TFS Financial CORP
Form 10-K
November 29, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 30, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For transition period from to

Commission File Number 001-33390

TFS FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

United States of America	**52-2054948**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

7007 Broadway Avenue

Cleveland, Ohio	**44105**
(Address of Principal Executive Offices)	**(Zip Code)**

(216) 441-6000

(Registrant s telephone number, including area code)

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

Common Stock, par value $0.01 per share

(Title of class)

The NASDAQ Stock Market, LLC

(Name of exchange on which registered)

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

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

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

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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (do not check if a 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 x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 31, 2011, as reported by the NASDAQ Global Select Market, was approximately $849.7 million.

Indicate the number of shares outstanding of each of the Registrant s classes of common stock as of the latest practicable date.

At November 17, 2011 there were 308,915,893 shares of the Registrant s common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 73.52% of the Registrant s common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant s mutual holding company.

DOCUMENTS INCORPORATED BY REFERENCE (to the Extent Indicated Herein)

Portions of the registrant s Proxy Statement for the 2012 Annual Meeting of Shareholders are incorporated by reference in Part III hereof.

TFS Financial Corporation

INDEX

PART I

Item 1. Business

Forward Looking Statements

This report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements concerning trends in our provision for loan losses and charge-offs;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors that could affect the actual outcome of future events:

- significantly increased competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, including employment prospects and conditions that are worse than expected;
- decreased demand for our products and services and lower revenue and earnings because of a recession or other events;
- adverse changes and volatility in the securities markets;
- adverse changes and volatility in credit markets;
- legislative or regulatory changes that adversely affect our business, including changes in regulatory costs and capital requirements and changes related to our ability to pay dividends and the ability of Third Federal Savings and Loan Association of Cleveland, MHC to waive dividends;

our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or de novo branches, if any;

changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board;

future adverse developments concerning Fannie Mae or Freddie Mac;

changes in monetary and fiscal policy of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;

changes in policy and/or assessment rates of taxing authorities that adversely affect us;

changes in expense trends (including, but not limited to trends affecting non-performing assets, charge-offs and provisions for loan losses);

the impact of the current governmental effort to restructure the U.S. financial and regulatory system;

inability of third-party providers to perform their obligations to us;

adverse changes and volatility in real estate markets;

a slowing or failure of the moderate economic recovery;

the extensive reforms enacted in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which will impact us;

the adoption of implementing regulations by a number of different regulatory bodies under the Dodd-Frank Act, and uncertainty in the exact nature, extent and timing of such regulations and the impact they will have on us,

the impact of our coming under the jurisdiction of new federal regulators;

changes in our organization, or compensation and benefit plans;

the strength or weakness of the real estate markets and of the consumer and commercial credit sectors and its impact on the credit quality of our loans and other assets; and

the ability of the U.S. Federal government to manage federal debt limits.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please see **Item 1A. Risk Factors,** for a discussion of certain risks related to our business.

TFS FINANCIAL CORPORATION

TFS Financial Corporation (we, us, our, or the Company) was organized in 1997 as the mid-tier stock holding company for Third Federal Savings and Loan Association of Cleveland (Third Federal Savings and Loan or the Association). We completed our initial public stock offering on April 20, 2007 and issued 100,199,618 shares of common stock, or 30.16% of our post-offering outstanding common stock, to subscribers in the offering. Additionally, at the time of the public offering, 5,000,000 shares of our common stock, or 1.50% of our outstanding shares, were issued to the newly formed charitable foundation, Third Federal Foundation (the Foundation). Third Federal Savings and Loan Association of Cleveland, MHC (Third Federal Savings, MHC), our mutual holding company parent, holds the remainder of our outstanding common stock (227,119,132 shares). Net proceeds from our initial public stock offering were approximately $886 million and reflected the costs we incurred in completing the offering as well as a $106.5 million loan to the Third Federal Employee Stock Ownership Plan related to its acquisition of shares in the initial public stock offering.

Our ownership of the Association remains our primary business activity.

We also operate Third Capital, Inc. as a wholly-owned subsidiary.

As the holding company of Third Federal Savings and Loan, we are authorized to pursue other business activities permitted by applicable laws and regulations for savings and loan holding companies, which include making equity investments and the acquisition of banking and financial services companies.

