

## Section 1: 10-Q (10-Q)

**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, 2019

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



Flagstar Bancorp, Inc.

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

Michigan

(State or other jurisdiction of  
Incorporation or organization)

38-3150651

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

5151 Corporate Drive, Troy, Michigan

(Address of principal executive offices)

48098-2639

(Zip code)

(248) 312-2000

(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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act .

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

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

Title of each class	Trading symbol	Name of each exchange on which registered
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**Common stock**

**FBC**

**New York Stock Exchange**

As of October 31, 2019, 56,511,717 shares of the registrant's common stock, \$0.01 par value, were issued and outstanding.

**FLAGSTAR BANCORP, INC.**  
**FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2019**  
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## GLOSSARY OF ABBREVIATIONS AND ACRONYMS

The following list of abbreviations and acronyms are provided as a tool for the reader and may be used throughout this Report, including the Consolidated Financial Statements and Notes:

Term	Definition	Term	Definition
AFS	Available for Sale	HELOC	Home Equity Lines of Credit
Agencies	Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively	HELOAN	Home Equity Loan
ALCO	Asset Liability Committee	HOLA	Home Owners Loan Act
ALLL	Allowance for Loan & Lease Losses	Home equity	Second Mortgages, HELOANs, HELOCs
AOCI	Accumulated Other Comprehensive Income (Loss)	HTM	Held to Maturity
ASU	Accounting Standards Update	LIBOR	London Interbank Offered Rate
Basel III	Basel Committee on Banking Supervision Third Basel Accord	LHFI	Loans Held-for-Investment
C&I	Commercial and Industrial	LHFS	Loans Held-for-Sale
CDARS	Certificates of Deposit Account Registry Service	LTV	Loan-to-Value Ratio
CECL	Current Expected Credit Losses	Management	Flagstar Bancorp's Management
CET1	Common Equity Tier 1	MBS	Mortgage-Backed Securities
CLTV	Combined Loan to Value Ratio	MD&A	Management's Discussion and Analysis
Common Stock	Common Shares	MSR	Mortgage Servicing Rights
CRE	Commercial Real Estate	N/A	Not Applicable
DCB	Desert Community Bank	NYSE	New York Stock Exchange
Deposit Beta	The change in the annualized cost of our deposits, compared to the change in the Federal Reserve discount rate	OCC	Office of the Comptroller of the Currency
DOJ	United States Department of Justice	OCI	Other Comprehensive Income (Loss)
DOJ Liability	2012 Settlement Agreement with the Department of Justice	OTTI	Other-Than-Temporary-Impairment
DTA	Deferred Tax Asset	QTL	Qualified Thrift Lending
EVE	Economic Value of Equity	Regulatory Agencies	Board of Governors of the Federal Reserve, Office of the Comptroller of the Currency, U.S. Department of the Treasury, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, Securities and Exchange Commission
Fannie Mae	Federal National Mortgage Association	REO	Real estate owned and other nonperforming assets, net
FASB	Financial Accounting Standards Board	RMBS	Residential Mortgage-Backed Securities
FDIC	Federal Deposit Insurance Corporation	RWA	Risk Weighted Assets
Federal Reserve	Board of Governors of the Federal Reserve System	SEC	Securities and Exchange Commission
FHA	Federal Housing Administration	SOFR	Secured Oversight Financing Rate
FHLB	Federal Home Loan Bank	TARP Preferred	Troubled Asset Relief Program Fixed Rate Cumulative Perpetual Preferred Stock, Series C
FICO	Fair Isaac Corporation	TDR	Trouble Debt Restructuring
FRB	Federal Reserve Bank	UPB	Unpaid Principal Balance
Freddie Mac	Federal Home Loan Mortgage Corporation	U.S. Treasury	United States Department of Treasury
FTE	Full Time Equivalent Employees	VIE	Variable Interest Entities
GAAP	United States Generally Accepted Accounting Principles	XBRL	eXtensible Business Reporting Language
GNMA	Government National Mortgage Association		

## PART I. FINANCIAL INFORMATION

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

The following is Management's Discussion and Analysis of the financial condition and results of operations of Flagstar Bancorp, Inc. for the third quarter of 2019, which should be read in conjunction with the financial statements and related notes set forth in Part I, Item 1 of this Form 10-Q and Part II, Item 8 of Flagstar Bancorp, Inc.'s 2018 Annual Report on Form 10-K for the year ended December 31, 2018.

Certain statements in this Form 10-Q, including but not limited to statements included within Management's Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements are based on the current beliefs and expectations of our management. Actual results may differ from those set forth in forward-looking statements. See Forward-Looking Statements on page 38 of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2018 Annual Report on Form 10-K for the year ended December 31, 2018. Additional information about Flagstar can be found on our website at [www.flagstar.com](http://www.flagstar.com).

Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference will include our wholly-owned subsidiary Flagstar Bank, FSB (the "Bank"). See the Glossary of Abbreviations and Acronyms on page 3 for definitions used throughout this Form 10-Q.

#### Introduction

We are a savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. We provide commercial and consumer banking services and we are the 5th largest bank mortgage originator in the nation and the 5th largest subservicer of mortgage loans nationwide. At September 30, 2019, we had 4,171 full-time equivalent employees. Our common stock is listed on the NYSE under the symbol "FBC."

Our relationship-based business model leverages our full-service bank's capabilities and our national mortgage platform to create and build financial solutions for our customers. At September 30, 2019, we operated 160 full-service banking branches that offer a full set of banking products to consumer, commercial, and government customers. Our banking footprint spans Michigan, Indiana, California, Wisconsin, Ohio and contiguous states.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, our own loan officers, which includes our direct lending team, from 88 retail locations in 26 states and two call centers. We are also a leading national servicer of mortgage loans and provide complementary ancillary offerings including MSR lending, servicing advance lending and recapture services.

#### Recent Acquisitions

On December 1, 2018, we closed on the purchase of 52 branches from Wells Fargo located in Indiana, Michigan, Wisconsin and Ohio. In the first quarter of 2018, we closed on the purchase of the mortgage loan warehouse business from Santander Bank and completed the acquisition of eight Desert Community Bank branches located in San Bernardino County, California.

#### Operating Segments

Our operations are conducted through our three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. For further information, see MD&A - Operating Segments and Note 17 - Segment Information.

**Selected Financial Ratios**  
(Dollars in millions, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(In millions and percentages)				
<b>Selected Mortgage Statistics:</b>				
Mortgage rate lock commitments (fallout-adjusted) (1)	\$ 9,197	\$ 8,290	\$ 24,143	\$ 25,024
Mortgage loans originated	\$ 9,262	\$ 9,199	\$ 23,416	\$ 26,125
Mortgage loans sold and securitized	\$ 8,186	\$ 8,423	\$ 22,194	\$ 24,930
<b>Selected Ratios:</b>				
Interest rate spread (2)	2.48%	2.57%	2.57%	2.57%
Net interest margin	3.05%	2.93%	3.07%	2.85%
Return on average assets	1.20%	1.04%	1.08%	1.00%
Return on average tangible assets (3)	1.27%	1.07%	1.16%	1.02%
Return on average common equity	14.72%	12.80%	12.90%	12.10%
Return on average tangible common equity (4)	17.12%	13.67%	15.30%	12.78%
Efficiency ratio	75.2%	74.6%	75.0%	76.2%
Effective tax provision rate	18.4%	20.0%	18.6%	20.1%
<b>Average Balances:</b>				
Average interest-earning assets	\$ 18,997	\$ 16,786	\$ 17,693	\$ 16,050
Average interest-paying liabilities	\$ 12,893	\$ 13,308	\$ 12,767	\$ 13,150
Average stockholders' equity	\$ 1,722	\$ 1,514	\$ 1,658	\$ 1,468

	September 30, 2019	December 31, 2018	September 30, 2018
(In millions, except per share data and percentages)			
<b>Selected Statistics:</b>			
Book value per common share	\$ 30.69	\$ 27.19	\$ 26.34
Tangible book value per share (3)	\$ 27.62	\$ 23.90	\$ 25.13
Number of common shares outstanding	56,510,341	57,749,464	57,625,439
Common equity-to-assets ratio	7.88%	8.47%	8.12%
Tangible common equity to assets ratio (3)	7.08%	7.45%	7.74%
Capitalized value of mortgage servicing rights	1.14%	1.35%	1.43%
Bancorp Tier 1 leverage (to adjusted avg. total assets)	7.98%	8.29%	8.36%
Bank Tier 1 leverage (to adjusted avg. total assets)	8.35%	8.67%	8.77%
Number of bank branches	160	160	108
Number of FTE employees	4,171	3,938	3,496

- (1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on previous historical experience and the impact of changes in interest rates.
- (2) Interest rate spread is the difference between the annualized yield earned on average interest-earning assets for the period and the annualized rate of interest paid on average interest-bearing liabilities for the period.
- (3) Excludes goodwill and intangibles of \$174 million, \$190 million, and \$70 million at September 30, 2019, December 31, 2018, and September 30, 2018, respectively. See Non-GAAP Financial Measures for further information.
- (4) Excludes goodwill, intangible assets and the associated amortization, net of tax. See Non-GAAP Financial Measures for further information.

## Results of Operations

The following table summarizes our results of operations for the periods indicated:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
(Dollars in millions, except per share data)						
Net interest income	\$ 146	\$ 124	\$ 22	\$ 410	\$ 345	\$ 65
Provision (benefit) for loan losses	1	(2)	3	18	(3)	21
Total noninterest income	171	107	64	448	341	107
Total noninterest expense	238	173	65	643	523	120
Provision for income taxes	15	12	3	37	33	4
Net income	\$ 63	\$ 48	\$ 15	\$ 160	\$ 133	\$ 27
<b>Income per share</b>						
Basic	\$ 1.12	\$ 0.84	\$ 0.28	\$ 2.83	\$ 2.32	\$ 0.51
Diluted	\$ 1.11	\$ 0.83	\$ 0.28	\$ 2.80	\$ 2.28	\$ 0.52

### Overview

In the third quarter of 2019 our results demonstrated the earnings potential of our unique business model as all three operating segments reported improved results as compared to the same period in the prior year. Third quarter financial results were characterized by growth in net interest income driven by strong balance sheet growth, higher noninterest income driven by net gain on loan sales and positive credit metrics.

Through the first nine months of 2019, average loans held for investment grew \$2.3 billion or 10 percent compared to the same period in 2018 led by \$1.4 billion of broad based growth in our commercial portfolio and a \$0.9 billion increase in our consumer portfolio driven by non-auto indirect loans, mortgage loans and HELOCs. This loan growth was supported by the low cost deposits acquired through our 2018 banking acquisitions which drove a \$1.6 billion increase in average total retail deposits.

Net gain on loan sales increased \$68.0 million for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018 driven by a 30 basis point increase in margin which was driven by our continued focus on price discipline, combined with efforts to optimize channel mix, volume and margin.

We also continued to grow our subservicing business for which we have increased the number of loans serviced or sub-serviced by 375,000 or 61 percent in the 12 months ended September 30, 2019, ending the third quarter of 2019 at 994,000 accounts. This business generates subservicing fee income and custodial deposits which are used to support loan growth or as an alternative funding source and have increased \$1.8 billion for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018.



## Net Interest Income

### Comparison to Prior Year Quarter

The following table presents details on our net interest margin and net interest income on a consolidated basis:

	Three Months Ended September 30,					
	2019			2018		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
(Dollars in millions)						
<b>Interest-Earning Assets</b>						
Loans held-for-sale	\$ 3,786	\$ 40	4.22%	\$ 4,393	\$ 52	4.69%
<b>Loans held-for-investment</b>						
Residential first mortgage	3,282	29	3.58%	3,027	27	3.63%
Home equity	934	13	5.37%	695	9	5.12%
Other	658	10	5.99%	128	2	5.54%
Total consumer loans	4,874	52	4.24%	3,850	38	3.96%
Commercial real estate	2,594	35	5.39%	2,106	29	5.37%
Commercial and industrial	1,767	22	4.97%	1,330	18	5.28%
Warehouse lending	2,508	32	5.00%	1,586	21	5.10%
Total commercial loans	6,869	89	5.14%	5,022	68	5.26%
Total loans held-for-investment (1)	11,743	141	4.77%	8,872	106	4.70%
Loans with government guarantees	574	4	2.78%	292	3	4.20%
Investment securities	2,713	17	2.63%	3,100	21	2.81%
Interest-earning deposits	181	1	2.22%	129	1	2.38%
Total interest-earning assets	18,997	203	4.27%	16,786	183	4.32%
Other assets	2,200			1,825		
Total assets	\$ 21,197			\$ 18,611		
<b>Interest-Bearing Liabilities</b>						
<b>Retail deposits</b>						
Demand deposits	\$ 1,388	\$ 3	0.88%	\$ 727	\$ 3	1.62%
Savings deposits	3,262	10	1.20%	3,229	7	0.90%
Money market deposits	722	1	0.34%	252	—	0.62%
Certificates of deposit	2,583	15	2.40%	2,150	10	1.78%
Total retail deposits	7,955	29	1.45%	6,358	20	1.27%
<b>Government deposits</b>						
Demand deposits	324	—	0.61%	283	1	0.59%
Savings deposits	619	3	1.73%	564	2	1.48%
Certificates of deposit	310	1	1.76%	327	1	1.52%
Total government deposits	1,253	4	1.45%	1,174	4	1.28%
Wholesale deposits and other	744	5	2.42%	537	3	2.03%
Total interest-bearing deposits	9,952	38	1.52%	8,069	27	1.32%
Short-term Federal Home Loan Bank advances and other borrowings	1,910	10	2.24%	3,465	18	2.10%
Long-term Federal Home Loan Bank advances	536	2	1.72%	1,280	7	2.11%
Other long-term debt	495	7	5.60%	494	7	5.62%
Total interest-bearing liabilities	12,893	57	1.79%	13,308	59	1.75%
<b>Noninterest-bearing deposits</b>						
Retail deposits and other	1,315			1,298		
Custodial deposits (2)	4,550			1,969		
Total Noninterest-bearing deposits	5,865			3,267		
Other liabilities	717			522		
Stockholders' equity	1,722			1,514		
Total liabilities and stockholders' equity	\$ 21,197			\$ 18,611		
Net interest income		\$ 146			\$ 124	

Interest rate spread (3)	2.48%	2.57%
Net interest margin (4)	3.05%	2.93%
Ratio of average interest-earning assets to interest-bearing liabilities	147.3%	126.1%

- (1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
- (2) Approximately 80 percent includes custodial deposits from loans serviced which pay interest that is recognized as an offset in net loan administration income.
- (3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.
- (4) Net interest margin is net interest income divided by average interest-earning assets.

The following table presents the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities. The table distinguishes between the changes related to average outstanding balances (changes in volume while holding the initial rate constant) and the changes related to average interest rates (changes in average rates while holding the initial balance constant). The rate/volume mix variances are allocated to rate.

	<b>Three Months Ended September 30,</b>		
	<b>2019 Versus 2018 Increase (Decrease)</b>		
	<b>Due to:</b>		
	<b>Rate</b>	<b>Volume</b>	<b>Total</b>
		(Dollars in millions)	
<b>Interest-Earning Assets</b>			
Loans held-for-sale	\$ (5)	\$ (7)	\$ (12)
<b>Loans held-for-investment</b>			
Residential first mortgage	—	2	2
Home equity	1	3	4
Other	1	7	8
Total consumer loans	2	12	14
Commercial real estate	(1)	7	6
Commercial and industrial	(2)	6	4
Warehouse lending	(1)	12	11
Total commercial loans	(4)	25	21
Total loans held-for-investment	(2)	37	35
Loans with government guarantees	(2)	3	1
Investment securities	(1)	(3)	(4)
Total interest-earning assets	<u>\$ (10)</u>	<u>\$ 30</u>	<u>\$ 20</u>
<b>Interest-Bearing Liabilities</b>			
Interest-bearing deposits	\$ 5	\$ 6	\$ 11
Short-term Federal Home Loan Bank advances and other borrowings	—	(8)	(8)
Long-term Federal Home Loan Bank advances	(1)	(4)	(5)
Total interest-bearing liabilities	4	(6)	(2)
Change in net interest income	<u>\$ (14)</u>	<u>\$ 36</u>	<u>\$ 22</u>

Net interest income increased \$22 million, or 18 percent, for the three months ended September 30, 2019, compared to the same period in 2018. The increase was primarily driven by growth in average interest earning assets led by continued growth in the loans held-for-investment portfolio along with \$1.9 billion growth in total deposits as a result of our 2018 banking acquisition and \$2.6 billion growth in noninterest bearing custodial deposits driven by elevated refinancing activity and growth in our servicing business. This growth resulted in a 48 percent reduction of funding from FHLB advances.

- Net interest margin expanded 12 basis points to 3.05 percent, as compared to 2.93 percent, primarily due to channel mix with broad-based growth across the commercial portfolios and non-auto indirect portfolio along with a reduction in funding costs driven by growth in noninterest bearing custodial balances. This was partially offset by higher average rate on total retail deposits driven by higher short term market rates compared to the same period a year ago.
- Average interest-earning assets increased \$2.2 billion primarily due to growth in our LHFI portfolio partially offset by a decrease in LHFS average balances. Average commercial loans increased \$1.8 billion with broad-based growth across the CRE and C&I loan portfolios. Average warehouse loans increased \$0.9 billion benefiting from growth in the overall mortgage market driven by a lower interest rate environment. Our consumer loan portfolio increased by \$1.0 billion, as we continued to grow our non-auto indirect portfolio as well as HELOC and first mortgage loans. The LHFS portfolio decreased \$607 million primarily due to managing the held for sale portfolio to lower balances to facilitate higher yielding asset growth.
- Average interest-bearing liabilities decreased \$415 million. This was primarily due to a \$2.3 billion reduction in FHLB advances which were replaced by a \$1.9 billion increase in average interest-bearing deposits and a \$2.6 billion increase in average noninterest-bearing deposits led by higher custodial deposits driven by elevated refinance activity and growth in our subservicing business.

Comparison to Prior Year to Date

The following table presents details on our net interest margin and net interest income on a consolidated basis:

	Nine Months Ended September 30,					
	2019			2018		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
(Dollars in millions)						
<b>Interest-Earning Assets</b>						
Loans held-for-sale	\$ 3,532	\$ 119	4.48%	\$ 4,265	\$ 142	4.44%
Loans held-for-investment						
Residential first mortgage	3,158	85	3.61%	2,893	76	3.52%
Home equity	832	34	5.50%	681	26	5.13%
Other	512	25	6.51%	71	3	5.37%
Total consumer loans	4,502	144	4.29%	3,645	105	3.86%
Commercial real estate	2,414	102	5.56%	2,026	79	5.12%
Commercial and industrial	1,702	67	5.20%	1,269	51	5.26%
Warehouse lending	1,898	74	5.17%	1,312	51	5.08%
Total commercial loans	6,014	243	5.34%	4,607	181	5.15%
Total loans held-for-investment (1)	10,516	387	4.89%	8,252	286	4.58%
Loans with government guarantees	511	11	2.88%	288	8	3.86%
Investment securities	2,957	61	2.77%	3,127	64	2.74%
Interest-earning deposits	177	3	2.38%	118	2	1.95%
Total interest-earning assets	17,693	581	4.37%	16,050	502	4.15%
Other assets	2,184			1,784		
Total assets	<u>\$ 19,877</u>			<u>\$ 17,834</u>		
<b>Interest-Bearing Liabilities</b>						
Retail deposits						
Demand deposits	\$ 1,311	\$ 8	0.80%	\$ 660	\$ 4	0.89%
Savings deposits	3,181	26	1.10%	3,376	21	0.85%
Money market deposits	748	2	0.31%	235	1	0.54%
Certificates of deposit	2,561	44	2.29%	1,927	24	1.64%
Total retail deposits	7,801	80	1.37%	6,198	50	1.09%
Government deposits						
Demand deposits	298	1	0.62%	256	1	0.54%
Savings deposits	582	8	1.76%	512	5	1.29%
Certificates of deposit	304	4	1.81%	369	4	1.34%
Total government deposits	1,184	13	1.49%	1,137	10	1.14%
Wholesale deposits and other	518	9	2.35%	325	5	1.99%
Total interest-bearing deposits	9,503	102	1.44%	7,660	65	1.13%
Short-term Federal Home Loan Bank advances and other borrowings	2,420	44	2.45%	3,713	50	1.81%
Long-term Federal Home Loan Bank advances	349	4	1.71%	1,283	21	2.15%
Other long-term debt	495	21	5.76%	494	21	5.53%
Total interest-bearing liabilities	12,767	171	1.80%	13,150	157	1.58%
Noninterest-bearing deposits						
Retail deposits and other	1,278			1,043		
Custodial deposits (2)	3,524			1,678		
Total Noninterest-bearing deposits	4,802			2,721		
Other liabilities						
Stockholders' equity	650			495		
Stockholders' equity	1,658			1,468		
Total liabilities and stockholders' equity	<u>\$ 19,877</u>			<u>\$ 17,834</u>		
Net interest income		<u>\$ 410</u>			<u>\$ 345</u>	
Interest rate spread (3)			<u>2.57%</u>			<u>2.57%</u>
Net interest margin (4)			3.07%			2.85%

Ratio of average interest-earning assets to interest-bearing liabilities

138.6%

122.1%

- (1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
- (2) Approximately 80 percent includes custodial deposits from loans subserviced which pay interest that is recognized as an offset in net loan administration income.
- (3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.
- (4) Net interest margin is net interest income divided by average interest-earning assets.

