC securitization trust has been dissolved as of June 30, 2015.

The significant unobservable inputs used in the fair value measurement of the MSR's are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation would result in a significantly lower (higher) fair value measurement.

The key economic assumptions used in determining the fair value of those MSR's capitalized during the three and nine months ended September 30, 2015 and 2014 periods were as follows.

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2015	2014	2015	2014	
Weighted-average life (in years)	7.9	7.9	7.9	8.0	
Weighted-average constant prepayment rate	11.0	% 12.0	% 11.2	% 11.8	%
Weighted-average discount rate	10.9	% 11.7	% 10.8	% 12.0	%

The key economic assumptions reflected in the overall fair value of the entire portfolio of MSR's were as follows.

	September 30, 2015	December 31, 2014	
Weighted-average life (in years)	7.1	6.6	
Weighted-average constant prepayment rate	13.3	% 15.0	%
Weighted-average discount rate	10.4	% 10.9	%

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

The significant unobservable inputs used in the fair value measurement of the DOJ litigation settlement are future balance sheet and growth rate projections for overall asset growth, MSR growth, peer group return on assets and return on assets improvement. The current assumptions are based on management's approved, strategic performance targets beyond the current strategic modeling horizon (2015). The Bank's target asset growth rate post-2015 is based on growth in the balance sheet. Significant increases (decreases) in the Bank's growth rate in isolation could result in a significantly lower (higher) fair value measurement. Significant increases (decreases) in the Bank's MSR growth rate in isolation could result in a marginally lower (higher) fair value measurement. Significant increases (decreases) in the peer group's return on assets improvement in isolation could result in a marginally higher (lower) fair value measurement. Significant increases (decreases) in the Bank's return on assets in isolation could result in a marginally higher (lower) fair value measurement.

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Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

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

	Level 3 (1) (Dollars in millions)
September 30, 2015	
Impaired loans held-for-investment (2)	
Residential first mortgage loans	\$36
Commercial and industrial loans	3
Reposessed assets (3)	17
Totals	\$56
December 31, 2014	
Impaired loans held-for-investment (2)	
Residential first mortgage loans	\$74
Reposessed assets (3)	19
Totals	\$93

(1) The fair values are obtained at various dates during the three months ended September 30, 2015 and December 31, 2014, respectively.

(2) The Company recorded \$20 million and \$76 million in fair value losses on impaired loans (included in provision for loan losses on Consolidated Statements of Operations) during the three and nine months ended September 30, 2015, respectively, compared to \$10 million and \$38 million in fair value losses on impaired loans during the three and nine months ended September 30, 2014, respectively.

(3) The Company recorded \$1 million and \$2 million in losses related to write downs of reposessed assets based on the estimated fair value of the specific assets during the three and nine months ended September 30, 2015, respectively, and recognized net gain of \$1 million and \$2 million on sales of reposessed assets (both write downs and net gains/losses are included in assets resolution expense on the Consolidated Statements of Operations) during the three and nine months ended September 30, 2015, respectively. The Company recorded \$2 million and \$4 million in losses related to write downs of reposessed assets based on the estimated fair value of the specific assets during the three and nine months ended September 30, 2014, respectively, and recognized net gains of \$1 million and \$4 million on sales of reposessed assets during the three and nine months ended September 30, 2014, respectively.

The following tables present the quantitative information about non-recurring level 3 fair value financial instruments and the fair value measurements as of September 30, 2015 and December 31, 2014.

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
September 30, 2015 (Dollars in millions)				
Impaired loans held-for-investment				
Residential first mortgage loans	\$36	Fair value of collateral	Loss severity discount	35% - 45% (41.4%)
Commercial and industrial loans	\$3	Fair value of collateral	Loss severity discount	40% - 50% (50.1%)
Reposessed assets	\$17	Fair value of collateral	Loss severity discount	0% - 100% (39.5%)
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
December 31, 2014 (Dollars in millions)				
Impaired loans held-for-investment				

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Residential first mortgage loans	\$74	Fair value of collateral	Loss severity discount	35% - 47% (36.9%)
Reposessed assets	\$19	Fair value of collateral	Loss severity discount	7% - 100% (45.4%)

Non-Recurring Significant Unobservable Inputs

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

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Fair Value of Financial Instruments

The following tables present the carrying amount of financial instruments measured at either fair value, historical cost or amortized cost and the estimated fair value of those financial instruments.