Our cash flow depends primarily on earnings from the investment of the portion of the net offering proceeds we retained, and any dividends we receive from Third Federal Savings and Loan and Third Capital, Inc. All of our officers are also officers of the Association. In addition, we use the services of the support staff of the Association from time to time. We may hire additional employees, as needed, to the extent we expand our business in the future.

THIRD CAPITAL, INC.

Third Capital, Inc. is a Delaware corporation that was organized in 1998 as our wholly-owned subsidiary. At September 30, 2011, Third Capital, Inc. had consolidated assets of $79.9 million, and for the fiscal year ended September 30, 2011, Third Capital, Inc. had consolidated net income of $3.9 million. Third Capital, Inc. has no separate operations other than as the holding company for its operating subsidiaries, and as a minority investor or

partner in other entities including minority investments in private equity funds. The following is a description of the entities, other than the private equity funds, in which Third Capital, Inc. is the owner, an investor or a partner.

Hazelmere Investment Group I, Ltd. This entity engages in net lease transactions of commercial buildings in targeted markets. Third Capital, Inc. is a partner of this entity, receives a preferred return on amounts contributed to acquire investment properties and has a 70% ownership interest in remaining earnings. A former director of the Company indirectly owns or controls the majority of the remaining 30% ownership interest of this entity. Hazelmere *Investment Group I, Ltd.* had pre-tax income of $1.4 million during fiscal 2011.

Third Cap Associates, Inc. This Ohio corporation also maintains minority investments in private equity funds, and owns 49% and 60%, respectively, of two title agencies that provide escrow and settlement services in the State of Ohio, primarily to customers of Third Federal Savings and Loan. For the fiscal year ended September 30, 2011, Third Cap Associates, Inc. recorded net income of $2.2 million.

Third Capital Mortgage Insurance Company. This Vermont corporation reinsures private mortgage insurance on residential mortgage loans originated by Third Federal Savings and Loan. For the fiscal year ended September 30, 2011, Third Capital Mortgage Insurance Company recorded net income of $1.1 million.

THIRD FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLEVELAND

General

Third Federal Savings and Loan is a federally chartered savings and loan association headquartered in Cleveland, Ohio that was organized in 1938. In May 1997, the Association reorganized into its current two-tier mutual holding company structure. The Association s principal business consists of originating and servicing residential real estate mortgage loans and attracting retail savings deposits.

The Association s business strategy is to originate mortgage loans with interest rates that are competitive with those of similar products offered by other financial institutions in its markets. Similarly, the Association offers high-yield checking accounts and high-yield savings accounts and certificate of deposit accounts, each bearing interest rates that are competitive with similar products offered by other financial institutions in its markets. The Association expects to continue to pursue this business philosophy. While this strategy does not enable it to earn the highest rates of interest on loans it offers or pay the lowest rates on its deposit accounts, the Association believes that this strategy is the primary reason for its successful growth in the past.

The Association attracts retail deposits from the general public in the areas surrounding its main office and its branch offices. It also utilizes its internet website and its customer service call center to generate loan applications and attract retail deposits. In addition to residential real estate mortgage loans, the Association originates residential construction loans. Prior to June 28, 2010, the Association also actively originated home equity loans and lines of credit. In connection with its home equity risk reduction program, in June 2010, originations of home equity loans and lines of credit were suspended. The Association retains in its portfolio a large portion of the loans that it originates. Loans that the Association sells consist primarily of long-term, fixed-rate residential real estate mortgage loans. Since June 2010, the volume of loan sales has decreased significantly as, to date, the Association has not adopted certain loan origination requirement changes affecting loan eligibility for sale as promulgated by Fannie Mae, effective July 1, 2010. The Association retains the servicing rights on all loans that it sells. The Association s revenues are derived primarily from interest on loans and, to a lesser extent, interest on interest-bearing deposits in other financial institutions, deposits maintained at the Federal Reserve, federal funds sold, and investment securities, including mortgage-backed securities. The Association also generates revenues from fees and service charges. The Association s primary sources of funds are deposits, borrowings, principal and interest payments on loans and securities and proceeds from loan sales.

The Association s website address is www.thirdfederal.com. Filings of the Company made with the Securities and Exchange Commission are available for free on the Association s website. Information on that website is not and should not be considered a part of this document.