The following table presents the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities consistent with the quarter to date table above.

	Nine Months Ended September 30,		
	2019 Versus 2018 Increase (Decrease)		
	Due to:		
	Rate	Volume	Total
	(Dollars in millions)		
<b>Interest-Earning Assets</b>			
Loans held-for-sale	\$ 1	\$ (24)	\$ (23)
<b>Loans held-for-investment</b>			
Residential first mortgage	2	7	9
Home equity	2	6	8
Other	4	18	22
Total consumer loans	8	31	39
Commercial real estate	8	15	23
Commercial and industrial	(1)	17	16
Warehouse lending	1	22	23
Total commercial loans	8	54	62
Total loans held-for-investment	16	85	101
Loans with government guarantees	(3)	6	3
Investment securities	—	(3)	(3)
Interest-earning deposits and other	—	1	1
Total interest-earning assets	\$ 14	\$ 65	\$ 79
<b>Interest-Bearing Liabilities</b>			
Interest-bearing deposits	\$ 21	\$ 16	\$ 37
Short-term Federal Home Loan Bank advances and other borrowings	12	(18)	(6)
Long-term Federal Home Loan Bank advances	(2)	(15)	(17)
Other long-term debt	—	—	—
Total interest-bearing liabilities	31	(17)	14
Change in net interest income	\$ (17)	\$ 82	\$ 65

Net interest income increased \$65 million, or 18.8 percent, for the nine months ended September 30, 2019, compared to the same period in 2018. The increase was primarily driven by growth in average interest earning assets led by continued growth in the loans held-for-investment portfolio which was supported by a \$2.1 billion increase in noninterest bearing deposits and \$1.8 billion growth in custodial deposits which resulted in 45 percent lower FHLB advances.

- Net interest margin expanded 22 basis points to 3.07 percent, as compared to 2.85 percent, primarily due to growth in our higher yielding commercial loan portfolio and a reduction in funding costs driven by growth in noninterest bearing deposits and custodial balances.
- Average interest-earning assets increased \$1.6 billion primarily due to growth in our LHFI portfolio partially offset by a decrease in LHFS average balances. Average commercial loans increased \$1.4 billion with broad based growth across the CRE, C&I and warehouse portfolios. Our consumer loan portfolio increased by \$0.9 billion, as we continued to grow our high quality non-auto indirect portfolio as well as HELOC and first mortgage loans. The LHFS portfolio decreased \$0.7 billion primarily due to managing the held for sale portfolio to lower balances to facilitate higher yielding asset growth.
- Average interest-bearing liabilities decreased \$383 million. This was primarily due to a \$2.2 billion reduction in FHLB advances, partially offset by a \$1.8 billion increase in average interest-bearing deposits driven by deposits acquired from the Wells Fargo in December of 2018. Further supporting asset growth, our noninterest bearing liabilities increased \$2.1 billion, driven by higher custodial and noninterest bearing deposits.

## Provision for Loan Losses

The provision for loan losses was \$1 million and \$18 million for the three and nine months ended September 30, 2019, respectively. The low level of provision and net charge offs over the most recent three month period reflects our strong asset quality, low delinquencies and no nonperforming commercial loans at September 30, 2019. For the most recent nine month period, the higher provision was primarily due to the \$29 million net charge off of the Live Well loan which has been fully resolved partially offset by a reduction in the allowance balance due to reduced inherent risk in the consumer portfolio.

The provision for loan losses was a benefit of \$2 million and \$3 million for the three and nine months ended September 30, 2018, respectively. These benefits were driven by favorable asset quality trends partially offset by provisioning to support interest earning asset growth.

For further information on the provision for loan losses see MD&A - Credit Quality.

## Noninterest Income

The following tables provide information on our noninterest income along with other mortgage metrics:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
Net gain on loan sales	\$ 110	\$ 43	\$ 67	\$ 234	\$ 166	\$ 68
Loan fees and charges	29	23	6	70	67	3
Net return on mortgage servicing rights	(2)	13	(15)	9	26	(17)
Loan administration income	5	5	—	22	15	7
Deposit fees and charges	10	5	5	28	15	13
Other noninterest income	19	18	1	85	52	33
Total noninterest income	\$ 171	\$ 107	\$ 64	\$ 448	\$ 341	\$ 107

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
Mortgage rate lock commitments (fallout-adjusted) (1)	\$ 9,197	\$ 8,290	\$ 907	\$ 24,143	\$ 25,024	\$ (881)
Net margin on mortgage rate lock commitments (fallout-adjusted) (1)(2)	1.20%	0.51%	0.69%	0.96%	0.66%	0.30%
Mortgage loans sold and securitized	\$ 8,186	\$ 8,423	\$ (237)	\$ 22,194	\$ 24,930	\$ (2,736)

- (1) Fallout-adjusted refers to mortgage rate lock commitments which are adjusted by estimates of the percentage of mortgage loans in the pipeline that are not expected to close based on our historical experience and impact of changes in interest rates.
- (2) Gain on sale margin is based on net gain on loan sales (excludes net gain on loan sales of \$2 million from loans transferred from LHFI during the nine months ended September 30, 2019) to fallout-adjusted mortgage rate lock commitments.

### *Comparison to Prior Year Quarter*

Noninterest income increased \$64 million for the three months ended September 30, 2019, compared to the three months ended September 30, 2018, primarily due to the following:

- Net gain on loan sales increased \$67 million, primarily due to a 69 basis point improvement in gain on sale margin resulting from improved market conditions, a focus on price discipline, combined with efforts to optimize volume and margin in the current quarter, in addition to \$907 million higher fallout-adjusted locks.
- Loan fees and charges increased \$6 million driven by higher subservicing ancillary fees from an increase of 330,000 loans being subserviced. Net loan administration income was flat as higher subservicing fees were offset by higher interest credits on custodial deposits which were elevated in the third quarter of 2019 due to higher refinance activity.
- Deposit fees and charges increased \$5 million, driven by growth in our customer and deposit base as a result of our 2018 branch acquisitions.
- Net return on MSR, including the impact of hedges, decreased \$15 million compared to the prior period, primarily due to higher prepayments driven by higher refinance activity in the third quarter of 2019 as compared to the third quarter of 2018.

### *Comparison to Prior Year to Date*

Noninterest income increased \$107 million for the nine months ended September 30, 2019, compared to the nine months ended September 30, 2018, primarily due to the following:

- Net gain on loan sales increased \$68 million, primarily due to a 30 basis point improvement in gain on sale margin resulting from improved market conditions, a focus on price discipline, combined with efforts to optimize volume and margin, despite \$881 million lower fallout-adjusted locks.
- Other noninterest income increased \$33 million primarily due to the DOJ Liability fair value adjustment of \$25 million in the second quarter of 2019. The remaining increase was primarily driven by higher fee based income generated on our commercial loan portfolio.
- Deposit fees and charges increased \$13 million, driven by growth in our customer and deposit base as a result of our 2018 branch acquisitions.
- Loan administration income increased \$7 million, primarily due to growth in the average number of subserviced loans by 515,292, partially offset by an increase in refinancing activity driving higher interest on custodial deposits.
- Loan fees and charges increased \$3 million, primarily due to \$2.7 billion lower mortgage originations.
- Net return on MSR, including the impact of hedges, decreased \$17 million, primarily due to higher prepayments as long-term market rates have declined in 2019 driving higher refinance activity.



## Noninterest Expense

The following table sets forth the components of our noninterest expense:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
Compensation and benefits	\$ 98	\$ 76	\$ 22	\$ 275	\$ 236	\$ 39
Occupancy and equipment	40	31	9	118	91	27
Commissions	38	21	17	76	64	12
Loan processing expense	22	14	8	60	43	17
Legal and professional expense	6	7	(1)	18	19	(1)
Federal insurance premiums	5	6	(1)	14	18	(4)
Intangible asset amortization	3	1	2	11	—	11
Other noninterest expense	26	17	9	71	52	19
<b>Total noninterest expense</b>	<b>\$ 238</b>	<b>\$ 173</b>	<b>\$ 65</b>	<b>\$ 643</b>	<b>\$ 523</b>	<b>\$ 120</b>
Efficiency ratio	75.2%	74.6%	0.6%	75.0%	76.2%	(1.2)%
Average number of FTE	4,163	3,570	593	4,071	3,617	454

Noninterest expense increased \$65 million and \$120 million, respectively, for the three and nine months ended September 30, 2019, compared to the three and nine months ended September 30, 2018. The increase for both periods has been primarily driven by growth in our community banking business as a result of our 2018 banking acquisitions, growth in our servicing business and a shift toward our retail mortgage origination channel which results in higher commission expense.

The following provides further information related to the increase in noninterest expense:

### Comparison to Prior Year Quarter

- Compensation and benefits increased \$22 million, or 29 percent, primarily due to higher average FTE as a result of our December 2018 banking acquisition and growth in our servicing business along with higher compensation expense driven by our recent performance.
- Commissions increased \$17 million, or 81 percent, primarily from an increase in retail mortgage originations supporting higher gain on sale and the achievement of performance hurdles resulting in higher payout rates.
- Occupancy and equipment and other noninterest expense both increased \$9 million primarily driven by growth in our businesses as a result of acquisitions.
- Loan processing expense increased \$8 million, primarily due to higher subservicing expenses resulting from a 67 percent growth in number of loans subserviced for others.
- Intangible asset amortization increased \$2 million, due to intangible assets associated with our December 2018 acquisition.

### Comparison to Prior Year to Date

- Compensation and benefits increased \$39 million, or 17 percent, primarily due to higher average FTE driven by our 2018 banking acquisitions.
- Commissions increased \$12 million primarily from an increase in retail mortgage originations supporting higher gain on sale and the achievement of performance hurdles resulting in higher payout rates.
- Occupancy and equipment and other noninterest expense increased \$27 million and \$19 million, respectively, primarily driven by strategic acquisitions.
- Loan processing expense increased \$17 million, primarily due to higher subservicing expenses resulting from growth in our subservicing business.
- Intangible asset amortization increased \$11 million, due to intangible assets associated with our 2018 acquisitions.

### ***Provision for Income Taxes***

Our provision for income taxes for the three and nine months ended September 30, 2019 was \$15 million and \$37 million, respectively, compared to a provision of \$12 million and \$33 million for the three and nine months ended September 30, 2018, respectively.

Our effective tax rate for the three and nine months ended September 30, 2019 was 18.4 percent and 18.6 percent, respectively, compared to 20.0 percent and 20.1 percent for the three and nine months ended September 30, 2018, respectively. Our effective tax rate differs from the combined federal and state statutory tax rate primarily due to non-taxable bank owned life insurance and other tax-exempt earnings, partially offset by nondeductible expenses.

### **Operating Segments**

Our operations are conducted through three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. The Other segment includes the remaining reported activities. 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 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.

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 17 - Segment Information.

### ***Community Banking***

Our Community Banking segment serves commercial, governmental and consumer customers in our banking footprint which spans throughout Michigan, Indiana, California, Wisconsin, Ohio and contiguous states. We also serve home builders, correspondents, and commercial customers on a national basis. The Community Banking segment originates and purchases loans, while also providing deposit and fee based services to consumer, business, and mortgage lending customers.

Our commercial customers operate in a diversified range of industries including financial, insurance, service, manufacturing, and distribution. We offer financial products to these customers for use in their normal business operations, as well as providing financing of working capital, capital investments, and equipment. Additionally, our commercial real estate business supports income producing real estate and home builders. The Community Banking segment also offers warehouse lines of credit to non-bank mortgage lenders.

Our Community Banking segment has seen continued growth, both organically and through strategic acquisitions. In the last 12 months, our commercial and consumer loan portfolios have grown 51 percent and 11 percent to \$7.6 billion and \$4.9 billion, respectively. Average deposits for the nine months ended September 30, 2019 have increased to \$10.2 billion, compared to \$8.6 billion for the same period in 2018 driven by branch acquisitions in 2018 which expanded our banking footprint.

Community Banking	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
<b>Summary of Operations</b>						
Net interest income	\$ 115	\$ 81	\$ 34	\$ 326	\$ 231	\$ 95
(Provision) benefit for loan losses	—	(1)	1	(18)	(2)	(16)
Net interest income after (provision) benefit for loan losses	115	80	35	308	229	79
Net (loss) on loan sales	(8)	(3)	(5)	(23)	(10)	(13)
Other noninterest income	17	10	7	44	27	17
Total noninterest income	9	7	2	21	17	4
Compensation and benefits	(26)	(17)	(9)	(74)	(51)	(23)
Other noninterest expense and directly allocated overhead	(44)	(27)	(17)	(131)	(81)	(50)
Total noninterest expense	(70)	(44)	(26)	(205)	(132)	(73)
Income before indirect overhead allocations and income taxes	54	43	11	124	114	10
Indirect overhead allocations	(10)	(9)	(1)	(30)	(29)	(1)
Provision (benefit) for income taxes	9	7	2	20	18	2
Net income	\$ 35	\$ 27	\$ 8	\$ 74	\$ 67	\$ 7
<b>Key Metrics</b>						
Efficiency Ratio	56.6%	51.2%	5.4 %	59.0%	53.5%	5.5 %
Return on average assets	1.1%	1.2%	(0.1)%	0.9%	1.1%	(0.2)%
Average number of FTE employees	1,330	846	484	1,325	811	514

#### *Comparison to Prior Year Quarter*

The Community Banking segment reported net income of \$35 million for the three months ended September 30, 2019, compared to \$27 million for the three months ended September 30, 2018. The increase in net income was primarily due to \$34 million growth in net interest income attributed to strong growth in both our commercial and consumer portfolios as supported by deposits acquired from our 2018 branch acquisitions. Growth in our operations also caused noninterest expense to increase \$26 million for the three months ended September 30, 2019.

#### *Comparison to Prior Year to Date*

The Community Banking segment reported net income of \$74 million for the nine months ended September 30, 2019, compared to \$67 million for the nine months ended September 30, 2018. The increase in net income was primarily due to \$95 million growth in net interest income attributed to growth in both our commercial and consumer loan portfolios, enhanced by our 2018 banking acquisitions. In addition, noninterest income increased, attributable to deposit fees from our expanded branch network as well as stronger commercial loan fees. Provision for loan losses increased \$16 million primarily due to the \$29 million net charge off of the Live Well loan which has been fully resolved. To support our investments relating to organic growth, acquisitions, and the diversification of our product offerings, our operating costs increased \$73 million.

## Mortgage Originations

We are a leading national originator of residential first mortgages. Our Mortgage Origination segment utilizes multiple distribution channels to originate or acquire one-to-four family residential mortgage loans on a national scale, primarily to sell. We originate certain mortgage loans, including certain jumbo and non-conforming loans, for our LHFI portfolio which generate interest income in the Community Banking segment. The Community Banking segment purchases these loans from the Mortgage Origination segment which results in the recognition of a gain on loan sales by the Mortgage Origination segment and a loss on loan sales in the Community Banking segment.

Mortgage Originations	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
<b>Summary of Operations</b>						
Net interest income	\$ 27	\$ 36	\$ (9)	\$ 73	\$ 100	\$ (27)
(Provision) benefit for loan losses	(1)	—	(1)	(1)	(1)	—
Net interest income after (provision) benefit for loan losses	26	36	(10)	72	99	(27)
Net gain on loan sales	118	46	72	257	176	81
Other noninterest income	15	30	(15)	49	76	(27)
Total noninterest income	133	76	57	306	252	54
Compensation and benefits	(30)	(26)	(4)	(83)	(83)	—
Other noninterest expense and directly allocated overhead	(72)	(41)	(31)	(161)	(129)	(32)
Total noninterest expense	(102)	(67)	(35)	(244)	(212)	(32)
Income before indirect overhead allocations and income taxes	57	45	12	134	139	(5)
Indirect overhead allocation	(10)	(16)	6	(30)	(51)	21
Provision (benefit) for income taxes	10	6	4	22	18	4
Net income	\$ 37	\$ 23	\$ 14	\$ 82	\$ 70	\$ 12
<b>Key Metrics</b>						
Mortgage rate lock commitments (fallout-adjusted) (1)	\$ 9,197	\$ 8,290	\$ 907	\$ 24,143	\$ 25,024	\$ (881)
Efficiency Ratio	64.3%	59.8%	4.5%	65.0%	60.9%	4.1%
Return on average assets	2.7%	1.6%	1.1%	1.7%	1.3%	0.4%
Average number of FTE employees	1,429	1,464	(35)	1,358	1,575	(217)

(1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on our historical experience and the impact of changes in interest rates.

## Comparison to Prior Year Quarter

The Mortgage Originations segment reported net income of \$37 million for the three months ended September 30, 2019 and \$23 million for the three months ended September 30, 2018. Net gain on loan sales increased \$72 million driven by \$907 million higher fallout adjusted mortgage rate locks and 69 basis points higher margin resulting from improved market conditions and a shift in channel mix toward higher margin retail channels. Higher net gain on loan sales were partially offset by higher other noninterest expense of \$31 million driven by higher commissions and increased expense related to the channel mix shift towards retail along with a \$9 million decrease in net interest income primarily due to a decrease of \$607 million in average LHFS balances which supported higher yielding asset growth in the community banking segment and a \$15 million decrease in net return on MSRs primarily due to increased runoff as a result of higher refinance activity driven by lower interest rates.

## Comparison to Prior Year to Date

The Mortgage Originations segment reported net income of \$82 million for the nine months ended September 30, 2019, compared to \$70 million for the nine months ended September 30, 2018. Net gain on loan sales increased \$81 million, driven by higher margin resulting from improved market conditions and a shift in channel mix toward higher margin retail channels. Higher net gain on loan sales were partially offset by a \$27 million decrease in net interest income resulting from \$733 million lower average LHFS balances which supported higher yielding asset growth in the community banking segment. Other noninterest income decreased \$27 million primarily driven by a \$2.7 billion decline in origination volume and \$17 million decrease in net return on MSR's primarily related to increased runoff as a result of higher refinance activity driven by lower interest rates. In addition, noninterest expense increased \$32 million driven by higher commissions due to volume and increased expense related to the channel mix shift towards retail.

### Mortgage Servicing

The Mortgage Servicing segment services loans when we hold the MSR asset and subservices mortgage loans for others through a scalable servicing platform on a fee for service basis. We may also collect other ancillary fees on loans serviced and earn income through the use of noninterest-bearing escrows. The loans we service generate custodial deposits which provide a stable funding source which supports interest-earning asset generation in the Community Bank and Mortgage Origination segments. Custodial deposits arise due to our servicing or subservicing of loans for others and represent the portion of the investor custodial accounts on deposit with the Bank. For certain subservice agreements, these deposits require us to credit the MSR owner interest against subservicing fees we charge. This cost is a component of net loan administration income. The Mortgage Servicing segment also services loans for our LHFI portfolio in the Community Banking segment and our own MSR portfolio in the Mortgage Originations segment for which it earns intersegment revenue on a fee per loan basis.