	September 30, 2015				
	Carrying Value	Total	Level 1	Level 2	Level 3
(Dollars in millions)					
Assets					
Cash and cash equivalents	\$ 195	\$ 195	\$ 195	\$—	\$—
Investment securities available-for-sale	1,150	1,150	—	1,150	—
Investment securities held-to-maturity	1,108	1,118	—	1,118	—
Loans held-for-sale	2,408	2,164	—	2,164	—
Loans with government guarantees	509	494	—	494	—
Loans held-for-investment, net	5,317	5,307	—	7	5,300
Repossessed assets	17	17	—	—	17
Federal Home Loan Bank stock	113	113	—	113	—
Mortgage servicing rights	294	294	—	—	294
Bank owned life insurance	176	176	—	176	—
Other investments	100	100	—	—	100
Other assets, foreclosure claims	231	231	—	231	—
Derivative Financial Instruments					
U.S. Treasury and euro dollar futures	2	2	2	—	—
Rate lock commitments	44	44	—	—	44
Swap futures	3	3	—	3	—
Mortgage back securities forwards	2	2	2	—	—
Forward agency and loan sales	1	1	—	1	—
Interest rate swaps and swaptions	15	15	—	15	—
Liabilities					
Retail deposits					
Demand deposits and savings accounts	(4,850)	(4,643)	—	(4,643)	—
Certificates of deposit	(813)	(816)	—	(816)	—
Government deposits	(1,207)	(1,189)	—	(1,189)	—
Company controlled deposits	(1,267)	(1,179)	—	(1,179)	—
Federal Home Loan Bank advances	(2,024)	(2,027)	—	(2,027)	—
Long-term debt	(279)	(117)	—	(85)	(32)
Warrant liabilities	(8)	(8)	—	(8)	—
Litigation settlement	(84)	(84)	—	—	(84)
Derivative Financial Instruments					
U.S. Treasury and euro dollar futures	(2)	(2)	(2)	—	—
Interest rate swap on FHLB advances	(8)	(8)	(8)	—	—
Swap futures	(1)	(1)	—	(1)	—
Forward agency and loan sales	(29)	(29)	—	(29)	—
Interest rate swaps	(10)	(10)	—	(10)	—

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	December 31, 2014				
	Carrying Value	Estimated Fair Value			
		Total	Level 1	Level 2	Level 3
	(Dollars in millions)				
Assets					
Cash and cash equivalents	\$136	\$136	\$136	\$—	\$—
Investment securities available-for-sale	1,672	1,672	—	1,670	2
Loans held-for-sale	1,244	1,196	—	1,196	—
Loans with government guarantees	1,128	1,094	—	1,094	—
Loans held-for-investment, net	4,151	3,998	—	26	3,972
Repossessed assets	19	19	—	—	19
Federal Home Loan Bank stock	155	155	155	—	—
Mortgage servicing rights	258	258	—	—	258
Other investments	100	100	—	—	100
Derivative Financial Instruments					
Interest rate swaps	6	6	—	6	—
U.S. Treasury futures	7	7	7	—	—
Rate lock commitments	31	31	—	—	31
Agency forwards	2	2	2	—	—
Liabilities					
Retail deposits					
Demand deposits and savings accounts	(4,565)	(4,291)	—	(4,291)	—
Certificates of deposit	(813)	(816)	—	(816)	—
Government deposits	(918)	(884)	—	(884)	—
Company controlled deposits	(773)	(770)	—	(770)	—
Federal Home Loan Bank advances	(514)	(514)	(514)	—	—
Long-term debt	(331)	(172)	—	(88)	(84)
Warrant liabilities	(6)	(6)	—	(6)	—
Litigation settlement	(82)	(82)	—	—	(82)
Derivative Financial Instruments					
Interest rate swaps	(6)	(6)	—	(6)	—
U.S. Treasury futures	(1)	(1)	(1)	—	—
Forward agency and loan sales	(13)	(13)	—	(13)	—