Market Area

Third Federal Savings and Loan conducts its operations from its main office in Cleveland, Ohio, and from 39 additional, full-service branches and eight loan production offices located throughout the states of Ohio and Florida. In Ohio, the Association s 22 full-service offices are located in the northeast Ohio counties of Cuyahoga, Lake, Lorain, Medina and Summit, four loan production offices are located in the central Ohio county of Franklin (Columbus, Ohio) and four loan production offices are located in the southern Ohio counties of Butler and Hamilton (Cincinnati, Ohio). In Florida, 17 full-service branches are located in the counties of Pasco, Pinellas, Hillsborough, Sarasota, Lee, Collier, Palm Beach and Broward. The economies and housing markets in Ohio and Florida have been negatively impacted by the current economic situation. Both states have experienced dramatic increases in foreclosures and reductions in employment rates and housing values. The depressed housing market and employment uncertainties have created consumer pessimism and apprehension, which is manifested in suppressed consumer housing demand.

The Association also provides savings products in all 50 states and first mortgage refinance loans in ten selected states outside of its branch footprint through its customer service call center and its internet site.

Competition

The Association faces intense competition in its market areas both in making loans and attracting deposits. Its market areas have a high concentration of financial institutions, including large money center and regional banks, community banks and credit unions, and it faces additional competition for deposits from money market funds, brokerage firms, mutual funds and insurance companies. Some of its competitors offer products and services that the Association currently does not offer, such as commercial business loans, trust services and private banking.

The majority of the Association s deposits are held in its offices located in Cuyahoga County, Ohio. As of June 30, 2011 (the latest date for which information is publicly available), the Association had $4.88 billion of deposits in Cuyahoga County, and ranked second among all financial institutions with offices in the county in terms of deposits, with a market share of 12.96%. As of that date, the Association had $6.16 billion of deposits in the State of Ohio, and ranked 9th among all financial institutions in the state in terms of deposits, with a market share of 2.64%. As of June 30, 2011, the Association had $2.73 billion of deposits in the State of Florida, and ranked 22nd among all financial institutions in terms of deposits, with a market share of 0.66%.

During calendar 2009 and 2010 and extending into the current calendar year, the Federal Deposit Insurance Corporation (FDIC) administered the resolution of hundreds of troubled financial institutions and the Depository Insurance Fund (DIF) incurred significant losses and the reserves of the DIF were substantially depleted. This depletion has prompted re-examination of the method of assessing insured institutions and rebuilding the fund. Further, the Dodd-Frank Act, which was signed into law in July 2010, required that the FDIC amend its regulations to define assessment base as an insured institution s average total assets minus average tangible equity during the assessment period. This revision had the effect of eliminating the funding cost advantage that borrowed funds generally had when compared to the funding cost associated with deposits. As a result, many financial institutions, including institutions that compete in our markets, have targeted retail deposit gathering as a more attractive funding source than borrowings, and have become more active and more competitive in their deposit product pricing. The combination of reduced demand by borrowers and more competition with respect to rates paid to depositors has created an increasingly difficult marketplace for attracting deposits, which could adversely affect future operating results.

From October 2010 through September 2011, the Association had the largest market share of conventional purchase mortgage loans originated in Cuyahoga County, Ohio. For the same period, it also had the largest market share of conventional purchase mortgage loans originated in the seven northeast Ohio counties which comprise the Cleveland and Akron metropolitan statistical areas. In addition, based on the same statistics, the Association has consistently been one of the six largest lenders in Franklin County (Columbus, Ohio) and Hamilton County (Cincinnati, Ohio) since it entered those markets in 1999.

The Association s primary strategy for increasing and retaining its customer base is to offer competitive deposit and loan rates and other product features, delivered with exceptional customer service, in each of the markets it serves.