Mortgage Servicing	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
<b>Summary of Operations</b>						
Net interest income after (provision) for loan losses	\$ 5	\$ 2	\$ 3	\$ 11	\$ 5	\$ 6
Total noninterest income	40	24	16	113	65	48
Compensation and benefits	(7)	(4)	(3)	(19)	(13)	(6)
Other noninterest expense and directly allocated overhead	(24)	(18)	(6)	(73)	(49)	(24)
Total noninterest expense	(31)	(22)	(9)	(92)	(62)	(30)
Income before indirect overhead allocations and income taxes	14	4	10	32	8	24
Indirect overhead allocations	(4)	(5)	1	(13)	(15)	2
Provision (benefit) for income taxes	2	—	2	4	(2)	6
Net income (loss)	\$ 8	\$ (1)	\$ 9	\$ 15	\$ (5)	\$ 20
<b>Key Metrics</b>						
Average number of loans serviced and subserviced	988,251	591,769	396,482	979,353	515,292	464,061
Efficiency Ratio	68.9%	86.9%	(18.0)%	74.2%	88.6%	(14.4)%
Return on average assets	80.7%	(14.5)%	95.2%	41.8%	(24.5)%	66.3%
Average number of FTE employees	300	238	62	286	221	65

The following table presents loans serviced and the number of accounts associated with those loans.

	September 30, 2019		December 31, 2018		September 30, 2018	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts
	(Dollars in millions)					
<b>Loan servicing</b>						
Subserviced for others (2)	\$ 171,145	826,472	\$ 146,040	705,149	\$ 106,297	494,950
Serviced for others	25,039	106,992	21,592	88,434	21,835	88,410
Serviced for own loan portfolio (3)	8,058	60,088	7,438	57,401	8,033	35,185
<b>Total loans serviced</b>	<b>\$ 204,242</b>	<b>993,552</b>	<b>\$ 175,070</b>	<b>850,984</b>	<b>\$ 136,165</b>	<b>618,545</b>

(1) UPB, net of write downs, does not include premiums or discounts.

(2) Includes temporary short-term subservicing performed as a result of sales of servicing-released MSR. Includes repossessed assets.

(3) Includes LHFI (residential first mortgage, home equity and other consumer), LHFS (residential first mortgage), loans with government guarantees (residential first mortgage), and repossessed assets.

#### *Comparison to Prior Year Quarter*

The Mortgage Servicing segment reported net income of \$8 million for the three months ended September 30, 2019, compared to net loss of \$1 million for the three months ended September 30, 2018. The \$9 million increase in net income was primarily driven by a 64 percent increase in the average number of loans serviced or sub-serviced, during the three months ended September 30, 2019, compared to the three months ended September 30, 2018. This drove a \$16 million increase in noninterest income and a \$3 million increase in net interest income after provision for loan losses as a result of higher average custodial balances, partially offset by \$9 million higher noninterest expense to support business growth.

#### *Comparison to Prior Year to Date*

The Mortgage Servicing segment reported net income of \$15 million for the nine months ended September 30, 2019, compared to a net loss of \$5 million for the nine months ended September 30, 2018. The \$20 million improvement in net income was primarily driven by a 78 percent increase in the average number of loans serviced or sub-serviced, during the nine months ended September 30, 2019, compared to the nine months ended September 30, 2018. This drove a \$44 million increase in loan administration income and a \$4 million increase in other ancillary income, partially offset by a \$30 million increase in noninterest expense to support business growth.

#### *Other*

The Other segment includes the treasury functions, which include the impact of interest rate risk management, balance sheet funding activities and the investment securities portfolios, as well as other expenses of a corporate nature, including corporate staff, risk management, and legal expenses which are charged to the line of business segments. In addition, the Other segment includes revenue and expenses not directly assigned or allocated to the Community Banking, Mortgage Originations or Mortgage Servicing segments.

Other	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
	(Dollars in millions)					
<b>Summary of Operations</b>						
Net interest income (1)	\$ (1)	\$ 5	\$ (6)	\$ —	\$ 9	\$ (9)
(Provision) benefit for loan losses	—	3	(3)	1	6	(5)
Net interest income (expense) after (provision) benefit for loan losses	(1)	8	(9)	1	15	(14)
Total noninterest income (1)	(11)	—	(11)	8	7	1
Compensation and benefits	(35)	(29)	(6)	(99)	(89)	(10)
Other noninterest expense and directly allocated overhead (1)	—	(11)	11	(3)	(28)	25
Total noninterest expense	(35)	(40)	5	(102)	(117)	15
Income (loss) before indirect overhead allocations and income taxes	(47)	(32)	(15)	(93)	(95)	2
Indirect overhead allocations	24	30	(6)	73	95	(22)
Provision (benefit) for income taxes	(6)	(1)	(5)	(9)	(1)	(8)
Net income (loss)	\$ (17)	\$ (1)	\$ (16)	\$ (11)	\$ 1	\$ (12)

#### Key Metrics

Average number of FTE employees	1,104	1,022	82	1,102	1,010	92
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(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

#### Comparison to Prior Year Quarter

The Other segment reported a net loss of \$17 million, for the three months ended September 30, 2019, compared to a net loss of \$1 million for the three months ended September 30, 2018. The \$16 million decrease was primarily due to a decrease in net interest income as a result of the Bank's overall asset sensitive position and the drop in rates relative to the rate environment in the third quarter of 2018. Additionally, there was a \$3 million benefit for loan losses from ALLL estimate changes not allocated to any other segment that occurred in the three months ended September 30, 2018, which did not recur this year.

#### Comparison to Prior Year to Date

The Other segment reported a net loss of \$11 million for the nine months ended September 30, 2019, compared to net income of \$1 million for the nine months ended September 30, 2018. The decrease in net income was primarily due to a reduction in net interest income as a result of the Bank's overall asset sensitive position and the drop in rates relative to the rate environment in the third quarter of 2018. Additionally, the benefit for loan losses from ALLL estimate changes not allocated to any other segment were \$5 million higher in the nine month period ended September 30, 2018 as compared to the current year.

#### Risk Management

Certain risks are inherent in our business and include, but are not limited to operational, strategic, credit, regulatory compliance, legal, reputation, liquidity, market and cyber. We continuously invest in our risk management activities which are focused on ensuring we properly identify, measure and manage such risks across the entire enterprise to maintain safety and soundness and maximize profitability. We hold capital to protect us from unexpected loss arising from these risks.

A comprehensive discussion of risks affecting us can be found in the Risk Factors section included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2018. Some of the more significant processes used to manage and control credit, market, liquidity and operational risks are described in the following paragraphs.

#### Credit Risk

Credit risk is the risk of loss to us arising from an obligor's inability or failure to meet contractual payment or performance terms. We provide loans, extend credit, and enter into financial derivative contracts, all of which have related credit risk.

We maintain credit limits in compliance with regulatory requirements. Under the Home Owners Loan Act (HOLA), the Bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15 percent of Tier 1 and Tier 2 capital plus any portion of the allowance for credit losses not included in the Tier 2 capital. This limit was \$267.2 million as of September 30, 2019. We maintain a more conservative maximum internal Bank credit limit than required by HOLA of \$100 million to any one borrower/obligor relationship, with the exception of warehouse borrower/obligor relationships which have a higher internal Bank limit of \$125 million as all advances are fully collateralized by residential mortgage loans and this asset class has had very low levels of historical loss. We have a tracking and reporting process to monitor lending concentration levels and all credit exposures to a single or related borrower that exceed \$50 million must be approved by the Board of Directors.

Our commercial loan portfolio has been built on our relationship-based lending strategy. We provide financing and banking products to our commercial customers in our core banking footprint and will follow those established customer relationships to meet their financing needs in areas outside of our footprint. We have also formed relationship lending on a national scale through our home builder finance and warehouse lending businesses. For all of our commercial loans, we use strict underwriting standards and adhere to granular concentration limits to manage the credit risk in our portfolio.

We have built our consumer loan portfolio by adding high quality first mortgage loans to our balance sheet making up 66 percent of our total consumer loan portfolio at September 30, 2019. We have also grown our home equity loans and lines of credit as well as our other consumer loan portfolio, led by our non-auto indirect lending business, which makes up 75% of the 'other consumer' loan portfolio. The consumer loan portfolio has been built on strong underwriting criteria and within concentration limits intended to diversify our risk profile.

### **Loans held-for-investment**

The following table summarizes loans held-for-investment by category:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>	<u>Change</u>
	(Dollars in millions)		
<b>Consumer loans</b>			
Residential first mortgage	\$ 3,258	\$ 2,999	\$ 259
Home equity (1)	985	731	254
Other	693	314	379
Total consumer loans	<u>4,936</u>	<u>4,044</u>	<u>892</u>
<b>Commercial loans</b>			
Commercial real estate	2,697	2,152	545
Commercial and industrial	1,700	1,433	267
Warehouse lending	3,215	1,459	1,756
Total commercial loans	<u>7,612</u>	<u>5,044</u>	<u>2,568</u>
Total loans held-for-investment	<u>\$ 12,548</u>	<u>\$ 9,088</u>	<u>\$ 3,460</u>

(1) Includes second mortgages, HELOCs and HELOANs.

We continue to strengthen our Community Banking segment by growing interest earning assets. Our commercial loan portfolio has grown \$2.6 billion, or 51 percent, from December 31, 2018 to September 30, 2019, led by growth in our warehouse lending portfolio due to increased refinance activity in the mortgage industry. In addition, our consumer loan portfolio has increased \$892 million, or 22 percent, from December 31, 2018 to September 30, 2019, led by a \$379 million increase in other consumer loans, primarily due to growth in our non-auto indirect lending business, and a \$259 million increase in residential first mortgage loans.

*Residential first mortgage loans.* We originate or purchase various types of conforming and non-conforming fixed and adjustable rate loans underwritten using Fannie Mae and Freddie Mac guidelines for the purpose of purchasing or refinancing owner occupied and second home properties. We typically hold certain mortgage loans in LHFI that do not qualify for sale to the Agencies and that have an acceptable yield and risk profile. The LTV requirements on our residential first mortgage loans vary depending on occupancy, property type, loan amount, and FICO scores. Loans with LTVs exceeding 80 percent are required to obtain mortgage insurance. As of September 30, 2019, loans in this portfolio had an average FICO of 756 and an average LTV of 70 percent.



The following table presents our total residential first mortgage LHFH by major category:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
	(Dollars in millions)	
<b>Estimated LTVs (1)</b>		
Less than 80% and refreshed FICO scores (2):		
Equal to or greater than 660	\$ 2,397	\$ 2,462
Less than 660	89	54
80% and greater and refreshed FICO scores (2):		
Equal to or greater than 660	672	448
Less than 660	96	29
U.S. government guaranteed	4	6
<b>Total</b>	<u>\$ 3,258</u>	<u>\$ 2,999</u>
<b>Geographic region</b>		
California	\$ 1,274	\$ 1,238
Michigan	433	314
Texas	221	193
Washington	211	195
Florida	188	195
Illinois	100	103
Colorado	84	72
Arizona	78	72
New York	68	73
Maryland	52	57
Others	549	487
<b>Total</b>	<u>\$ 3,258</u>	<u>\$ 2,999</u>

(1) LTVs reflect loan balance at the date reported, as a percentage of property values as appraised at loan origination.

(2) FICO scores are updated at least on a quarterly basis or more frequently, if available.

The following table presents our total residential first mortgage LHFH as of September 30, 2019, by year of origination:

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015 and Prior</u>	<u>Total</u>
	(Dollars in millions)					
Residential first mortgage loans	\$ 825	\$ 498	\$ 587	\$ 486	\$ 862	\$ 3,258
Percent of total	25.3%	15.3%	18.0%	14.9%	26.5%	100.0%

*Home equity.* Our home equity portfolio includes HELOANs, second mortgage loans, and HELOCs. These loans require full documentation and are underwritten and priced in an effort to ensure credit quality and loan profitability. Our debt-to-income ratio on HELOANs and HELOCs is capped at 43 percent and 45 percent, respectively. We currently limit the maximum CLTV to 89.99 percent and FICO scores to a minimum of 660 for primary residences and 680 for second homes. Second mortgage loans and HELOANs are fixed rate loans and are available with terms up to 20 years. HELOC loans are variable-rate loans that contain a 10-year interest only draw period followed by a 20-year amortizing period. At September 30, 2019, HELOCs and HELOANs in a first lien position totaled \$148 million. As of September 30, 2019, loans in this portfolio had an average FICO of 750 and an average CLTV of 68 percent.

*Other consumer loans.* Our other consumer loan portfolio consists of secured and unsecured loans originated through our indirect lending business, third party originations and our Community Banking segment. The following table presents our other consumer loan portfolio by purchase type.

	September 30, 2019		December 31, 2018	
	Balance	% of Portfolio	Balance	% of Portfolio
(Dollars in millions)				
Indirect Lending	\$ 519	74.9%	\$ 153	48.7%
Point of Sale	58	8.4%	28	8.9%
Other	116	16.7%	133	42.4%
<b>Total other consumer loans</b>	<b>\$ 693</b>	<b>100%</b>	<b>\$ 314</b>	<b>100%</b>

At September 30, 2019, other consumer loans increased to \$693 million compared to \$314 million at December 31, 2018. The increase is primarily due to growth in our high quality non-auto indirect lending business, driven by our established relationships with dealers for the origination of boat and recreational vehicle consumer loans. As of September 30, 2019, loans in our indirect portfolio had an average FICO of 765. Point of sale loans include loans originated in conjunction with third-party financial technology companies.

*Commercial real estate loans.* The commercial real estate portfolio contains loans collateralized by diversified property types which are primarily income producing in the normal course of business. The majority of our retail exposure is to neighborhood strip centers and single tenant locations, which include drug stores. Generally, the maximum LTV is 80 percent, or 90 percent for owner-occupied real estate, and the minimum debt service coverage is 1.20. At September 30, 2019, our average LTV and average debt service coverage for our CRE portfolio was 49 percent and 2.55 times, respectively. Our CRE loans primarily earn interest at a variable rate.

We have established a national home builder finance program and at September 30, 2019, our commercial portfolio contained \$2.0 billion in commitments with \$911 million in outstanding loans. The majority of these loans are collateralized and included in our CRE portfolio while the remaining loans are unsecured and included in our C&I portfolio.

The following table presents our total CRE LHFIs by collateral location and collateral type:

	MI	TX	CA	CO	FL	Other	Total	% by collateral type
(Dollars in millions)								
<b>September 30, 2019</b>								
Home Builder	\$ 1	\$ 223	\$ 104	\$ 161	\$ 99	\$ 161	\$ 749	27.8%
Owner Occupied	312	4	25	—	5	64	410	15.3%
Retail	202	—	6	4	—	119	331	12.3%
Multi family	134	58	9	1	32	115	349	12.9%
Office	136	18	16	—	2	53	225	8.3%
Hotel/motel	98	17	22	—	—	46	183	6.8%
Senior Living facility	47	26	—	—	—	68	141	5.2%
Industrial	45	—	10	—	1	28	84	3.1%
Parking garage/Lot	10	9	1	—	1	34	55	2.0%
Land - Residential	4	—	13	—	12	6	35	1.3%
Single family residence	26	—	—	—	—	2	28	1.0%
Shopping Mall	4	—	14	—	—	—	18	0.7%
Non Profit	1	—	2	1	3	3	10	0.4%
All Other (1)	8	22	7	2	7	33	79	2.9%
<b>Total</b>	<b>\$ 1,028</b>	<b>\$ 377</b>	<b>\$ 229</b>	<b>\$ 169</b>	<b>\$ 162</b>	<b>\$ 732</b>	<b>\$ 2,697</b>	<b>100.0%</b>
<b>Percent by state</b>	<b>38.1%</b>	<b>14.0%</b>	<b>8.5%</b>	<b>6.3%</b>	<b>6.0%</b>	<b>27.1%</b>	<b>100.0%</b>	

(1) All other primarily includes: mini-storage facilities, data centers, movie theater, etc.

*Commercial and industrial loans.* Commercial and industrial LHFIs typically include lines of credit and term loans and leases to businesses for use in normal business operations to finance working capital, equipment and capital purchases, acquisitions and expansion projects. We lend to customers with a history of profitability and a long-term business model. Generally, leverage conforms to industry standards and the minimum debt service coverage is 1.20 times. The majority of our C&I loans earn interest at a variable rate.

The following table presents our total C&I LHFIs by borrower's geographic location and industry type as defined by North American Industry Classification System (NAICS):

	MI	CA	OH	WI	IN	TX	NY	SC	LA	CT	Other	Total	% by industry
<b>September 30, 2019</b>													
Financial & Insurance	\$ 26	\$ 20	\$ 24	\$ 3	\$ 15	\$ 31	\$ 73	\$ 74	\$ 22	\$ 6	\$ 104	\$ 398	23.4%
Services	154	42	2	—	10	32	—	—	23	43	87	\$ 393	23.1%
Manufacturing	156	5	43	8	1	13	—	—	—	—	60	\$ 286	16.8%
Home Builder Finance	—	29	9	—	—	78	2	—	27	—	14	\$ 159	9.4%
Distribution	139	11	2	—	2	—	—	—	—	—	16	\$ 170	10.0%
Rental & Leasing	74	—	9	—	1	—	—	—	—	—	35	\$ 119	7.0%
Healthcare	2	13	—	18	1	9	1	—	—	—	33	\$ 77	4.5%
Government & Education	30	6	—	—	22	—	—	—	—	22	—	\$ 80	4.7%
Servicing Advances	—	—	—	—	—	—	—	—	—	—	10	\$ 10	0.6%
Commodities	3	—	—	—	1	—	—	—	—	—	4	\$ 8	0.5%
Total	\$ 584	\$ 126	\$ 89	\$ 29	\$ 53	\$ 163	\$ 76	\$ 74	\$ 72	\$ 71	\$ 363	\$1,700	100.0%
Percent by state	34.4%	7.4%	5.2%	1.7%	3.1%	9.6%	4.5%	4.4%	4.2%	4.2%	21.4%	100.0%	

*Warehouse lending.* We have a national platform with relationship managers across the country. We offer warehouse lines of credit to other mortgage lenders which allow the lender to fund the closing of residential mortgage loans. Each extension, advance, or draw-down on the line is fully collateralized by residential mortgage loans and is paid off when the lender sells the loan to an outside investor or, in some instances, to the Bank.

Underlying mortgage loans are predominantly originated using the Agencies' underwriting standards. The guideline for debt to tangible net worth is 15 to 1. The aggregate committed amount of adjustable-rate warehouse lines of credit granted to other mortgage lenders at September 30, 2019 was \$4.8 billion, of which \$3.2 billion was outstanding, compared to \$3.8 billion at December 31, 2018, of which \$1.5 billion was outstanding.

### *Credit Quality*

Trends in certain credit quality characteristics in our loan portfolios, remain strong and are a result of our focus on effectively managing credit risk through our careful underwriting standards and processes. The credit quality of our loan portfolios is demonstrated by low delinquency levels, minimal charge-offs and low levels of nonperforming loans over an extended period.

For all loan categories within the consumer and commercial loan portfolio, loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due (or nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank. When a loan is placed on nonaccrual status, the unpaid accrued interest income is reversed. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

## Nonperforming assets

The following table sets forth our nonperforming assets:

	September 30, 2019	December 31, 2018
	(Dollars in millions)	
<b>LHFI</b>		
<b>Consumer loans</b>		
Residential first mortgage	\$ 14	\$ 11
Home equity	1	1
Other Consumer	1	—
Total nonperforming LHFI	16	12
<b>TDRs</b>		
<b>Consumer loans</b>		
Residential first mortgage	8	8
Home equity	2	2
Total nonperforming TDRs	10	10
Total nonperforming LHFI and TDRs (1)	26	22
Real estate and other nonperforming assets, net	9	7
LHFS	17	10
Total nonperforming assets	\$ 52	\$ 39
Nonperforming assets to total assets (2)	0.16%	0.16 %
Nonperforming LHFI and TDRs to LHFI	0.21%	0.24 %
Nonperforming assets to LHFI and repossessed assets (2)	0.29%	0.32 %

(1) Includes less than 90 day past due performing loans placed on nonaccrual. Interest is not being accrued on these loans.

(2) Ratio excludes LHFS, which are recorded at fair value.

The following table sets forth activity related to our total nonperforming LHFI and TDRs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
Beginning balance	\$ 63	\$ 27	\$ 22	\$ 29
Additions	4	1	82	9
<b>Reductions</b>				
Principal payments	(39)	(1)	(41)	(5)
Charge-offs	(1)	—	(34)	(1)
Returned to performing status	(1)	(1)	(1)	(4)
Transfers to REO	—	(1)	(2)	(3)
Total nonperforming LHFI and TDRs (1)	\$ 26	\$ 25	\$ 26	\$ 25

(1) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans.