The methods and assumptions used by the Company in estimating fair value of financial instruments which are required for disclosure only, are as follows:

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

Investment securities held-to-maturity. Fair values are generated using market inputs, where possible, including quoted prices (the closing price in an exchange market), bid prices (the price at which a buyer stands ready to purchase), and other market information.

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

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

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Federal Home Loan Bank stock. No secondary market exists for Federal Home Loan Bank stock. The stock is bought and sold at par by the Federal Home Loan Bank. Management believes that the recorded value equals the fair value.

Bank owned life insurance. The fair value of bank owned life insurance policies is based on the cash surrender values of the policies as reported by the insurance companies.

Other assets, foreclosure claims. The fair value of foreclosure claims with government guarantees approximates the carrying amount.

Deposit accounts. The fair value of deposits with no defined maturity is estimated based on a discounted cash flow model that incorporates current market rates for similar products and expected attrition. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.

Federal Home Loan Bank advances. Rates currently available for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

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

Fair Value Option

The Company elected the fair value option for certain items as discussed throughout the Notes to the Consolidated Financial Statements to mitigate a divergence between accounting losses and economic exposure. Interest income on loans held-for-sale is accrued on the principal outstanding primarily using the "simple-interest" method.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Assets	(Dollars in millions)			
Loans held-for-sale				
Net gain on loan sales	\$134	\$80	\$276	\$269
Other noninterest income	—	—	—	(1)
Loans held-for-investment				
Interest income on loans	\$1	\$—	\$4	\$—
Other noninterest income	(1)	(6)	(35)	(35)
Liabilities				
Long-term debt				
Other noninterest income	\$3	\$6	\$28	\$14
Litigation settlement				
Other noninterest expense	\$—	\$(2)	2	\$13

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The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding as of September 30, 2015 and December 31, 2014 for assets and liabilities for which the fair value option has been elected.

	September 30, 2015 (Dollars in millions)		December 31, 2014			
	Unpaid Principal Balance	Fair Value	Fair Value Over / (Under) Unpaid Principal Balance	Unpaid Principal Balance	Fair Value	Fair Value Over / (Under) Unpaid Principal Balance
Assets						
Nonaccrual loans						
Loans held-for-investment	\$19	\$9	\$(10)	) \$11	\$5	\$(6)
Total nonaccrual loans	\$19	\$9	\$(10)	) \$11	\$5	\$(6)
Other performing loans						
Loans held-for-sale	\$2,060	\$2,164	\$104	\$1,144	\$1,196	\$52
Loans held-for-investment	136	123	(13)	) 225	206	(19)
Total other performing loans	\$2,196	\$2,287	\$91	\$1,369	\$1,402	\$33
Total loans						
Loans held-for-sale	\$2,060	\$2,164	\$104	\$1,144	\$1,196	\$52
Loans held-for-investment	155	132	(23)	) 236	211	(25)
Total loans	\$2,215	\$2,296	\$81	\$1,380	\$1,407	\$27
Liabilities						
Long-term debt	\$(33)	\$(32)	)\$1	\$(88)	\$(84)	)\$4
Litigation settlement (1)	\$(118)	\$(84)	)\$34	\$(118)	\$(82)	)\$36

(1) The Company is obligated to pay \$118 million in installment payments upon meeting certain performance conditions.

Note 18 – Segment Information

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

The Mortgage Originations segment originates, acquires and sells one-to-four family residential mortgage loans. The origination and acquisition of mortgage loans comprises the majority of the lending activity. Mortgage loans are originated through home loan centers, national call centers, the Internet and unaffiliated banks and mortgage banking and brokerage companies, where the net interest income and the gains from sales associated with these loans are recognized in the Mortgage Originations segment.