We rely on the Association s more than 70-year history of serving its customers and the communities in which it operates, the Association s high capital levels, and liquidity alternatives to maintain and nurture customer and marketplace confidence. The Company s high capital ratio continues to reflect the beneficial impact of our April 2007 initial public offering, which raised net proceeds of $886 million. At September 30, 2011, our ratio of shareholders equity to total assets was 16.3%. Our liquidity alternatives include management and monitoring of the level of liquid assets held in our portfolio as well as the maintenance of alternative wholesale funding sources. At September 30, 2011, our liquidity ratio was 6.81% (which we compute as the sum of cash and cash equivalents plus unpledged investment securities for which ready markets exist, divided by total assets) and, through the Association, we had the ability to immediately borrow an additional $814.4 million from the Federal Home Loan Bank of Cincinnati (FHLB of Cincinnati) under existing credit arrangements along with $293.0 million from the Federal Reserve Bank of Cleveland (Federal Reserve). See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation Liquidity and Capital Resources.

We continue to utilize a multi-faceted approach to support our efforts to instill customer and marketplace confidence. First, we provide thorough and timely information to all of our associates so as to prepare them for their day-to-day interactions with customers and other individuals who are not part of the Company. We believe that it is important that our customers and others sense the comfort level and confidence of our associates throughout their dealings. Second, we encourage our management team to maintain a presence and to be available in our branches and other areas of customer contact, so as to provide more opportunities for informal contact and interaction with our customers and community members. Third, our CEO remains accessible to both local and national media, as a spokesman for our institution as well as an observer and interpreter of financial marketplace situations and events. Fourth, we periodically include advertisements in local newspapers that display our strong capital levels and history of service. We also continue to emphasize our traditional tagline STRONG * STABLE * SAFE in our advertisements and branch displays. Finally, for customers who adhere to the old adage of trust but verify, we refer them to the safety/security rankings of a nationally recognized, independent rating organization that specializes in the evaluation of financial institutions, which has awarded Third Federal Savings and Loan its highest rating.

Lending Activities

The Association s principal lending activity is the origination of first mortgage loans to purchase or refinance residential real estate. Its current policies generally provide that it will maintain between 40% and 70% of its assets in fixed-rate, residential real estate, first mortgage loans and up to 20% of its assets in adjustable-rate, residential real estate, first mortgage loans, subject to its liquidity levels and the credit demand of its customers. At September 30, 2011 adjustable-rate, residential real estate, first mortgage loans comprised 17% of total assets. We anticipate that the current 20% limit will be increased to reflect our desire to originate and hold more adjustable-rate mortgage loans in order to reduce interest rate risk. The Association also originates residential construction loans and prior to June 28, 2010 originated a significant amount of home equity loans and lines of credit. Refer to *Monitoring and Limiting Our Credit Risk* section in Item 7 for additional information regarding home equity loans and lines of credit. At September 30, 2011, residential real estate mortgage loans totaled $7.38 billion, or 74.1% of our loan portfolio, home equity loans and lines of credit totaled $2.49 billion, or 25.0% of our loan portfolio, and residential construction loans totaled $82.0 million, or 0.8% of our loan portfolio.

Loan Portfolio Composition. The following table sets forth the composition of the loan portfolio, by type of loan segregated by geographic location at the dates indicated, excluding loans held for sale. Construction loans are on properties located in Ohio and the balances of consumer loans are immaterial. Therefore, neither was segregated by geographic location.

	September 30,									
	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
Residential non-Home Today(1)										
Ohio	$ 5,691,614		$ 4,843,804		$ 4,582,542		$ 5,133,689		$ 4,732,374	
Florida	1,269,242		1,168,701		1,285,426		1,105,836		970,936	
Other	159,933		125,949		122,315		159,967		139,517	
Total	7,120,789	71.5%	6,138,454	65.4%	5,990,283	64.0%	6,399,492	68.7%	5,842,827	71.5%
Residential Home Today										
Ohio	252,879		268,983		279,835		291,386		292,642	
Florida	10,784		10,940		11,128		11,070		10,695	
Other	356		610		729		697		709	
Total	264,019	2.6	280,533	3.0	291,692	3.1	303,153	3.3	304,046	3.7
Home equity loans and lines of credit(2)										
Ohio	982,591		1,145,819		1,192,498		1,098,912		1,008,716	
Florida	712,087		797,658		831,979		731,538		481,605	
California	293,307		324,778		343,432		292,100		109,440	
Other	503,213		580,435		615,094		365,504		268,138	
Total	2,491,198	25.0	2,848,690	30.4	2,983,003	31.8	2,488,054	26.7	1,867,899	22.8
Construction	&nbs									