During the nine months ended September 30, 2019 and September 30, 2018, we did not have any sales of nonperforming loans. In the third quarter of 2019, we received proceeds in exchange for the collateral related to Live Well Financial, Inc. and we have no further exposure related to this borrower in our financial statements.

## Delinquencies

The following table sets forth loans 30-89 days past due in our LHFI portfolio:

	September 30, 2019	December 31, 2018
	(Dollars in millions)	
<b>Performing loans past due 30-89:</b>		
<b>Consumer loans</b>		
Residential first mortgage	\$ 7	\$ 6
Home equity	2	1
Other	3	—
Total performing loans past due 30-89 days	<u>\$ 12</u>	<u>\$ 7</u>

Early stage delinquencies increased at September 30, 2019, as loans 30 to 89 days past due were \$12 million, or 0.10 percent of total LHFI, compared to \$7 million, or 0.08 percent of total LHFI, at December 31, 2018. For further information, see Note 4 - Loans Held-for-Investment.

## Troubled debt restructurings (held-for-investment)

Troubled debt restructurings ("TDRs") are modified loans in which a borrower demonstrates financial difficulties and for which a concession has been granted as a result. Nonperforming TDRs are included in nonaccrual loans. TDRs remain in nonperforming status until a borrower has made payments and is current for at least six consecutive months. Performing TDRs are not considered to be nonaccrual so long as we believe that all contractual principal and interest due under the restructured terms will be collected.

The following table sets forth a summary of TDRs by performing status:

	September 30, 2019	December 31, 2018
	(Dollars in millions)	
<b>Performing TDRs</b>		
<b>Consumer Loans</b>		
Residential first mortgage	\$ 20	\$ 22
Home equity	19	22
<b>Commercial Loans</b>		
Total performing TDRs	<u>39</u>	<u>44</u>
<b>Nonperforming TDRs</b>		
Nonperforming TDRs	3	3
Nonperforming TDRs, performing for less than six months	7	7
Total nonperforming TDRs	<u>10</u>	<u>10</u>
Total TDRs	<u>\$ 49</u>	<u>\$ 54</u>
ALLL on consumer TDR loans	<u>\$ 8</u>	<u>\$ 10</u>

At September 30, 2019 our total TDR loans decreased \$5 million compared to December 31, 2018 primarily due to principal payments and payoffs out-pacing new additions. Of our total TDR loans, 79 percent and 82 percent were in performing status at September 30, 2019 and December 31, 2018, respectively. For further information, see Note 4 - Loans Held-for-Investment.

## Allowance for Loan Losses

The ALLL represents management's estimate of probable losses that are inherent in our LHFI portfolio but which have not yet been realized. For further information, see Note 4 - Loans Held-for-Investment.

The ALLL was \$110 million at September 30, 2019, compared to \$128 million at December 31, 2018. The ALLL as a percentage of LHFI was 0.9 percent at September 30, 2019 compared to 1.4 percent at December 31, 2018. The decline in ALLL as a percentage of LHFI is reflective of strong credit quality, as loan growth in both the consumer and commercial loan portfolios consists of high credit quality assets, combined with sustained low delinquency and charge-off levels. At September 30, 2019, we had a 0.9 percent allowance coverage on both our consumer loan portfolio and our commercial loan portfolio.

The following table sets forth certain information regarding the allocation of our ALLL to each loan category:

	<b>September 30, 2019</b>			
	<b>Investment Loan Portfolio</b>	<b>Percent of Portfolio</b>	<b>Allowance Amount</b>	<b>Allowance as a Percent of Loan Portfolio</b>
(Dollars in millions)				
<b>Consumer loans</b>				
Residential first mortgage	\$ 3,250	25.9%	\$ 28	0.9%
Home Equity	982	7.8%	16	1.6%
Other	693	5.5%	6	0.9%
Total consumer loans	4,925	39.3%	50	1.0%
<b>Commercial loans</b>				
Commercial real estate	2,697	21.5%	33	1.2%
Commercial and industrial	1,701	13.6%	22	1.3%
Warehouse lending	3,215	25.6%	5	0.2%
Total commercial loans	7,613	60.7%	60	0.8%
Total consumer and commercial loans (1)	\$ 12,538	100.0%	\$ 110	0.9%

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

	<b>December 31, 2018</b>			
	<b>Investment Loan Portfolio</b>	<b>Percent of Portfolio</b>	<b>Allowance Amount</b>	<b>Allowance as a Percentage of Loan Portfolio</b>
(Dollars in millions)				
<b>Consumer loans</b>				
Residential first mortgage	\$ 2,991	32.9%	\$ 38	1.3%
Home equity	729	8.0%	15	2.1%
Other consumer	314	3.5%	3	1.0%
Total consumer loans	4,034	44.4%	56	1.4%
<b>Commercial loans</b>				
Commercial real estate	2,152	23.7%	48	2.2%
Commercial and industrial	1,433	15.8%	18	1.3%
Warehouse lending	1,459	16.1%	6	0.4%
Total commercial loans	5,044	55.6%	72	1.4%
Total loans held-for-investment (1)	\$ 9,078	100.0%	\$ 128	1.4%

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

The following table presents changes in ALLL:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
Beginning balance	\$ 110	\$ 137	\$ 128	\$ 140
Provision (benefit) for loan losses	1	(2)	18	(3)
<b>Charge-offs</b>				
<b>Consumer loans</b>				
Residential first mortgage	(1)	(2)	(3)	(3)
Home equity	(1)	—	(1)	(2)
Other consumer	(2)	—	(5)	(1)
<b>Commercial loans</b>				
Commercial and industrial	—	—	(31)	—
Total charge offs	(4)	(2)	(40)	(6)
<b>Recoveries</b>				
<b>Consumer loans</b>				
Residential first mortgage	1	1	1	1
Home equity	1	—	2	2
Other consumer	—	—	—	—
Total consumer loans	2	1	3	3
<b>Commercial loans</b>				
Commercial real estate	—	—	—	—
Commercial and industrial	1	—	1	—
Warehouse lending	—	—	—	—
Total commercial loans	1	—	1	—
Total recoveries	3	1	4	3
Charge-offs, net of recoveries	(1)	(1)	(36)	(3)
Ending balance	\$ 110	\$ 134	\$ 110	\$ 134
Net charge-off to LHFII ratio (annualized) (1)	0.02%	0.05%	0.52%	0.05%

(1) Excludes loans carried at fair value.

## Market Risk

Market risk is the risk of reduced earnings and/or declines in the net market value of the balance sheet due to changes in market rates. Our primary market risk is interest rate risk which impacts our net interest income, fee income related to interest sensitive activities such as mortgage origination and servicing income, and loan and deposit demand.

We are subject to interest rate risk due to:

- The maturity or repricing of assets and liabilities at different times or for different amounts
- Differences in short-term and long-term market interest rate changes
- The remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change

Our Asset/Liability Committee ("ALCO"), which is composed of our executive officers and certain members of other management, monitors interest rate risk on an on-going basis in accordance with policies approved by our board of directors. The ALCO reviews interest rate positions and considers the impact projected interest rate scenarios have on earnings, capital, liquidity, business strategies, and other factors. However, management has the latitude to change interest rate positions within certain limits if, in management's judgment, the change will enhance profitability or minimize risk.

To assess and manage interest rate risk, sensitivity analysis is used to determine the impact on earnings and the net market value of the balance sheet across various interest rate scenarios, balance sheet trends, and strategies.

### Net interest income sensitivity

Management uses a simulation model to analyze the sensitivity of net interest income to changes in interest rates across various interest rate scenarios which demonstrates the level of interest rate risk inherent in the existing balance sheet. The analysis holds the current balance sheet values constant and does not take into account management intervention. In addition, we assume certain correlation rates, often referred to as a “deposit beta,” for interest-bearing deposits, wherein the rates paid to customers change relative to changes in benchmark interest rates. The effect on net interest income over a 12 month time horizon due to hypothetical changes in market interest rates is presented in the table below. In this interest rate shock simulation, as of the periods presented, interest rates have been adjusted by instantaneous parallel changes rather than in a ramp simulation which applies interest rate changes over time. All rates, short-term and long-term, are changed by the same amount (e.g. plus or minus 100 basis points) resulting in the shape of the yield curve remaining unchanged.

September 30, 2019			
Scenario	Net interest income	\$ Change	% Change
(Dollars in millions)			
100	\$581	\$38	7.0%
Constant	\$543	\$—	—%
(100)	\$500	\$(43)	(7.9)%
December 31, 2018			
Scenario	Net interest income	\$ Change	% Change

  

(Dollars in millions)			
100	\$491	\$13	2.7%
Constant	\$478	\$—	—%
(100)	\$465	\$(13)	(2.7)%

In the net interest income simulations, our balance sheet exhibits slight asset sensitivity. When interest rates rise our net interest income increases. Conversely, when interest rates fall our net interest income decreases. At September 30, 2019, the \$65 million increase in net interest income in the constant scenario as compared to that at December 31, 2018 was primarily driven by the growth in our interest earning assets partially offset by lower short term market rates compared to the same period a year ago.

The net interest income sensitivity analysis has certain limitations and makes various assumptions. Key elements of this interest rate risk exposure assessment include maintaining a static balance sheet and parallel rate shocks. Future interest rates not moving in a parallel manner across the yield curve, how the balance sheet will respond and shift based on a change in future interest rates and how the Company will respond are not included in this analysis and limit the predictive value of these scenarios.

### Economic value of equity

Management also utilizes Economic Value of Equity (EVE), a point in time analysis of the economic value of our current balance sheet position, which measures interest rate risk over a longer term. The EVE calculation represents a hypothetical valuation of equity, and is defined as the market value of assets, less the market value of liabilities, adjusted for the market value of off-balance sheet instruments. The assessment of both the short-term earnings (Net Interest Income Sensitivity) and long-term valuation (EVE) approaches, rather than Net Interest Income Sensitivity alone provide a more comprehensive analysis of interest rate risk exposure.

There are assumptions and inherent limitations in any methodology used to estimate the exposure to changes in market interest rates and as such, sensitivity calculations used in this analysis are hypothetical and should not be considered to be predictive of future results. This analysis evaluates risks to the current balance sheet only and does not incorporate future growth assumptions. Additionally, the analysis assumes interest rate changes are instantaneous and the new rate environment is constant but does not include actions management may undertake to manage risk in response to interest rate changes. Each rate scenario reflects unique prepayment and repricing assumptions. Management derives these assumptions by considering published market prepayment expectations, repricing characteristics, our historical experience, and our asset and liability management strategy. This analysis assumes that changes in interest rates may not affect or could partially affect certain instruments based on their characteristics.



The following table is a summary of the changes in our EVE that are projected to result from hypothetical changes in market interest rates as well as our internal policy limits for changes in our EVE based on the different scenarios. The interest rates, as of the dates presented, are adjusted by instantaneous parallel rate increases and decreases as indicated in the scenarios shown in the table below.

September 30, 2019					December 31, 2018					Policy Limits
Scenario	EVE	EVE%	\$ Change	% Change	Scenario	EVE	EVE%	\$ Change	% Change	
(Dollars in millions)										
300	\$ 2,768	12.5%	\$ 25	0.9 %	300	\$ 1,617	8.8%	\$ (223)	(12.1)%	22.5%
200	\$ 2,811	12.7%	\$ 68	2.5 %	200	\$ 1,720	9.4%	\$ (120)	(6.5)%	15.0%
100	\$ 2,811	12.7%	\$ 68	2.5 %	100	\$ 1,794	9.8%	\$ (46)	(2.5)%	7.5%
Current	\$ 2,743	12.4%	\$ —	— %	Current	\$ 1,840	10.0%	\$ —	— %	—%
(100)	\$ 2,621	11.8%	\$ (122)	(4.4)%	(100)	\$ 1,849	10.1%	\$ 9	0.5 %	7.5%

Our balance sheet exhibits asset sensitivity in various interest rate scenarios. The increase in EVE is the result of the amount of assets that would be expected to reprice exceeding the amount of liabilities repriced in the +200 scenario. At September 30, 2019 and December 31, 2018, for each scenario shown, the percentage change in our EVE is within our Board policy limits.

### *Derivative financial instruments*

As a part of our risk management strategy, we use derivative financial instruments to minimize fluctuation in earnings caused by market risk. We use forward sales commitments to hedge our unclosed mortgage origination pipeline and funded mortgage LHFS. All of our derivatives and mortgage loan production originated for sale are accounted for at fair market value. Changes to our unclosed mortgage origination pipeline are based on changes in fair value of the underlying loan, which is impacted most significantly by changes in interest rates and changes in the probability that the loan will not fund within the terms of the commitment, referred to as a fallout factor or, inversely, a pull-through rate. Market risk on interest rate lock commitments and mortgage LHFS is managed using corresponding forward sale commitments. The adequacy of these hedging strategies, and the ability to fully or partially hedge market risk, rely on various assumptions or projections, including a fallout factor, which is based on a statistical analysis of our actual rate lock fallout history. For further information, see Note 8 - Derivative Financial Instruments and Note 16 - Fair Value Measurements.

### *Mortgage Servicing Rights (MSRs)*

Our MSRs are sensitive to interest rate volatility and are highly susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve. We utilize derivatives, including interest rate swaps and swaptions, as part of our overall hedging strategy to manage the impact of changes in the fair value of the MSRs, however these risk management strategies do not completely eliminate repricing risk. Our hedging strategies rely on assumptions and projections regarding assets and general market factors, many of which are outside of our control. For further information, see Note 7 - Mortgage Servicing Rights, Note 8 - Derivative Financial Instruments and Note 16 - Fair Value Measurements.

### **Liquidity Risk**

Liquidity risk is the risk that we will not have sufficient funds, at a reasonable cost, to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects the ability to, at a reasonable cost, meet loan demand, to accommodate possible outflows in deposits and to take advantage of interest rate and market opportunities. The ability of a financial institution to meet current financial obligations is a function of the balance sheet structure, the ability to liquidate assets, and access to various sources of funds.

### *Parent Company Liquidity*

The Company currently obtains its liquidity primarily from dividends from the Bank. The primary uses of the Company's liquidity are debt service, external dividend payments and operating expenses, which include compensation and benefits, legal and professional expense and general administrative expenses. At September 30, 2019, the Company held \$179 million of cash on deposit at the Bank, or 3.7 years of future cash outflows, external dividend payments and debt service coverage when excluding the redemption of \$250 million of senior notes which mature on July 15, 2021.

The OCC and FRB regulate all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. A subsidiary of a savings and loan holding company, such as the Bank, is required to file a notice with the FRB and, in certain circumstances, application with the OCC at least 30 days prior to each proposed capital distribution. Pursuant to Federal Banking regulations, whether an application to the OCC is required is based on a number of factors including whether the institution qualifies as an eligible association under the OCC rules and regulations, the institution would not be at least adequately capitalized following the distribution or if the total amount of all capital distributions (including each proposed capital distribution) for the applicable calendar year exceeds net income for that year to date plus the retained net income for the preceding two years. In addition, as a subsidiary of a savings and loan holding company, a 30-day notice from the Bank must be provided to the FRB prior to declaring or paying any dividend to the holding company. Additional restrictions on dividends apply if the Bank fails the QTL test. As of September 30, 2019, the bank is in compliance with the QTL test.

At September 30, 2019, the Bank is able to pay dividends to the holding company of approximately \$305 million without submitting an application to the OCC and remain well capitalized.

### ***Bank Liquidity***

Our primary sources of funding are deposits from retail and government customers, custodial deposits related to loans we service and FHLB borrowings. We use the FHLB of Indianapolis as a significant source for funding our residential mortgage origination business due to the flexibility in terms which allows us to borrow or repay borrowings as daily cash needs require. The amount we can borrow, or the value we receive for the assets pledged to our liquidity providers, varies based on the amount and type of pledged collateral, as well as the perceived market value of the assets and the "haircut" of the market value of the assets. That value is sensitive to the pricing and policies of our liquidity providers and can change with little or no notice.

Further, other sources of liquidity include our LHFS portfolio and unencumbered investment securities. We primarily originate agency-eligible LHFS and therefore the majority of new residential first mortgage loan originations are readily convertible to cash, either by selling them as part of our monthly agency sales, RMBS, private party whole loan sales, or by pledging them to the FHLB and borrowing against them. In addition, we have the ability to sell unencumbered investment securities or use them as collateral. At September 30, 2019, we had \$2,152 million available in unencumbered investment securities.

Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. We balance the liquidity of our loan assets to our available funding sources. Our LHFI portfolio is primarily funded with stable core deposits whereas our warehouse loans and LHFS may be funded with FHLB borrowings and custodial deposits. Warehouse loans are typically more liquid than other loan assets, as loans are repaid within a short amount of time, when the lender sells the loan to an outside investor or, in some instances, to the Bank. As not all asset categories require the same level of liquidity, our loan-to-deposit ratio shows how we manage our liquidity position, how much liquidity we have and the agility of our balance sheet. The Company's HFI loan-to-deposit ratio, was 74% percent for the three months ended September 30, 2019. Excluding warehouse loans, which have draws that typically pay off within a few weeks, and custodial deposits, which represent mortgage escrow accounts on deposit with the Bank, the HFI loan-to-deposit ratio was 82% percent for the three months ended September 30, 2019.

Management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity. As governed and defined by our Board liquidity policy, we maintain adequate excess liquidity levels appropriate to cover unanticipated liquidity needs. In addition to this liquidity, we also maintain targeted minimum levels of unused borrowing capacity as another cushion against unexpected liquidity needs. Each business day, we forecast 90 days of daily cash needs. This allows us to determine our projected near term daily cash fluctuations and also to plan and adjust, if necessary, future activities. As a result, in an adverse environment, we would be able to make adjustments to operations as required to meet the liquidity needs of our business, including adjusting deposit rates to increase deposits, planning for additional FHLB borrowings, accelerating sales of LHFS (agencies and/or private), selling LHFI or investment securities, borrowing through the use of repurchase agreements, reducing originations, making changes to warehouse funding facilities, or borrowing from the discount window.

The following table presents primary sources of funding as of the dates indicated:

**Liquidity Table**

	<u>September 30, 2019</u>	<u>December 31, 2018</u>	<u>Change</u>
	(Dollars in millions)		
<b>Deposits</b>			
Retail deposits	\$ 9,318	\$ 8,854	\$ 464
Government deposits	1,414	1,202	212
Wholesale deposits	635	583	52
Custodial deposits	4,378	1,741	2,637
Total deposits	<u>\$ 15,745</u>	<u>\$ 12,380</u>	<u>\$ 3,365</u>
<b>Borrowed Funds</b>			
Federal Home Loan Bank advances and other short-term debt	\$ 2,979	\$ 3,394	\$ (415)
Other long-term debt	496	495	1
Total borrowed funds	<u>\$ 3,475</u>	<u>\$ 3,889</u>	<u>\$ (414)</u>

The following table presents certain liquidity sources and borrowing capacity as of the dates indicated:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>	<u>Change</u>
	(Dollars in millions)		
<b>Federal Home Loan Bank advances</b>			
Outstanding Advances	\$ 2,975	\$ 3,143	\$ (168)
Line of credit	—	—	—
Total used borrowing capacity	<u>\$ 2,975</u>	<u>\$ 3,143</u>	<u>\$ (168)</u>
<b>Borrowing capacity</b>			
Collateralized borrowing capacity	\$ 2,959	\$ 2,810	\$ 149
Line of credit available	30	30	—
Total unused borrowing capacity	<u>\$ 2,989</u>	<u>\$ 2,840</u>	<u>\$ 149</u>
<b>FRB discount window</b>			
Collateralized borrowing capacity	\$ 251	\$ 409	\$ (158)
<b>Unencumbered investment securities</b>			
Agency - Commercial	\$ 1,280	\$ 737	\$ 543
Agency - Residential	779	475	304
Municipal obligations	28	28	—
Corporate debt obligations	64	41	23
Other	1	1	—
Total unencumbered investment securities	<u>\$ 2,152</u>	<u>\$ 1,282</u>	<u>\$ 870</u>

## Deposits

The following table presents a composition of our deposits:

	September 30, 2019		December 31, 2018		Change
	Balance	% of Deposits	Balance	% of Deposits	
(Dollars in millions)					
<b>Retail deposits</b>					
Branch retail deposits					
Demand deposit accounts	\$ 1,249	7.9%	\$ 1,297	10.5%	\$ (48)
Savings accounts	2,913	18.5%	2,812	22.7%	101
Money market demand accounts	520	3.3%	628	5.1%	(108)
Certificates of deposit/CDARS (1)	2,558	16.2%	2,387	19.3%	171
Total branch retail deposits	7,240	46.0%	7,124	57.6%	116
Commercial deposits (2)					
Demand deposit accounts	1,503	9.5%	1,243	10.0%	260
Savings accounts	380	2.4%	314	2.5%	66
Money market demand accounts	195	1.2%	173	1.4%	22
Total commercial retail deposits	2,078	13.2%	1,730	13.9%	348
Total retail deposits	\$ 9,318	59.2%	\$ 8,854	71.5%	\$ 464
<b>Government deposits</b>					
Demand deposit accounts	\$ 336	2.1%	\$ 326	2.6%	\$ 10
Savings accounts	751	4.8%	567	4.6%	184
Certificates of deposit/CDARS (1)	327	2.1%	309	2.5%	18
Total government deposits	1,414	9.0%	1,202	9.7%	212
Wholesale deposits	635	4.0%	583	4.7%	52
Custodial deposits (3)	4,378	27.8%	1,741	14.1%	2,637
Total deposits (4)	\$ 15,745	100.0%	\$ 12,380	100.0%	\$ 3,365

(1) The aggregate amount of certificates of deposit with a minimum denomination of \$100,000 was approximately \$2.0 billion and \$1.9 billion at September 30, 2019 and December 31, 2018, respectively.