The Mortgage Servicing segment services and sub-services mortgage loans, on a fee basis, for others. Also, the Mortgage Servicing segment services, on a fee basis, residential mortgages held-for-investment by the Community Banking segment and mortgage servicing rights held by the Other segment. The Mortgage Servicing segment may also collect ancillary fees, such as late fees, and earns income through the use of noninterest-bearing escrows.

The Community Banking segment originates loans, 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. Products offered through these teams include checking accounts, savings accounts, money market accounts, certificates of deposit, other services, consumer loans, commercial loans, and warehouse lines of credit. Other financial services available to consumer and commercial customers include lines of credit, revolving credit, customized treasury management solutions, equipment leasing, inventory, and accounts receivable lending and capital markets services such as interest rate risk protection products.

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The Other segment includes the treasury functions, funding revenue associated with stockholders' equity, the impact of interest rate risk management, the impact of balance sheet funding activities, and miscellaneous other expenses of a corporate nature. Treasury functions include administering the investment securities portfolios, balance sheet funding, interest rate risk management and MSR asset valuation, certain derivative and sales into the secondary market. In addition, the Other segment includes revenue and expenses related to treasury and corporate assets and liabilities and equity not directly assigned or allocated to the Mortgage Originations, Mortgage Servicing or Community Banking operating segments.

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

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

	Three Months Ended September 30, 2015					
	Mortgage Origination	Mortgage Servicing	Community Banking	Other		Total
Summary of Operations	(Dollars in millions)					
Net interest income	\$19	\$4	\$44	\$6		\$73
Net gain (loss) on loan sales	72	—	(4	) —		68
Representation and warranty reserve - change in estimate	(4	) 10	—	—		6
Other noninterest income	17	14	12	11		54
Total net interest income and noninterest income	104	28	52	17		201
Benefit for loan losses	—	—	1	—		1
Asset resolution	—	—	—	—		—
Depreciation and amortization expense	(1	) (1	) (1	) (9	) (12)
Other noninterest expense	(47	) (37	) (38	) 3		(119
Total noninterest expense	(48	) (38	) (39	) (6	) (131)
Income (loss) before federal income taxes	56	(10	) 14	11		71
Provision for federal income taxes	—	—	—	24		24
Net income (loss)	\$56	\$(10	) \$14	\$(13	) \$47	
Intersegment revenue	\$15	\$(5	) \$(4	) \$(6) \$—	
Average balances						
Loans held-for-sale	\$2,179	\$—	\$21	\$—		\$2,200
Loans with government guarantees	—	547	—	—		547
Loans held-for-investment	4	—	5,348	60		5,412
Total assets	2,337	860	5,336	3,772		12,305
Deposits	—	1,487	6,773	—		8,260

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	Three Months Ended September 30, 2014					
	Mortgage Origination	Mortgage Servicing	Community Banking	Other	Total	
Summary of Operations	(Dollars in millions)					
Net interest income	\$16	\$6	\$38	\$4	\$64	
Net gain on loan sales	52	—	—	—	52	
Representation and warranty reserve - change in estimate	(11) (2) —	—	(13)
Other noninterest income	17	12	14	3	46	
Total net interest income and noninterest income	74	16	52	7	149	
Provision for loan losses	—	—	(8) —	(8)
Asset resolution	—	(13) (1) —	(14)
Depreciation and amortization expense	—	(2) (1) (3) (6)
Other noninterest expense	(59) (56) (41) (3) (159)
Total noninterest expense	(59) (71) (43) (6) (179)
Income (loss) before federal income taxes	15	(55) 1	1	(38)
Benefit for federal income taxes	—	—	—	(10) (10)
Net income (loss)	\$15	\$(55) \$1	\$11	\$(28)
Intersegment revenue	\$2	\$4	\$—	\$(6) \$—	
Average balances						
Loans held-for-sale	\$1,590	\$—	\$39	\$—	\$1,629	
Loans with government guarantees	—	1,215	—	—	1,215	
Loans held-for-investment	—	—	4,088	—	4,088	