(2) Contains deposits from commercial and business banking customers.

(3) Represents investor custodial accounts and escrows controlled by us in connection with loans serviced or subserved for others that have been placed on deposit with the Bank.

(4) Total exposure related to uninsured deposits over \$250,000 was approximately \$3.6 billion and \$2.8 billion at September 30, 2019 and December 31, 2018, respectively.

Total deposits increased \$3.4 billion, or 27 percent at September 30, 2019 compared to December 31, 2018, driven by growth in our servicing business which resulted in a \$2.6 billion increase in custodial deposits.

We utilize local governmental agencies and other public units as an additional source for deposit funding. We are not required to hold collateral against our government deposits from Michigan government entities as they are covered by the Michigan Business and Growth Fund. At September 30, 2019, we were required to hold collateral for our government deposits in California that were in excess of \$250,000. In Indiana, Wisconsin and Ohio, we may be required to hold collateral against our government deposits based on a variety of factors including, but not limited to, the size of individual deposits and external bank ratings. At September 30, 2019, collateral held on government deposits in these states were de minimis. Government deposit accounts include \$327 million of certificates of deposit with maturities typically less than one year and \$1 billion in checking and savings accounts at September 30, 2019.

Custodial deposits arise due to our servicing or subservicing of loans for others and represent the portion of the investor custodial accounts on deposit with the Bank. For certain subservice agreements, these deposits require us to credit the MSR owner interest against subservicing income. This cost is a component of net loan administration income.

We participate in the CDARS program, through which certain customer CDs are exchanged for CDs of similar amounts from other participating banks and customers may receive FDIC insurance up to \$50 million. This program helps the Bank secure larger deposits and attract and retain customers. At September 30, 2019, we had \$146 million of total CDs enrolled in the CDARS program, a decrease of \$31 million from December 31, 2018.

### ***FHLB Advances***

The FHLB provides loans, also referred to as advances, on a fully collateralized basis, to savings banks and other member financial institutions. We are required to maintain a minimum amount of qualifying collateral securing FHLB advances. In the event of default, the FHLB advance is similar to a secured borrowing, whereby the FHLB has the right to sell the pledged collateral to settle the fair value of the outstanding advances.

We rely upon advances from the FHLB as a source of funding for the origination or purchase of loans for sale in the secondary market and for providing duration specific short-term and long-term financing. The outstanding balance of FHLB advances fluctuates from time to time depending on our current inventory of mortgage LHFS and the availability of lower cost funding sources. Our portfolio includes short-term fixed rate advances and long-term fixed rate advances.

We are currently authorized through a resolution of our Board of Directors to apply for advances from the FHLB using approved loan types as collateral, which includes residential first mortgage loans, home equity lines of credit, and commercial real estate loans. As of September 30, 2019, our Board of Directors authorized and approved a line of credit with the FHLB of up to \$10.0 billion, which is further limited based on our total assets and qualified collateral, as determined by the FHLB. At September 30, 2019, we had \$3.0 billion of advances outstanding and an additional \$3.0 billion of collateralized borrowing capacity available at the FHLB.

### ***Federal Reserve Discount Window***

We have arrangements with the FRB of Chicago to borrow from its discount window. The discount window is a borrowing facility that we may utilize for short-term liquidity needs arising from special or unusual circumstances. The amount we are allowed to borrow is based on the lendable value of the collateral that we provide. To collateralize the line, we pledge investment securities and loans that are eligible based on FRB of Chicago guidelines.

At September 30, 2019, we pledged collateral, which included commercial loans, municipal bonds, and agency bonds, to the FRB of Chicago amounting to \$268 million with a lendable value of \$251 million. At December 31, 2018, we pledged collateral to the FRB of Chicago amounting to \$448 million with a lendable value of \$409 million.

### ***Debt***

As part of our overall capital strategy, we previously raised capital through the issuance of junior subordinated notes to our special purpose trusts formed for the offerings, which issued Tier 1 qualifying preferred stock ("trust preferred securities"). The trust preferred securities are callable by us at any time. Interest is payable on a quarterly basis; however, we may defer interest payments for up to 20 quarters without default or penalty. At September 30, 2019, we are current on all interest payments. Additionally, we have \$250 million of senior debt outstanding at September 30, 2019 ("Senior Notes") which matures on July 15, 2021. For further information, see Note 9 - Borrowings.

### **Operational Risk**

Operational risk is the risk of loss due to human error, inadequate or failed internal systems and controls, violations of, or noncompliance with, laws, rules and regulations, prescribed practices, or ethical standards, and external influences such as market conditions, fraudulent activities, disasters, and security risks. We continuously strive to adapt our system of internal controls to ensure compliance with laws, rules, and regulations, and to improve the oversight of our operational risk.

We evaluate internal systems, processes, and controls to mitigate loss from cyber-attacks and, to date, have not experienced any material losses. The goal of this framework is to implement effective operational risk techniques and strategies, minimize operational and fraud losses, and enhance our overall performance.

### ***Loans with government guarantees***

Substantially all of our loans with government guarantees continue to be insured or guaranteed by the FHA or the U.S. Department of Veterans Affairs. In the event of a government guaranteed loan borrower default, the Bank has a unilateral option to repurchase loans sold to GNMA that are 90 days past due and recover losses through a claims process from the insurer. Nonperforming repurchased loans in this portfolio earn interest at a rate based upon the 10-year U.S. Treasury note rate from the time the underlying loan becomes delinquent, which is not paid by the FHA until claimed. Additionally, if the Bank cures the loan, it can be re-sold to GNMA. If not, the Bank can begin the process of collecting the government guarantee by filing a claim in accordance with established guidelines. Certain loans within our portfolio may be subject to indemnifications and insurance limits which expose us to limited credit risk.

In both the three and nine months ended September 30, 2019, we had less than \$1 million in net charge-offs related to loans with government guarantees and have reserved for the remaining risks within other assets and as a component of our ALLL on residential first mortgages. These additional expenses or charges arise due to insurance limits on VA insured loans and FHA property foreclosure and preservation requirements that may result in a loss in excess of all, or part of, the guarantee.

Our loans with government guarantees portfolio totaled \$607 million at September 30, 2019, as compared to \$392 million at December 31, 2018. The increase is primarily due to holding more Ginnie Mae mortgage servicing rights which naturally results in higher repurchases.

For further information, see Note 5 - Loans with Government Guarantees.

### ***Representation and warranty reserve***

When we sell mortgage loans, we make customary representations and warranties to the purchasers, including sponsored securitization trusts and their insurers (primarily Fannie Mae and Freddie Mac). An estimate of the fair value of the guarantee associated with the mortgage loans is recorded in other liabilities in the Consolidated Statements of Financial Condition, which was \$5 million at September 30, 2019, as compared to \$7 million at December 31, 2018.

### **Capital**

Management actively reviews and manages our capital position and strategy. We conduct quarterly capital stress tests and capital adequacy assessments which utilize internally defined scenarios. These analyses are designed to help management and the Board better understand the integrated sensitivity of various risk exposures through quantifying the potential financial and capital impacts of hypothetical stressful events and scenarios. We make adjustments to our balance sheet composition taking into consideration potential business risks, regulatory requirements and the flexibility to support future growth. We prudently manage our capital position and work with our regulators to ensure that our capital levels are appropriate considering our risk profile.

The capital standards we are subject to include requirements contemplated by the Dodd-Frank Act as well as guidelines reached by Basel III. These risk-based capital adequacy guidelines are intended to measure capital adequacy with regard to a banking organization's balance sheet, including off-balance sheet exposures such as unused portions of loan commitments, letters of credit, and recourse arrangements. Our capital ratios are maintained at levels in excess of those considered to be "well-capitalized" by regulators. Tier 1 leverage was 7.98 percent at September 30, 2019 providing a 298 basis point stress buffer above the minimum level needed to be considered "well-capitalized." Additionally, total risk-based capital to RWA was 11.54 percent at September 30, 2019 providing a 154 basis point stress buffer above the minimum level needed to be considered "well-capitalized".

Dodd-Frank Act Section 171, commonly known as the Collins Amendment, established minimum Tier 1 leverage and risk-based capital requirements for insured depository institutions, depository institution holding companies, and non-bank financial companies that are supervised under the Federal Reserve. Under the amendment, certain hybrid securities, such as trust preferred securities, may be included in Tier 1 capital for bank holding companies that had total assets below \$15 billion as of December 31, 2009. As we were below \$15 billion in assets as of December 31, 2009, the trust preferred securities classified as long term debt on our balance sheet will be included as Tier 1 capital, unless we complete an acquisition of a depository institution holding company or a depository institution and we report total assets greater than \$15 billion in the quarter in which the acquisition occurs. Should that event occur, our trust preferred securities would be included in Tier 2 capital.

## Regulatory Capital Simplification

The Bank and Flagstar have been subject to the capital requirements of the Basel III rules since January 1, 2015. On July 9, 2019, the Agencies issued the Final Capital Simplification Rule (the "New Rule") which simplifies certain requirements in the Agencies' current regulatory capital rules. The New Rule increases the CET1 capital threshold deductions from 10 percent to 25 percent for MSRs, temporary difference DTAs and investments in the capital of unconsolidated financial institutions. Further, the New Rule eliminates the aggregate 15 percent CET1 deduction threshold for MSRs, temporary difference DTAs and investments in the capital of unconsolidated financial institutions effective for periods after April 1, 2020. On September 17, 2019 the FDIC finalized an additional rule that permits non-advanced approaches banking organizations to early adopt the New Rule for periods beginning January 1, 2020. Flagstar intends on implementing capital simplification on January 1, 2020 and we are currently managing our capital in anticipation of such date.

For the period presented, the following table sets forth our capital ratios under the current rules and the New Rule, as well as our excess capital over well-capitalized minimums under both rules.

Flagstar Bancorp	Actual		Well-Capitalized Under Prompt Corrective Action Provisions		Under New Rule		Excess Capital Over Well-Capitalized Minimum (1)	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Current Rule	Capital Simplification Rules
	(Dollars in millions)							
<b>September 30, 2019</b>								
Tier 1 leverage capital (to adjusted avg. total assets)	\$ 1,668	7.98%	\$ 1,045	5.0%	\$ 1,773	8.44%	\$ 623	\$ 728
Common equity Tier 1 capital (to RWA)	1,428	9.25%	1,003	6.5%	1,533	9.56%	425	530
Tier 1 capital (to RWA)	1,668	10.81%	1,235	8.0%	1,773	11.06%	433	538
Total capital (to RWA)	1,781	11.54%	1,543	10.0%	1,886	11.76%	238	343

(1) Excess capital is the difference between the actual capital ratios under either the current rule or the proposed capital simplification rules and the well-capitalized minimum ratio, multiplied by the relevant asset base.

As presented in the table above, our constraining capital ratio is our total capital to risk weighted assets at 11.54 percent. It would take a \$238 million after-tax loss, with the balance sheet remaining constant, for our total risk-based capital ratio to fall below the level considered to be "well-capitalized" under the current rule and an after-tax loss of \$343 million, under the New Rule.

As of September 30, 2019, we had \$285 million in MSRs, \$49 million in DTAs arising from temporary differences and no material investments in unconsolidated financial institutions or minority interest which drive differences between our current capital ratios and what would be reported under the New Rule. For additional information on our capital requirements, see Note 14 - Regulatory Capital.

## Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes non-GAAP financial measures such as tangible book value per share, tangible common equity to assets ratio, return on average assets and return on average tangible common equity. We believe these non-GAAP financial measures provide additional information that is useful to investors in helping to understand the underlying performance and trends of the Company.

Non-GAAP financial measures have inherent limitations, which are not required to be uniformly applied and are not audited. Readers should be aware of these limitations and should be cautious with respect to the use of such measures. To mitigate these limitations, we have practices in place to ensure that these measures are calculated using the appropriate GAAP or regulatory components in their entirety and to ensure that our performance is properly reflected to facilitate consistent period-to-period comparisons. Our method of calculating these non-GAAP measures may differ from methods used by other companies. Although we believe the non-GAAP financial measures disclosed in this report enhance investors' understanding of our business and performance, these non-GAAP measures should not be considered in isolation, or as a substitute for those financial measures prepared in accordance with GAAP. Where non-GAAP financial measures are used, the most directly comparable GAAP or regulatory financial measure, as well as the reconciliation to the most directly comparable GAAP or regulatory financial measure, can be found in this report.

**Tangible book value per share, tangible common equity to assets ratio, return on average assets and return on average tangible common equity.** The Company believes that tangible book value per share, tangible common equity to assets ratio, return on average assets and return on average tangible common equity provide a meaningful representation of its operating performance on an ongoing basis. Management uses these measures to assess performance of the Company against its peers and evaluate overall performance. The Company believes these non-GAAP financial measures provide useful information for investors, securities analysts and others because it provides a tool to evaluate the Company's performance on an ongoing basis and compared to its peers.

The following table provides a reconciliation of non-GAAP financial measures.

	<u>September 30, 2019</u>	<u>December 31, 2018</u>	<u>September 30, 2018</u>	
	(Dollars in millions)			
Total stockholders' equity	\$ 1,734	\$ 1,570	\$ 1,518	
Less: Goodwill and intangible assets	174	190	70	
<b>Tangible book value/Tangible common equity</b>	<b>\$ 1,560</b>	<b>\$ 1,380</b>	<b>\$ 1,448</b>	
Number of common shares outstanding	56,510,341	57,749,464	57,625,439	
<b>Tangible book value per share</b>	<b>\$ 27.62</b>	<b>\$ 23.90</b>	<b>\$ 25.13</b>	
Total assets	\$ 22,048	\$ 18,531	\$ 18,697	
<b>Tangible common equity to assets ratio</b>	<b>7.08%</b>	<b>7.45%</b>	<b>7.74%</b>	
Total average assets	\$ 21,197	\$ 19,966	\$ 18,611	
Less: Average goodwill and intangible assets	176	129	71	
Total average tangible assets	\$ 21,021	\$ 19,837	\$ 18,540	
	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	(Dollars in millions, except share data)			
Net income	\$ 63	\$ 48	\$ 160	\$ 133
Plus: Intangible asset amortization (after-tax)	2	1	10	—
Tangible net income	65	49	170	133
Total average equity	\$ 1,722	\$ 1,514	\$ 1,658	\$ 1,468
Less: Average goodwill and intangible assets	176	71	184	54
Total average tangible equity	1,546	1,443	1,474	1,414
Return on average assets	1.20%	1.04%	1.08%	1.00%
<b>Return on average tangible assets</b>	<b>1.27%</b>	<b>1.07%</b>	<b>1.16%</b>	<b>1.02%</b>
Return on average common equity	14.72%	12.80%	12.90%	12.10%
<b>Return on average tangible common equity</b>	<b>17.12%</b>	<b>13.67%</b>	<b>15.30%</b>	<b>12.78%</b>

### Critical Accounting Estimates

Various elements of our accounting policies, by their nature, are subject to estimation techniques, valuation assumptions and other subjective assessments. Certain accounting policies that, due to the judgment, estimates and assumptions are critical to an understanding of our Consolidated Financial Statements and the Notes, are described in Item 1. These policies relate to: (a) the determination of our ALLL and (b) fair value measurements. We believe the judgment, estimates and assumptions used in the preparation of our Consolidated Financial Statements and the Notes are appropriate given the factual circumstances at the time. However, given the sensitivity of our Consolidated Financial Statements and the Notes to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations and/or financial condition. For further information on our critical accounting policies, please refer to our Form 10-K for the year ended December 31, 2018, which is available on our website, [flagstar.com](http://flagstar.com), under the Investor Relations section, or on the website of the Securities and Exchange Commission, at [sec.gov](http://sec.gov).



## **Forward – Looking Statements**

Certain statements in this Form 10-Q, including but not limited to statements included within the Management’s Discussion and Analysis of Financial Condition and Results of Operations, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. In addition, we may make forward-looking statements in our other documents filed with or furnished to the Security and Exchange Commission (SEC), and our management may make forward-looking statements orally to analysts, investors, representatives of the media, and others.

Generally, forward-looking statements are not based on historical facts but instead represent management’s current beliefs and expectations regarding future events and are subject to significant risks and uncertainties. Such statements may be identified by words such as believe, expect, anticipate, intend, plan, estimate, may increase, may fluctuate, and similar expressions or future or conditional verbs such as will, should, would, and could. Our actual results and capital and other financial conditions may differ materially from those described in the forward-looking statements depending upon a variety of factors, including without limitation the precautionary statements included within each individual business’ discussion and analysis of our results of operations and the risk factors listed and described in Item 1A. to Part I, of our Annual Report on Form 10-K for the year ended December 31, 2018 and Item 1A. to Part II, of this Quarterly Report on Form 10-Q, which are incorporated by reference herein.

Other than as required under United States securities laws, we do not undertake to update the forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

**Item 1. Financial Statements**

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

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
	(Unaudited)	
<b>Assets</b>		
Cash	\$ 234	\$ 260
Interest-earning deposits	119	148
Total cash and cash equivalents	353	408
Investment securities available-for-sale	1,697	2,142
Investment securities held-to-maturity	635	703
Loans held-for-sale (\$4,122 and \$3,732 measured at fair value, respectively)	4,196	3,869
Loans held-for-investment (\$10 and \$10 measured at fair value, respectively)	12,548	9,088
Loans with government guarantees	607	392
Less: allowance for loan losses	(110)	(128)
Total loans held-for-investment and loans with government guarantees, net	13,045	9,352
Mortgage servicing rights	285	290
Net deferred tax asset	68	103
Federal Home Loan Bank stock	303	303
Premises and equipment, net	417	390
Goodwill and intangible assets	174	190
Other assets	875	781
Total assets	<u>\$ 22,048</u>	<u>\$ 18,531</u>
<b>Liabilities and Stockholders' Equity</b>		
Noninterest-bearing deposits	\$ 5,649	\$ 2,989
Interest-bearing deposits	10,096	9,391
Total deposits	15,745	12,380
Short-term Federal Home Loan Bank advances and other	2,329	3,244
Long-term Federal Home Loan Bank advances	650	150
Other long-term debt	496	495
Other liabilities (\$35 and \$60 measured at fair value, respectively)	1,094	692
Total liabilities	20,314	16,961
<b>Stockholders' Equity</b>		
Common stock \$0.01 par value, 80,000,000 and 80,000,000 shares authorized; 56,510,341 and 57,749,464 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,481	1,522
Accumulated other comprehensive income (loss)	5	(47)
Retained earnings	247	94
Total stockholders' equity	<u>1,734</u>	<u>1,570</u>
Total liabilities and stockholders' equity	<u>\$ 22,048</u>	<u>\$ 18,531</u>

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Unaudited)			
<b>Interest Income</b>				
Loans	\$ 185	\$ 161	\$ 517	\$ 436
Investment securities	17	21	61	64
Interest-earning deposits and other	1	1	3	2
Total interest income	203	183	581	502
<b>Interest Expense</b>				
Deposits	38	27	102	65
Short-term Federal Home Loan Bank advances and other	10	18	44	50
Long-term Federal Home Loan Bank advances	2	7	4	21
Other long-term debt	7	7	21	21
Total interest expense	57	59	171	157
Net interest income	146	124	410	345
Provision (benefit) for loan losses	1	(2)	18	(3)
Net interest income after provision (benefit) for loan losses	145	126	392	348
<b>Noninterest Income</b>				
Net gain on loan sales	110	43	234	166
Loan fees and charges	29	23	70	67
Net return on mortgage servicing rights	(2)	13	9	26
Loan administration income	5	5	22	15
Deposit fees and charges	10	5	28	15
Other noninterest income	19	18	85	52
Total noninterest income	171	107	448	341
<b>Noninterest Expense</b>				
Compensation and benefits	98	76	275	236
Occupancy and equipment	40	31	118	91
Commissions	38	21	76	64
Loan processing expense	22	14	60	43
Legal and professional expense	6	7	18	19
Federal insurance premiums	5	6	14	18
Intangible asset amortization	3	1	11	—
Other noninterest expense	26	17	71	52
Total noninterest expense	238	173	643	523
Income before income taxes	78	60	197	166
Provision for income taxes	15	12	37	33
Net income	\$ 63	\$ 48	\$ 160	\$ 133
<b>Net income per share</b>				
Basic	\$ 1.12	\$ 0.84	\$ 2.83	\$ 2.32
Diluted	\$ 1.11	\$ 0.83	\$ 2.80	\$ 2.28
<b>Weighted average shares outstanding</b>				
Basic	56,484,499	57,600,360	56,607,944	57,483,802
Diluted	57,110,796	58,332,598	57,252,540	58,301,920

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

**Flagstar Bancorp, Inc.**  
**Consolidated Statements of Comprehensive Income**  
(In millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Unaudited)			
Net income	\$ 63	\$ 48	\$ 160	\$ 133
<b>Other comprehensive income (loss), net of tax</b>				
Investment securities	13	(9)	52	(47)
Derivatives and hedging activities	—	(1)	—	21
Other comprehensive income (loss), net of tax	13	(10)	52	(26)
Comprehensive income	\$ 76	\$ 38	\$ 212	\$ 107

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

**Flagstar Bancorp, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
(In millions, except share data)

	<u>Common Stock</u>		Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Number of Shares	Amount				
<b>Balance at December 31, 2017</b>	57,321,228	\$ 1	\$ 1,512	\$ (16)	\$ (98)	\$ 1,399
(Unaudited)						
Net income	—	—	—	—	133	133
Total other comprehensive income (loss)	—	—	—	(21)	—	(21)
Shares issued from Employee Stock Purchase Plan	88,566	—	—	—	—	—
Reclassification of certain income tax effects (1)	—	—	—	(5)	5	—
Stock-based compensation	215,645	—	7	—	—	7
<b>Balance at September 30, 2018</b>	<u>57,625,439</u>	<u>\$ 1</u>	<u>\$ 1,519</u>	<u>\$ (42)</u>	<u>\$ 40</u>	<u>\$ 1,518</u>
<b>Balance at December 31, 2018</b>	57,749,464	\$ 1	\$ 1,522	\$ (47)	\$ 94	\$ 1,570
(Unaudited)						
Net income	—	—	—	—	160	160
Total other comprehensive income (loss)	—	—	—	52	—	52
Shares issued from Employee Stock Purchase Plan	84,036	—	—	—	—	—
Dividends declared and paid @ .04/share	280	—	—	—	(7)	(7)
Stock-based compensation	194,266	—	9	—	—	9
Repurchase of shares (2)	(1,517,705)	—	(50)	—	—	(50)
<b>Balance at September 30, 2019</b>	<u>56,510,341</u>	<u>\$ 1</u>	<u>\$ 1,481</u>	<u>\$ 5</u>	<u>\$ 247</u>	<u>\$ 1,734</u>

(1) Income tax effects of the Tax Cuts and Jobs Act are reclassified from AOCI to retained earnings due to the adoption of ASU 2018-02.

(2) Includes dividend reinvestment shares

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

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

	<b>Nine Months Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
	(Unaudited)	
<b>Operating Activities</b>		
Net cash used in operating activities	\$ (15,700)	\$ (19,002)
<b>Investing Activities</b>		
Proceeds from sale of AFS securities including loans that have been securitized	\$ 15,631	\$ 18,362
Collection of principal on investment securities AFS	129	152
Purchase of investment securities AFS and other	(39)	(48)
Collection of principal on investment securities HTM	68	72
Proceeds received from the sale of LHFI	167	4
Net origination, purchase, and principal repayments of LHFI	(3,575)	(695)
Acquisition of premises and equipment, net of proceeds	(48)	(50)
Proceeds from the sale of MSRs	56	267
Other, net	(8)	(14)
Net cash provided by investing activities	\$ 12,381	\$ 18,050
<b>Financing Activities</b>		
Net change in deposit accounts	\$ 3,365	\$ 2,040
Net change in short-term FHLB borrowings and other short-term debt	(913)	(1,061)
Proceeds from increases in FHLB long-term advances and other debt	550	200
Repayment of FHLB long-term advances	(50)	(325)
Net receipt of payments of loans serviced for others	366	140
Accelerated share repurchase	(50)	—
Dividends declared and paid	(7)	—
Other	14	19
Net cash provided by financing activities	\$ 3,275	\$ 1,013
Net increase in cash, cash equivalents and restricted cash (1)	(44)	61
Beginning cash, cash equivalents and restricted cash (1)	432	223
Ending cash, cash equivalents and restricted cash (1)	\$ 388	\$ 284
<b>Supplemental disclosure of cash flow information</b>		
Interest paid on deposits and other borrowings	\$ 173	\$ —
Non-cash reclassification of investment securities HTM to AFS	\$ —	\$ 144
Non-cash reclassification of loans originated LHFI to LHFS	\$ 101	\$ 6
Non-cash reclassification of mortgage loans originated LHFS to LHFI	\$ —	\$ —
Non-cash reclassification of LHFS to AFS securities	\$ 15,198	\$ 18,360
Beneficial interest retained in securitization	\$ —	\$ —
MSRs resulting from sale or securitization of loans	\$ 203	\$ 283
<b>Operating section supplemental disclosures</b>		
Cash proceeds from sales of LHFS	\$ 7,714	\$ 7,028
Origination, premium paid and purchase of LHFS, net of principal repayments	\$ (23,249)	\$ (26,038)

(1) For further information on restricted cash, see Note 8 - Derivatives.

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

**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. GAAP for interim financial statements. Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," "our," the "Company" or "Flagstar" will include the Bank.

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 SEC. These interim financial statements are unaudited and include, in our opinion, all adjustments necessary for a fair statement 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 our Annual Report on Form 10-K for the year ended December 31, 2018, which is available on our website, flagstar.com, and on the SEC website, at sec.gov.

**Note 2 - Investment Securities**

The following table presents our investment securities:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(Dollars in millions)			
<b>September 30, 2019</b>				
<b>Available-for-sale securities</b>				
Agency - Commercial	\$ 964	\$ 7	\$ (2)	\$ 969
Agency - Residential	604	3	(3)	604
Corporate debt obligations	63	1	—	64
Municipal obligations	31	—	—	31
Other MBS	28	—	—	28
Certificate of deposits	1	—	—	1
Total available-for-sale securities (1)	<u>\$ 1,691</u>	<u>\$ 11</u>	<u>\$ (5)</u>	<u>\$ 1,697</u>
<b>Held-to-maturity securities</b>				
Agency - Commercial	\$ 325	\$ 1	\$ (1)	\$ 325
Agency - Residential	310	4	—	314
Total held-to-maturity securities (1)	<u>\$ 635</u>	<u>\$ 5</u>	<u>\$ (1)</u>	<u>\$ 639</u>
<b>December 31, 2018</b>				
<b>Available-for-sale securities</b>				
Agency - Commercial	\$ 1,413	\$ 4	\$ (43)	\$ 1,374
Agency - Residential	686	—	(24)	662
Corporate debt obligations	41	—	—	41
Municipal obligations	33	—	(1)	32
Other MBS	32	—	—	32
Certificate of Deposits	1	—	—	1
Total available-for-sale securities (1)	<u>\$ 2,206</u>	<u>\$ 4</u>	<u>\$ (68)</u>	<u>\$ 2,142</u>
<b>Held-to-maturity securities</b>				
Agency - Commercial	\$ 349	\$ —	\$ (13)	\$ 336
Agency - Residential	354	—	(9)	345
Total held-to-maturity securities (1)	<u>\$ 703</u>	<u>\$ —</u>	<u>\$ (22)</u>	<u>\$ 681</u>

(1) There were no securities of a single issuer, which are not governmental or government-sponsored, that exceeded 10 percent of stockholders' equity at September 30, 2019 or December 31, 2018.

We evaluate AFS and HTM investment securities for OTTI on a quarterly basis. An OTTI is considered to have occurred when the fair value of a debt security is below its amortized costs and we (1) have the intent to sell the security, (2) will more likely than not be required to sell the security before recovery of its amortized cost, or (3) do not expect to recover the entire amortized cost basis of the security. Investments that have an OTTI are written down through a charge to earnings for the amount representing the credit loss on the security. Gains and losses related to all other factors are recognized in other comprehensive income. Agency securities, which are either explicitly or implicitly backed by the federal government, comprised 95 percent of our total securities at September 30, 2019. This factor is considered when evaluating our investment securities for OTTI. During the three and nine months ended September 30, 2019 and September 30, 2018, we had no OTTI.

#### **Available-for-sale securities**

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

We purchased \$16 million and \$39 million of AFS securities, which were comprised of U.S. government sponsored agency MBS, certificate of deposits, and corporate debt obligations during the three and nine months ended September 30, 2019, respectively. We purchased \$43 million and \$48 million of AFS securities, which included U.S. government sponsored agency MBS, corporate debt obligations, and municipal obligations during the three and nine months ended September 30, 2018, respectively.

There were \$0 and \$432 million in sales of AFS securities during the three and nine months ended September 30, 2019, respectively. These sales resulted in a realized gain of \$7 million, reported in other noninterest income in the Consolidated Statements of Operations. These sales did not include those related to mortgage loans that had been securitized for sale in the normal course of business. There were no sales of AFS securities during the three and nine months ended September 30, 2018.

#### **Held-to-maturity securities**

Investment securities HTM are carried at amortized cost and adjusted for amortization of premiums and accretion of discounts using the interest method. Unrealized losses are not recorded to the extent they are temporary in nature.

There were no purchases or sales of HTM securities during both the three and nine months ended September 30, 2019 and September 30, 2018.

The following table summarizes available-for-sale and held-to-maturity securities, by duration, the unrealized loss positions on investment securities:



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

(Dollars in millions)

#### September 30, 2019

##### Available-for-sale securities

Agency - Commercial	\$ 204	22	\$ (2)	\$ 21	3	\$ —
Agency - Residential	280	27	(3)	61	9	—
Municipal obligations	8	3	—	1	1	—
Corporate debt obligations	—	—	—	—	—	—
Other MBS	—	—	—	13	2	—

##### Held-to-maturity securities

Agency - Commercial	\$ 159	13	\$ (1)	\$ —	—	\$ —
Agency - Residential	46	9	—	9	5	—

#### December 31, 2018

##### Available-for-sale securities

Agency - Commercial	\$ 1,025	74	\$ (43)	\$ 1	1	\$ —
Agency - Residential	647	79	(24)	14	5	—
Municipal obligations	28	16	(1)	1	2	—
Corporate debt obligations	—	—	—	7	2	—

##### Held-to-maturity securities

Agency - Commercial	\$ 336	26	\$ (13)	\$ —	—	\$ —
Agency - Residential	345	60	(9)	—	—	—

The following table shows the amortized cost and estimated fair value of securities by contractual maturity:

Investment Securities Available-for-Sale			Investment Securities Held-to-maturity		
Amortized Cost	Fair Value	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield

(Dollars in millions)

#### September 30, 2019

Due in one year or less	\$ 2	\$ 2	1.83%	\$ —	\$ —	—%
Due after one year through five years	12	12	2.63%	10	10	2.55%
Due after five years through 10 years	90	92	4.33%	9	9	2.26%
Due after 10 years	1,587	1,591	2.40%	616	620	2.45%
Total	\$ 1,691	\$ 1,697		\$ 635	\$ 639	

We pledge investment securities, primarily agency collateralized and municipal taxable mortgage obligations, to collateralize lines of credit and/or borrowings. At both September 30, 2019 and December 31, 2018, we had pledged investment securities of \$0.4 billion and \$1.9 billion, respectively.

#### Note 3 - Loans Held-for-Sale

The majority of our mortgage loans originated as LHFS are ultimately sold into the secondary market on a whole loan basis or by securitizing the loans into agency, government, or private label mortgage-backed securities. LHFS totaled \$4.2 billion and \$3.9 billion at September 30, 2019 and December 31, 2018, respectively. For the three and nine months ended September 30, 2019 we had net gain on loan sales associated with LHFS of \$110 million and \$232 million, respectively, as compared to \$43 million and \$166 million for the three and nine months ended September 30, 2018, respectively.

At September 30, 2019 and December 31, 2018, \$74 million and \$137 million, respectively, of LHFS were recorded at lower of cost or fair value. We elected the fair value option for the remainder of the loans in the portfolio.



#### Note 4 - Loans Held-for-Investment

The following table presents our loans held-for-investment:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
	(Dollars in millions)	
<b>Consumer loans</b>		
Residential first mortgage	\$ 3,258	\$ 2,999
Home equity	985	731
Other	693	314
Total consumer loans	<u>4,936</u>	<u>4,044</u>
<b>Commercial loans</b>		
Commercial real estate	2,697	2,152
Commercial and industrial	1,700	1,433
Warehouse lending	3,215	1,459
Total commercial loans	<u>7,612</u>	<u>5,044</u>
Total loans held-for-investment	<u>\$ 12,548</u>	<u>\$ 9,088</u>

The following table presents the UPB of our loan sales and purchases in the loans held-for-investment portfolio:

	<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>
	(Dollars in millions)	
<b>Loans Sold (1)</b>		
Performing loans	\$ 166	\$ 4
Total loans sold	<u>\$ 166</u>	<u>\$ 4</u>
Net gain associated with loan sales (2)	\$ 2	\$ —
<b>Loans Purchased</b>		
Home equity	199	—
Other consumer (3)	51	—
Total loans purchased	<u>\$ 250</u>	<u>\$ —</u>
Premium associated with loans purchased	\$ 9	\$ —

(1) Upon a change in our intent, the loans were transferred to LHFS and subsequently sold.

(2) Recorded in net gain on loan sales on Consolidated Statements of Operations.

(3) Does not include Greensky flow consumer loans.

We have pledged certain LHFI, LHFS, and loans with government guarantees to collateralize lines of credit and/or borrowings with the FHLB of Indianapolis and the FRB of Chicago. At September 30, 2019 we had pledged loans of \$7.9 billion, compared to \$6.8 billion at December 31, 2018.

#### Allowance for Loan Losses

We determine the estimate of the ALLL on at least a quarterly basis. Refer to Note 1- Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2018 for a description of the methodology. The ALLL, 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 common risk characteristics to determine our best estimate of incurred losses.

The following table presents changes in ALLL, by class of loan:

	Residential First Mortgage (1)	Home Equity	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)							
<b>Three Months Ended September 30, 2019</b>							
Beginning balance ALLL	\$ 26	\$ 16	\$ 5	\$ 35	\$ 23	\$ 5	\$ 110
Charge-offs	(1)	(1)	(2)	—	—	—	(4)
Recoveries	1	1	—	—	1	—	3
Provision (benefit)	2	—	3	(2)	(2)	—	1
Ending balance ALLL	<u>\$ 28</u>	<u>\$ 16</u>	<u>\$ 6</u>	<u>\$ 33</u>	<u>\$ 22</u>	<u>\$ 5</u>	<u>\$ 110</u>
<b>Three Months Ended September 30, 2018</b>							
Beginning balance ALLL	\$ 45	\$ 19	\$ 1	\$ 45	\$ 21	\$ 6	\$ 137
Charge-offs	(2)	—	—	—	—	—	(2)
Recoveries	1	—	—	—	—	—	1
Provision (benefit)	(4)	1	1	1	(1)	—	(2)
Ending balance ALLL	<u>\$ 40</u>	<u>\$ 20</u>	<u>\$ 2</u>	<u>\$ 46</u>	<u>\$ 20</u>	<u>\$ 6</u>	<u>\$ 134</u>
<b>Nine Months Ended September 30, 2019</b>							
Beginning balance ALLL	\$ 38	\$ 15	\$ 3	\$ 48	\$ 18	\$ 6	\$ 128
Charge-offs	(3)	(1)	(5)	—	(31)	—	(40)
Recoveries	1	2	—	—	1	—	4
Provision (benefit)	(8)	—	8	(15)	34	(1)	18
Ending balance ALLL	<u>\$ 28</u>	<u>\$ 16</u>	<u>\$ 6</u>	<u>\$ 33</u>	<u>\$ 22</u>	<u>\$ 5</u>	<u>\$ 110</u>
<b>Nine Months Ended September 30, 2018</b>							
Beginning balance ALLL	\$ 47	\$ 22	\$ 1	\$ 45	\$ 19	\$ 6	\$ 140
Charge-offs	(3)	(2)	(1)	—	—	—	(6)
Recoveries	1	2	—	—	—	—	3
Provision (benefit)	(5)	(2)	2	1	1	—	(3)
Ending balance ALLL	<u>\$ 40</u>	<u>\$ 20</u>	<u>\$ 2</u>	<u>\$ 46</u>	<u>\$ 20</u>	<u>\$ 6</u>	<u>\$ 134</u>

(1) Includes loans with government guarantees.

The ALLL was \$110 million at September 30, 2019 and \$134 million at September 30, 2018. The decrease is attributable to our strong asset quality, as loan growth in both the consumer and commercial loan portfolios consists of high credit quality assets, combined with sustained low delinquency and charge-off levels outside of the \$29 million net charge off of the Live Well loan which has been fully resolved.

The following table sets forth the method of evaluation, by class of loan:

	Residential First Mortgage (1)	Home Equity	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)							
<b>September 30, 2019</b>							
<b>Loans held-for-investment (2)</b>							
Individually evaluated	\$ 33	\$ 21	\$ 1	\$ —	\$ —	\$ —	\$ 55
Collectively evaluated	3,217	961	692	2,697	1,701	3,215	12,483
Total loans	<u>\$ 3,250</u>	<u>\$ 982</u>	<u>\$ 693</u>	<u>\$ 2,697</u>	<u>\$ 1,701</u>	<u>\$ 3,215</u>	<u>\$ 12,538</u>
<b>Allowance for loan losses (2)</b>							
Individually evaluated	\$ 5	\$ 8	\$ 1	\$ —	\$ —	\$ —	\$ 14
Collectively evaluated	23	8	5	33	22	5	96
Total allowance for loan losses	<u>\$ 28</u>	<u>\$ 16</u>	<u>\$ 6</u>	<u>\$ 33</u>	<u>\$ 22</u>	<u>\$ 5</u>	<u>\$ 110</u>
<b>December 31, 2018</b>							
<b>Loans held-for-investment (2)</b>							
Individually evaluated	\$ 32	\$ 23	\$ —	\$ —	\$ —	\$ —	\$ 55
Collectively evaluated	2,959	706	314	2,152	1,433	1,459	9,023
Total loans	<u>\$ 2,991</u>	<u>\$ 729</u>	<u>\$ 314</u>	<u>\$ 2,152</u>	<u>\$ 1,433</u>	<u>\$ 1,459</u>	<u>\$ 9,078</u>
<b>Allowance for loan losses (2)</b>							
Individually evaluated	\$ 4	\$ 7	\$ —	\$ —	\$ —	\$ —	\$ 11
Collectively evaluated	34	8	3	48	18	6	117
Total allowance for loan losses	<u>\$ 38</u>	<u>\$ 15</u>	<u>\$ 3</u>	<u>\$ 48</u>	<u>\$ 18</u>	<u>\$ 6</u>	<u>\$ 128</u>

(1) Includes allowance related to loans with government guarantees.

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

Loans are considered to be past due when any payment of principal or interest is 30 days past the scheduled payment date. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank.

We cease the accrual of interest on all classes of consumer and commercial loans upon the earlier of, becoming 90 days past due, or when doubt exists as to the ultimate collection of principal or interest (classified as nonaccrual or nonperforming loans). When a loan is placed on nonaccrual status, the accrued interest income is reversed and the loan may only return to accrual status when principal and interest become current and are anticipated to be fully collectible.

The following table sets forth the LHFI aging analysis of past due and current loans:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 Days or Greater Past Due (1)</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total LHFI</u>
	(Dollars in millions)					
<b>September 30, 2019</b>						
<b>Consumer loans</b>						
Residential first mortgage	\$ 6	\$ 1	\$ 22	\$ 29	\$ 3,229	\$ 3,258
Home equity	1	1	3	5	980	985
Other	2	1	1	4	689	693
Total consumer loans	9	3	26	38	4,898	4,936
<b>Commercial loans</b>						
Commercial real estate	—	—	—	—	2,697	2,697
Commercial and industrial (1)	—	—	—	—	1,700	1,700
Warehouse lending	—	—	—	—	3,215	3,215
Total commercial loans	—	—	—	—	7,612	7,612
Total loans (2)	<u>\$ 9</u>	<u>\$ 3</u>	<u>\$ 26</u>	<u>\$ 38</u>	<u>\$ 12,510</u>	<u>\$ 12,548</u>
<b>December 31, 2018</b>						
<b>Consumer loans</b>						
Residential first mortgage	\$ 4	\$ 2	\$ 19	\$ 25	\$ 2,974	\$ 2,999
Home Equity	1	—	3	4	727	731
Other	—	—	—	—	314	314
Total consumer loans	5	2	22	29	4,015	4,044
<b>Commercial loans</b>						
Commercial real estate	—	—	—	—	2,152	2,152
Commercial and industrial	—	—	—	—	1,433	1,433
Warehouse lending	—	—	—	—	1,459	1,459
Total commercial loans	—	—	—	—	5,044	5,044
Total loans (2)	<u>\$ 5</u>	<u>\$ 2</u>	<u>\$ 22</u>	<u>\$ 29</u>	<u>\$ 9,059</u>	<u>\$ 9,088</u>

(1) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans.

(2) Includes \$4 million and \$3 million of past due loans accounted for under the fair value option for September 30, 2019 and December 31, 2018, respectively.

Interest income is recognized on nonaccrual loans using a cash basis method. Interest that would have been accrued on impaired loans was less than \$1 million and \$1 million during the three and nine months ended September 30, 2019 and September 30, 2018, respectively. At September 30, 2019 and December 31, 2018, we had no loans 90 days past due and still accruing interest.

### Troubled Debt Restructurings

We may modify certain loans in both our consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. Troubled debt restructurings ("TDRs") are modified loans in which a borrower demonstrates financial difficulties and for which a concession has been granted as a result. Nonperforming TDRs are included in nonaccrual loans. TDRs remain in nonperforming status until a borrower has made payments and is current for at least six consecutive months. Performing TDRs are not considered to be nonaccrual so long as we believe that all contractual principal and interest due under the restructured terms will be collected. Performing and nonperforming TDRs remain impaired as interest and principal will not be received in accordance with the original contractual terms of the loan agreement. Refer to Note 1-Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2018 for a description of the methodology used to determine TDRs.

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. We measure impairments using a discounted cash flow method for performing TDRs and measure impairment based on collateral values for nonperforming TDRs.

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

	TDRs		
	Performing	Nonperforming	Total
(Dollars in millions)			
<b>September 30, 2019</b>			
<b>Consumer loans</b>			
Residential first mortgage	\$ 20	\$ 8	\$ 28
Home equity	19	2	21
Total TDRs (1)(2)	<u>\$ 39</u>	<u>\$ 10</u>	<u>\$ 49</u>
<b>December 31, 2018</b>			
<b>Consumer loans</b>			
Residential first mortgage	\$ 22	\$ 8	\$ 30
Home Equity	22	2	24
Total TDRs (1)(2)	<u>\$ 44</u>	<u>\$ 10</u>	<u>\$ 54</u>

(1) The ALLL on TDR loans totaled \$8 million and \$10 million at September 30, 2019 and December 31, 2018, respectively.

(2) Includes \$3 million and \$3 million of TDR loans accounted for under the fair value option at September 30, 2019 and December 31, 2018, respectively.

The following table provides a summary of newly modified TDRs:

	New TDRs			
	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase in Allowance at Modification
(Dollars in millions)				
<b>Three Months Ended September 30, 2019</b>				
Residential first mortgages	\$ 4	\$ 1	\$ 1	\$ —
Home equity (2)(3)	—	\$ —	\$ —	\$ —
Total TDR loans	<u>\$ 4</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ —</u>
<b>Three Months Ended September 30, 2018</b>				
Residential first mortgages	\$ 2	\$ —	\$ —	\$ —
Home equity (2)(3)	6	1	1	—
Total TDR loans	<u>\$ 8</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ —</u>
<b>Nine Months Ended September 30, 2019</b>				
Residential first mortgages	\$ 6	\$ 1	\$ 1	\$ —
Home equity (2)(3)	4	1	1	—
Total TDR loans	<u>\$ 10</u>	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ —</u>
<b>Nine Months Ended September 30, 2018</b>				
Residential first mortgages	\$ 13	\$ 2	\$ 2	\$ —
Home equity (2)(3)	14	1	1	—
Total TDR loans	<u>\$ 27</u>	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ —</u>

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

(2) Home equity post-modification UPB reflects write downs.

(3) Includes loans carried at the fair value option.

There were no residential first mortgage loans modified in the previous 12 months that subsequently defaulted during the three and nine months ended September 30, 2019 and September 30, 2018. All TDR classes within the consumer and commercial portfolios are considered subsequently defaulted when they are greater than 90 days past due within 12 months of the restructuring date.

## Impaired Loans

The following table presents individually evaluated impaired loans and the associated allowance:

	September 30, 2019			December 31, 2018		
	Recorded Investment	Net Unpaid Principal Balance	Related Allowance	Recorded Investment	Net Unpaid Principal Balance	Related Allowance
(Dollars in millions)						
<b>With no related allowance recorded</b>						
<b>Consumer loans</b>						
Residential first mortgage	\$ 17	\$ 21	\$ —	\$ 13	\$ 16	\$ —
Home equity	1	5	—	1	4	—
Other consumer	—	1	—	—	—	—
Total loans with no related allowance recorded	<u>\$ 18</u>	<u>\$ 27</u>	<u>\$ —</u>	<u>\$ 14</u>	<u>\$ 20</u>	<u>\$ —</u>
<b>With an allowance recorded</b>						
<b>Consumer loans</b>						
Residential first mortgage	\$ 16	\$ 16	\$ 3	\$ 19	\$ 20	\$ 4
Home equity	19	19	6	22	23	7
Other consumer	1	1	1	—	—	—
Total loans with an allowance recorded	<u>\$ 36</u>	<u>\$ 36</u>	<u>\$ 10</u>	<u>\$ 41</u>	<u>\$ 43</u>	<u>\$ 11</u>
<b>Total Impaired loans</b>						
<b>Consumer Loans</b>						
Residential first mortgage	\$ 33	\$ 37	\$ 3	\$ 32	\$ 36	\$ 4
Home equity	20	24	6	23	27	7
Other consumer	1	2	1	—	—	—
<b>Commercial loans</b>						
Commercial and industrial	—	—	—	—	—	—
Total impaired loans	<u>\$ 54</u>	<u>\$ 63</u>	<u>\$ 10</u>	<u>\$ 55</u>	<u>\$ 63</u>	<u>\$ 11</u>

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019		2018		2019		2018	
	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)								
<b>Consumer loans</b>								
Residential first mortgage	\$ 46	\$ —	\$ 34	\$ 1	\$ 38	\$ —	\$ 34	\$ 1
Home equity	7	—	24	—	17	—	25	1
Other consumer	1	—	—	—	1	—	—	—
Total impaired consumer loans	<u>54</u>	<u>—</u>	<u>58</u>	<u>1</u>	<u>56</u>	<u>—</u>	<u>59</u>	<u>2</u>
<b>Commercial loans</b>								
Commercial real estate	—	—	—	—	—	—	—	—
Commercial and industrial	25	—	—	—	20	—	2	—
Warehouse	—	—	—	—	—	—	—	—
Total impaired commercial loans	<u>25</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>20</u>	<u>—</u>	<u>2</u>	<u>—</u>
Total impaired loans	<u>\$ 79</u>	<u>\$ —</u>	<u>\$ 58</u>	<u>\$ 1</u>	<u>\$ 76</u>	<u>\$ —</u>	<u>\$ 61</u>	<u>\$ 2</u>



## Credit Quality

We utilize an internal risk rating system which is applied to all consumer and commercial loans. Descriptions of our 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 full collection or liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. For home equity loans and other consumer loans, we evaluate credit quality based on the aging and status of payment activity and any other known credit characteristics that call into question full repayment of the asset. Substandard loans may be placed on either accrual or non-accrual status.

*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. Due to the high probability of loss, doubtful assets are placed on non-accrual.

*Loss.* An asset classified as loss is considered uncollectible and of such little value that the continuance as a bankable asset is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but, rather that it is not practical or desirable to defer writing off the asset even though partial recovery may be affected in the future.

### *Consumer Loans*

Consumer loans consist of open and closed-end loans extended to individuals for household, family, and other personal expenditures, and includes consumer loans, and 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.

In accordance with regulatory guidance, we assign 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 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, 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 results in the final rating for the borrowing relationship.

The following table presents the credit quality of our LHFI portfolio:

	September 30, 2019				
	Pass	Watch	Special Mention	Substandard	Total Loans
(Dollars in millions)					
<b>Consumer Loans</b>					
Residential first mortgage	\$ 3,210	\$ 25	\$ —	\$ 23	\$ 3,258
Home equity	962	20	—	3	985
Other consumer	691	1	—	1	693
Total consumer loans	<u>\$ 4,863</u>	<u>\$ 46</u>	<u>\$ —</u>	<u>\$ 27</u>	<u>\$ 4,936</u>
<b>Commercial Loans</b>					
Commercial real estate	\$ 2,655	\$ 33	\$ 4	\$ 5	\$ 2,697
Commercial and industrial	1,624	44	27	5	1,700
Warehouse	3,033	165	17	—	3,215
Total commercial loans	<u>\$ 7,312</u>	<u>\$ 242</u>	<u>\$ 48</u>	<u>\$ 10</u>	<u>\$ 7,612</u>
<b>December 31, 2018</b>					
	Pass	Watch	Special Mention	Substandard	Total Loans
(Dollars in millions)					
<b>Consumer Loans</b>					
Residential first mortgage	\$ 2,952	\$ 28	\$ —	\$ 19	\$ 2,999
Home equity	705	23	—	3	731
Other consumer	314	—	—	—	314
Total consumer loans	<u>\$ 3,971</u>	<u>\$ 51</u>	<u>\$ —</u>	<u>\$ 22</u>	<u>\$ 4,044</u>
<b>Commercial Loans</b>					
Commercial real estate	\$ 2,132	\$ 14	\$ 5	\$ 1	\$ 2,152
Commercial and industrial	1,351	53	29	—	1,433
Warehouse	1,324	120	15	—	1,459
Total commercial loans	<u>\$ 4,807</u>	<u>\$ 187</u>	<u>\$ 49</u>	<u>\$ 1</u>	<u>\$ 5,044</u>

#### Note 5 - Loans with Government Guarantees

Substantially all loans with government guarantees are insured or guaranteed by the FHA or the U.S. Department of Veterans Affairs. FHA 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 or the U.S. Department of Veterans Affairs until claimed. Certain loans within our portfolio may be subject to indemnifications and insurance limits which expose us to limited credit risk. We have reserved for these risks within other assets and as a component of our ALLL on residential first mortgages.

Repossessed assets and the associated claims related to government guaranteed loans are recorded in other assets and totaled \$43 million and \$50 million, at September 30, 2019 and December 31, 2018, respectively.

#### Note 6 - Variable Interest Entities

We have no consolidated VIEs as of September 30, 2019 and December 31, 2018.

In connection with our securitization activities, we have retained a five percent interest in the investment securities of certain trusts ("other MBS") and are contracted as the servicer of the underlying loans, compensated based on market rates, which constitutes a continuing involvement in these trusts. Although we have a variable interest in these securitization trusts, we are not their primary beneficiary due to the relative size of our investment in comparison to the total amount of securities issued by the VIE and our inability to direct activities that most significantly impact the VIE's economic performance. As a result, we have not consolidated the assets and liabilities of the VIE in our Consolidated Statements of Financial Condition. The Bank's maximum exposure to loss is limited to our investment in the VIE, as well as the standard representations and warranties made in conjunction with the loan transfer. See Note 16 - Fair Value Measurements, for additional information.



## Note 7 - Mortgage Servicing Rights

We have investments in MSR that result from the sale of loans to the secondary market for which we retain the servicing. We account for MSR at their fair value. A primary risk associated with MSR is the potential reduction in fair 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. We utilize derivatives as economic hedges to offset changes in the fair value of the MSR resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. There is also a risk of valuation decline due to higher than expected increases in default rates, which we do not believe can be effectively managed using derivatives. For further information regarding the derivative instruments utilized to manage our MSR risks, see Note 8 - Derivative Financial Instruments.

Changes in the fair value of residential first mortgage MSR were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
Balance at beginning of period	\$ 316	\$ 257	\$ 290	\$ 291
Additions from loans sold with servicing retained	39	100	203	283
Reductions from sales	(12)	(51)	(57)	(273)
Changes in fair value due to (1):				
Decrease in MSR fair value due to pay-offs, pay-downs, run-off, model changes, and other	(30)	(3)	(60)	(12)
Changes in estimates of fair value due to interest rate risk (2)	(28)	10	(91)	24
Fair value of MSR at end of period	\$ 285	\$ 313	\$ 285	\$ 313

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

(2) Represents estimated MSR value change resulting primarily from market-driven changes which we manage through the use of derivatives.

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

	September 30, 2019			December 31, 2018		
	Actual	Fair value		Actual	Fair value	
		10% adverse change	20% adverse change		10% adverse change	20% adverse change
	(Dollars in millions)					
Option adjusted spread	5.41%	\$ 280	\$ 276	5.42%	\$ 284	\$ 280
Constant prepayment rate	11.24%	265	248	9.57%	278	268
Weighted average cost to service per loan	\$ 84.62	282	279	\$ 85.57	286	283

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 constant. In practice, a change in one assumption generally impacts other assumptions, which may either magnify or counteract the effect of the change. For further information on the fair value of MSR, see Note 16 - Fair Value Measurements.

*Contractual servicing and subservicing fees.* Contractual servicing and subservicing fees, including late fees and other ancillary income are presented below. Contractual servicing fees are included within net return on mortgage servicing rights 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 on subserviced loans, net of third party subservicing costs.

The following table summarizes income and fees associated with owned mortgage servicing rights:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(Dollars in millions)				
<b>Net return on mortgage servicing rights</b>				
Servicing fees, ancillary income and late fees (1)	\$ 25	\$ 17	\$ 70	\$ 46
Decrease in MSR fair value due to pay-offs, pay-downs, run-off, model changes, and other	(30)	(3)	(60)	(12)
Changes in estimates of fair value due to interest rate risk	(28)	10	(91)	24
Gain (loss) on MSR derivatives (2)	31	(11)	92	(27)
Net transaction costs on sale of MSR assets	—	—	(2)	(5)
<b>Total return included in net return on mortgage servicing rights</b>	<b>\$ (2)</b>	<b>\$ 13</b>	<b>\$ 9</b>	<b>\$ 26</b>

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

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

The following table summarizes income and fees associated with our mortgage loans subserviced for others:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(Dollars in millions)				
<b>Loan administration income on mortgage loans subserviced</b>				
Servicing fees and late fees (1)	\$ 27	\$ 14	\$ 77	\$ 36
Charges on subserviced custodial balances (2)	(20)	(9)	(50)	(20)
Other servicing charges	(2)	—	(5)	(1)
<b>Total income on mortgage loans subserviced, included in loan administration</b>	<b>\$ 5</b>	<b>\$ 5</b>	<b>\$ 22</b>	<b>\$ 15</b>

(1) Servicing fees are recorded on an accrual basis. Late fees are recorded on cash basis.

(2) Charges on subserviced custodial balances represent interest due to MSR owner.

## 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. Our policy is to present its derivative assets and derivative liabilities on the Consolidated Statement of Financial Condition on a gross basis, even when provisions allowing for set-off are in place. However, for derivative contracts cleared through certain central clearing parties, variation margin payments are recognized as settlements. We are exposed to non-performance risk by the counterparties to our various derivative financial instruments. A majority of our derivatives are centrally cleared through a Central Counterparty Clearing House or consist of residential mortgage interest rate lock commitments further limiting our exposure to non-performance risk. We believe that the non-performance risk inherent in our remaining derivative contracts is minimal based on credit standards and the collateral provisions of the derivative agreements.

*Derivatives not designated as hedging instruments:* We maintain 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. We also enter 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 LHFS 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 Operations.

*Derivatives designated as hedging instruments:* We have designated certain interest rate swaps as fair value hedges of fixed rate FHLB advances and investment securities available for sale using the last-of-layer method. Derivatives that are designated in hedging relationships are assessed for effectiveness using regression analysis at inception and qualitatively thereafter, unless regression analysis is deemed necessary. All designated hedge relationships were and are expected to be highly effective as of September 30, 2019. Cash flows and the profit impact associated with designated hedges are reported in the same category as the underlying hedged item.

The following table presents the notional amount, estimated fair value and maturity of our derivative financial instruments:

	<b>September 30, 2019 (1)</b>		
	<b>Notional Amount</b>	<b>Fair Value (2)</b>	<b>Expiration Dates</b>
	(Dollars in millions)		
<b>Derivatives in fair value hedge relationships:</b>			
<b>Assets</b>			
Interest rate swap on AFS Securities	\$ 100	\$ —	2022
<b>Liabilities</b>			
Interest rate swaps on AFS securities	\$ 200	\$ —	2020
<b>Derivatives not designated as hedging instruments:</b>			
<b>Assets</b>			
Futures	\$ 224	\$ —	2019-2023
Mortgage-backed securities forwards	3,658	11	2019
Rate lock commitments	5,036	51	2019-2020
Interest rate swaps and swaptions	737	34	2019-2029
Total derivative assets	<u>\$ 9,655</u>	<u>\$ 96</u>	
<b>Liabilities</b>			
Futures	\$ 242	\$ —	2020-2023
Mortgage-backed securities forwards	4,699	11	2019
Rate lock commitments	275	1	2019-2020
Interest rate swaps	1,628	5	2019-2049
Total derivative liabilities	<u>\$ 6,844</u>	<u>\$ 17</u>	

- (1) Variation margin pledged to or received from a Central Counterparty Clearing House is considered settlement of the derivative position for accounting purposes.  
(2) Derivative assets and liabilities are included in other assets and other liabilities on the Consolidated Statements of Financial Condition, respectively.

	<b>December 31, 2018 (1)</b>		
	<b>Notional Amount</b>	<b>Fair Value (2)</b>	<b>Expiration Dates</b>
	(Dollars in millions)		
<b>Derivatives in fair value hedge relationships:</b>			
<b>Assets</b>			
Interest rate swaps on CDs	\$ 20	\$ —	2019
<b>Liabilities</b>			
Interest rate swaps on CDs	\$ 10	\$ —	2019
<b>Derivatives not designated as hedging instruments:</b>			
<b>Assets</b>			
Futures	\$ 248	\$ —	2019-2023
Mortgage backed securities forwards	362	4	2019
Rate lock commitments	2,221	20	2019
Interest rate swaps and swaptions	1,662	23	2019-2049
Total derivative assets	<u>\$ 4,493</u>	<u>\$ 47</u>	
<b>Liabilities</b>			
Futures	\$ 1,513	\$ 1	2019-2023
Mortgage backed securities forwards	4,625	31	2019
Rate lock commitments	45	—	2019
Interest rate swaps	755	7	2019-2028
Total derivative liabilities	<u>\$ 6,938</u>	<u>\$ 39</u>	

- (1) Variation margin pledged to or received from a Central Counterparty Clearing House to cover the prior day's fair value of open positions, is considered settlement of the derivative position for accounting purposes.  
(2) Derivative assets and liabilities are included in other assets and other liabilities on the Consolidated Statements of Financial Condition, respectively.



The following tables present the derivatives subject to a master netting arrangement, including the cash pledged as collateral:

	Gross Amount	Gross Amounts Netted in the Statements of Financial Condition	Net Amount Presented in the Statements of Financial Condition	Gross Amounts Not Offset in the Statements of Financial Condition	
				Financial Instruments	Cash Collateral
(Dollars in millions)					
<b>September 30, 2019</b>					
<b>Derivatives not designated as hedging instruments:</b>					
<b>Assets</b>					
Mortgage backed securities forwards	\$ 11	\$ —	\$ 11	\$ —	\$ 3
Interest rate swaps and swaptions (1)	34	—	34	—	—
Total derivative assets	<u>\$ 45</u>	<u>\$ —</u>	<u>\$ 45</u>	<u>\$ —</u>	<u>\$ 3</u>
<b>Liabilities</b>					
Futures	\$ —	\$ —	\$ —	\$ —	\$ —
Mortgage backed securities forwards	11	—	11	—	16
Interest rate swaps (1)	5	—	5	—	41
Total derivative liabilities	<u>\$ 16</u>	<u>\$ —</u>	<u>\$ 16</u>	<u>\$ —</u>	<u>\$ 57</u>

**December 31, 2018**

**Derivatives not designated as hedging instruments:**

<b>Assets</b>					
Mortgage-backed securities forwards	\$ 4	\$ —	\$ 4	\$ —	\$ —
Interest rate swaps and swaptions (1)	23	—	23	—	14
Total derivative assets	<u>\$ 27</u>	<u>\$ —</u>	<u>\$ 27</u>	<u>\$ —</u>	<u>\$ 14</u>
<b>Liabilities</b>					
Futures	\$ 1	\$ —	\$ 1	\$ —	\$ 1
Mortgage-backed securities forwards	31	—	31	—	29
Interest rate swaps (1)	7	—	7	—	23
Total derivative liabilities	<u>\$ 39</u>	<u>\$ —</u>	<u>\$ 39</u>	<u>\$ —</u>	<u>\$ 53</u>

(1) Variation margin pledged to or received from a Central Counterparty Clearing House to cover the prior day's fair value of open positions, is considered settlement of the derivative position for accounting purposes.

The fair value basis adjustment on our hedged AFS securities is included in investment securities available for sale on our Consolidated Statements of Financial Condition. The carrying amount of our hedged securities was \$293 million at September 30, 2019 and zero at December 31, 2018 of which \$2 million and zero respectively, was due to the fair value hedge relationship. The closed portfolio of AFS securities designated in this last layer method hedge was \$295 million (amortized cost of \$292 million) at September 30, 2019 and zero at December 31, 2018 of which we have designated \$100 million.

The carrying amount of hedged FHLB advances was \$200 million at September 30, 2019 and zero at December 31, 2018. The fair value hedge relationship had a de minimis impact at September 30, 2019 and zero at December 31, 2018.

At September 30, 2019, we pledged a total of \$57 million related to derivative financial instruments, consisting of \$23 million of cash collateral on derivative liabilities and \$34 million of maintenance margin on centrally cleared derivatives and had an obligation to return cash of \$3 million on derivative assets at September 30, 2019. We pledged a total of \$53 million related to derivative financial instruments, consisting of \$30 million of cash collateral on derivatives and \$23 million of maintenance margin on centrally cleared derivatives and had an obligation to return cash of \$14 million on derivative assets at December 31, 2018. Within the Consolidated Statements of Financial Condition, the collateral related to derivative activity is included in other assets and other liabilities and the cash pledged as maintenance margin is restricted and included in other assets.



The following table presents the net gain (loss) recognized on designated instruments, net of the impact of offsetting positions:

	Amount Recorded in Net Interest Income (1)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
<b>Gain on cash flow hedging relationships in interest contracts:</b>				
Amount of loss reclassified from AOCI into income	\$ —	\$ 1	\$ —	\$ —
Total loss on hedges	\$ —	\$ 1	\$ —	\$ —

(1) The loss on fair value hedging relationships in interest contracts was de minimis for the three and nine months ended September 30, 2019, and the three and nine months ended September 30, 2018. During the second quarter of 2018, we de-designated all of our remaining cash flow hedge relationships.

The following table presents net gain (loss) recognized in income on derivative instruments, net of the impact of offsetting positions:

	Location of Gain (Loss)	Three Months Ended September 30,		Nine Months Ended September 30,	
		2019	2018	2019	2018
		(Dollars in millions)			
<b>Derivatives not designated as hedging instruments:</b>					
Futures	Net return on mortgage servicing rights	\$ —	\$ (1)	\$ (2)	\$ (4)
Interest rate swaps and swaptions	Net return on mortgage servicing rights	28	(8)	71	(16)
Mortgage-backed securities forwards	Net return on mortgage servicing rights	3	(2)	23	(6)
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	27	21	57	12
Forward commitments	Other noninterest income	—	—	2	—
Interest rate swaps (1)	Other noninterest income	2	1	3	2
Total derivative gain (loss)		\$ 60	\$ 11	\$ 154	\$ (12)

(1) Includes customer-initiated commercial interest rate swaps.

## Note 9 - Borrowings

### Federal Home Loan Bank Advances

The following is a breakdown of our FHLB advances outstanding:

	September 30, 2019		December 31, 2018	
	Amount	Rate	Amount	Rate
	(Dollars in millions)			
Short-term fixed rate term advances	\$ 2,325	1.89%	\$ 2,993	2.52%
Other short-term borrowings	4	2.32%	251	2.87%
Total short-term Federal Home Loan Bank advances and other borrowings	2,329		3,244	
Long-term Federal Home Loan Bank fixed rate advances (1)	650	1.45%	150	1.53%
Total Federal Home Loan Bank advances	\$ 2,979		\$ 3,394	

(1) Includes the current portion of fixed rate advances of \$0 and \$50 million at September 30, 2019 and December 31, 2018.

The following table contains detailed information on our FHLB advances and other borrowings:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
Maximum outstanding at any month end	\$ 2,979	\$ 5,085	\$ 3,391	\$ 5,740
Average outstanding balance	2,446	4,745	2,769	4,996
Average remaining borrowing capacity	4,957	2,165	3,932	1,830
Weighted average interest rate	2.10%	2.08%	2.33%	1.88%



The following table outlines the maturity dates of our FHLB advances and other borrowings:

	<b>September 30, 2019</b>
	(Dollars in millions)
2019	\$ 2,329
2020	—
2021	—
2022	—
Thereafter	650
Total	<u>\$ 2,979</u>

### Parent Company Senior Notes and Trust Preferred Securities

The following table presents long-term debt, net of debt issuance costs:

	<u>September 30, 2019</u>		<u>December 31, 2018</u>	
	<u>Amount</u>	<u>Interest Rate</u>	<u>Amount</u>	<u>Interest Rate</u>
	(Dollars in millions)			
<b>Senior Notes</b>				
Senior notes, matures 2021	\$ 249	6.125%	\$ 248	6.125%
<b>Trust Preferred Securities</b>				
Floating Three Month LIBOR Plus:				
3.25%, matures 2032	\$ 26	5.36%	\$ 26	6.07%
3.25%, matures 2033	26	5.55%	26	5.69%
3.25%, matures 2033	26	5.57%	26	6.05%
2.00%, matures 2035	26	4.30%	26	4.44%
2.00%, matures 2035	26	4.30%	26	4.44%
1.75%, matures 2035	51	3.87%	51	4.54%
1.50%, matures 2035	25	3.80%	25	3.94%
1.45%, matures 2037	25	3.57%	25	4.24%
2.50%, matures 2037	16	4.62%	16	5.29%
Total Trust Preferred Securities	<u>247</u>		<u>247</u>	
Total other long-term debt	<u>\$ 496</u>		<u>\$ 495</u>	

### Senior Notes

On July 11, 2016, we issued \$250 million of senior notes (“Senior Notes”) which mature on July 15, 2021. Prior to June 15, 2021, we may redeem some or all of the Senior Notes at a redemption price equal to the greater of 100 percent of the aggregate principal amount of the notes to be redeemed or the sum of the present values of the remaining scheduled payments discounted to the redemption date on a semi-annual basis using a discount rate equal to the Treasury Rate plus 0.50 percent, plus, in each case accrued and unpaid interest.

### Trust Preferred Securities

We sponsor nine trust subsidiaries, which issued preferred stock to third party investors. We issued junior subordinated debt securities to those trusts, which we have included in long-term debt. The junior subordinated debt securities are the sole assets of those trusts. The trust preferred securities are callable by us at any time. Interest is payable quarterly; however, we may defer interest payments for up to 20 quarters without default or penalty. As of September 30, 2019, we had no deferred interest.

## Note 10 - Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(Dollars in millions)				
<b>Investment securities</b>				
Beginning balance	\$ (8)	\$ (56)	\$ (47)	\$ (18)
Unrealized gain (loss)	18	(11)	61	(55)
Less: Tax provision (benefit)	5	(2)	15	(13)
Net unrealized gain (loss)	13	(9)	46	(42)
Reclassifications out of AOCI (1)	—	—	7	—
Less: Tax provision	—	—	1	—
Net unrealized gain reclassified out of AOCI	—	—	6	—
Reclassification of certain income tax effects (2)	—	—	—	(5)
Other comprehensive income (loss), net of tax	13	(9)	52	(47)
Ending balance	\$ 5	\$ (65)	\$ 5	\$ (65)
<b>Cash Flow Hedges</b>				
Beginning balance	\$ —	\$ 24	\$ —	\$ 2
Unrealized gain	—	—	—	28
Less: Tax provision	—	—	—	7
Net unrealized gain	—	—	—	21
Reclassifications out of AOCI (3)	—	(1)	—	—
Net unrealized gain reclassified out of AOCI	—	(1)	—	—
Other comprehensive income, net of tax	—	(1)	—	21
Ending balance	\$ —	\$ 23	\$ —	\$ 23

- (1) Reclassifications are reported in noninterest income on the Consolidated Statements of Operations.
- (2) Income tax effects of the Tax Cuts and Jobs Act are reclassified from AOCI to retained earnings due to early adoption of ASU 2018-02.
- (3) Reclassifications are reported in interest expense on the Consolidated Statements of Operations.

## Note 11 - Earnings Per Share

Basic earnings per share, excluding dilution, is computed by dividing earnings applicable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects 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 our earnings.

The following table sets forth the computation of basic and diluted earnings per share of common stock:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(Dollars in millions, except share data)				
Net income	\$ 63	\$ 48	\$ 160	\$ 133
<b>Weighted Average Shares</b>				
Weighted average common shares outstanding	56,484,499	57,600,360	56,607,944	57,483,802
<b>Effect of dilutive securities</b>				
Stock-based awards	626,297	732,238	644,596	818,118
Weighted average diluted common shares	57,110,796	58,332,598	57,252,540	58,301,920
<b>Earnings per common share</b>				
Basic earnings per common share	\$ 1.12	\$ 0.84	\$ 2.83	\$ 2.32
<b>Effect of dilutive securities</b>				
Stock-based awards	(0.01)	(0.01)	(0.03)	(0.04)
<b>Diluted earnings per common share</b>	\$ 1.11	\$ 0.83	\$ 2.80	\$ 2.28



## Note 12 - Stock-Based Compensation

We had stock-based compensation expense of \$4 million and \$9 million for the three and nine months ended September 30, 2019 and \$4 million and \$8 million for the three and nine months ended September 30, 2018, respectively.

### Restricted Stock and Restricted Stock Units

The following table summarizes restricted stock and restricted stock units activity:

	Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
	Shares	Weighted — Average Grant-Date Fair Value per Share	Shares	Weighted — Average Grant-Date Fair Value per Share
<b>Restricted Stock and Restricted Stock Units</b>				
Non-vested balance at beginning of period	1,612,174	\$ 29.11	1,620,568	\$ 27.27
Granted	—	—	325,209	31.88
Vested	(2,719)	33.64	(227,818)	23.91
Canceled and forfeited	(18,140)	32.48	(126,644)	22.58
Non-vested balance at end of period	1,591,315	\$ 29.06	1,591,315	\$ 29.06

### 2017 Employee Stock Purchase Plan

A total of 800,000 shares of the Company's common stock were reserved and authorized for issuance for purchase under the Employee Stock Purchase Plan (ESPP) of which 553,547 remain as of September 30, 2019. There were 24,373 and 84,036 shares issued under the ESPP during the three and nine months ended September 30, 2019 and the associated compensation expense was de minimis.

## Note 13 - Income Taxes

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

The following table presents our provision for income tax and effective tax provision rate:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Dollars in millions)			
Provision for income taxes	\$ 15	\$ 12	\$ 37	\$ 33
Effective tax provision rate	18.4%	20.0%	18.6%	20.1%

We believe that it is unlikely that our unrecognized tax benefits will change by a material amount during the next 12 months. We recognize interest and penalties related to unrecognized tax benefits in provision for income taxes.

## Note 14 - Regulatory Matters

### Regulatory Capital

We, along with 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. 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 included transition provisions through 2018. In preparation for the new capital simplification rules, the Basel III implementation phase-in has been halted, as the agencies issued a final rule that will maintain the capital rules' 2017 transition provisions for several regulatory capital deductions and certain other requirements that are subject to multi-year phase-in schedules in the regulatory capital rules.

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. We, along with the Bank, are considered "well-capitalized" at both September 30, 2019 and December 31, 2018.

The following tables present the regulatory capital ratios as of the dates indicated:

Flagstar Bancorp	Actual		For Capital Adequacy Purposes		Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in millions)						
<b>September 30, 2019</b>						
Tier 1 leverage (to adjusted avg. total assets)	\$ 1,668	7.98%	\$ 836	4.0%	\$ 1,045	5.0%
Common equity Tier 1 capital (to RWA)	1,428	9.25%	694	4.5%	1,003	6.5%
Tier 1 capital (to RWA)	1,668	10.81%	926	6.0%	1,235	8.0%
Total capital (to RWA)	1,781	11.54%	1,235	8.0%	1,543	10.0%
<b>December 31, 2018</b>						
Tier 1 leverage (to adjusted avg. total assets)	\$ 1,505	8.29%	\$ 726	4.0%	\$ 908	5.0%
Common equity Tier 1 capital (to RWA)	1,265	10.54%	540	4.5%	780	6.5%
Tier 1 capital (to RWA)	\$ 1,505	12.54%	\$ 720	6.0%	\$ 960	8.0%
Total capital (to RWA)	\$ 1,637	13.63%	\$ 960	8.0%	\$ 1,201	10.0%

N/A - Not applicable

Flagstar Bank	Actual		For Capital Adequacy Purposes		Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in millions)						
<b>September 30, 2019</b>						
Tier 1 leverage (to adjusted avg. total assets)	\$ 1,747	8.35%	\$ 837	4.0%	\$ 1,046	5.0%
Common equity tier 1 capital (to RWA)	1,747	11.33%	694	4.5%	1,002	6.5%
Tier 1 capital (to RWA)	1,747	11.33%	925	6.0%	1,233	8.0%
Total capital (to RWA)	1,860	12.06%	1,233	8.0%	1,542	10.0%
<b>December 31, 2018</b>						
Tier 1 leverage (to adjusted avg. total assets)	\$ 1,574	8.67%	\$ 726	4.0%	\$ 908	5.0%
Common equity tier 1 capital (to RWA)	1,574	13.12%	540	4.5%	780	6.5%
Tier 1 capital (to RWA)	1,574	13.12%	720	6.0%	960	8.0%
Total capital (to RWA)	1,705	14.21%	960	8.0%	1,200	10.0%

N/A - Not applicable

## Note 15 - Legal Proceedings, Contingencies and Commitments

### Legal Proceedings

We and our 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 practices of the Bank. In the course of such investigations or examinations, the Bank cooperates with such agencies and provides information as requested.

We assess the liabilities and loss contingencies in connection with pending or threatened legal and regulatory proceedings on at least a quarterly basis and establish accruals when we believe 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.

At September 30, 2019, we do 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 will be material to our financial statements, or that the ultimate outcome of these actions will have a material adverse effect on our financial condition, results of operations or cash flows.

#### *DOJ Liability*

On February 24, 2012, the Bank entered into a Settlement Agreement with the DOJ under which we agreed to make future payments totaling \$118 million in annual increments of up to \$25 million upon meeting all of the following conditions which are evaluated quarterly and include: (a) the reversal of the DTA valuation allowance, which occurred at the end of 2013; (b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred"), which occurred in July 2016; and (c) the Bank having a Tier 1 Leverage Capital Ratio of 11 percent or greater as filed in the Call Report with the OCC. At September 30, 2019, the Company had a Tier 1 Leverage Capital Ratio of 8.35 percent.

No payment would be required until six months after the Bank files its Call Report with the OCC first reporting that its Tier 1 Leverage Capital Ratio was 11 percent or greater. If all other conditions were then satisfied, an initial annual payment would be due at that time. The next annual payment is only made if such other conditions continue to be satisfied, otherwise payments are delayed until all such conditions are met. Further, making such a payment must not violate any material banking regulatory requirement, and the OCC must not object in writing.

Consistent with most mid-size banks, our Tier 1 Leverage Capital Ratio is impacted by (a) future dividends from the Bank to Bancorp and (b) continued growth in earning assets at the Bank which could have an impact on the timing of expected cash flows under the Settlement Agreement.

Consistent with our business and regulatory requirements, Flagstar shall seek in good faith to fulfill the conditions, and will not undertake any conduct or fail to take any action the purpose of which is to frustrate or delay our ability to fulfill any of the above conditions.

Additionally, if the Bank and Bancorp become party to a business combination in which the Bank or Bancorp represent less than 33.3 percent of the resulting company's assets, annual payments must commence twelve months after the date of that business combination.

The settlement agreement meets the definition of a financial instrument for which we elected the fair value option. We consider the assumptions a market participant would make to transfer the liability and evaluate the potential ways we might be required to begin making DOJ Liability payments and our estimates of the likelihood of these outcomes, which may change over time. The fair value of the liability is subject to significant uncertainty and is impacted by forecasted estimates of the timing of potential payments some of which are impacted by inputs including estimates of equity, earnings, timing and amount of dividends and growth of the balance sheet and their related impacts on forecasted Tier 1 Leverage Capital Ratio, the likelihood of the Bank or Bancorp being a party to a business combination resulting in terms which would require payments to commence, or any other means by which a payment could be made.

For further information on the fair value of the liability, see Note 16 - Fair Value Measurements.

#### *Other litigation accruals*

Excluding the DOJ Liability, our total accrual for contingent liabilities and settled litigation was \$2 million at September 30, 2019 and December 31, 2018.



## Commitments

The following table is a summary of the contractual amount of significant commitments:

	September 30, 2019	December 31, 2018
	(Dollars in millions)	
<b>Commitments to extend credit</b>		
Mortgage loans interest-rate lock commitments	\$ 5,325	\$ 2,293
Warehouse loan commitments	1,579	2,334
Commercial and industrial commitments	1,034	918
Other commercial commitments	1,907	1,260
HELOC commitments	526	429
Other consumer commitments	227	108
Standby and commercial letters of credit	81	63

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. 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. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us, upon extension of credit is based on management's credit evaluation of the counterparties.

These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the Consolidated Statements of Financial Condition. Our 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. We utilize the same credit policies in making commitments and conditional obligations as we do for balance sheet instruments. The types of credit we extend are as follows:

*Mortgage loan interest-rate lock commitments.* We enter into mortgage interest-rate lock commitments with our customers. These commitments are considered to be derivative instruments and the fair value of these commitments is recorded in the Consolidated Statements of Financial Condition in other assets. For further information, see Note 8 - Derivative Financial Instruments.

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

*Commercial and industrial and other commercial commitments.* 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.

*HELOC commitments.* Commitments to extend, originate or purchase credit are primarily lines of credit to consumers and have specified rates and maturity dates. Many of these commitments also have adverse change clauses, which allow us to cancel the commitment due to deterioration in the borrowers' creditworthiness or a decline in the collateral value.

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

*Standby and commercial letters of credit.* 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. These financial standby letters of credit irrevocably obligate the bank to pay a third party beneficiary when a customer fails to repay an outstanding loan or debt instrument.

We maintain a reserve for the estimate of 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. A reserve balance of \$3 million at both September 30, 2019 and December 31, 2018, is reflected in other liabilities on the Consolidated Statements of Financial Condition.

*Supplemental executive retirement plan with former CEO.* The Company entered into a supplemental executive retirement plan (“SERP”) with a former CEO in 2009. Under the plan, the former CEO was to receive a \$16 million payment in August 2018. The Company fully accrued for the SERP liability during that time period and no SERP payments have been made to the former CEO. Due to the condition of the Company at the time the former CEO’s employment ended, we believe that any payment under the SERP would be deemed to be a “Golden Parachute” payment and, therefore, is subject to certain banking regulations. As a result, we would need to make an application to the regulators to make a payment and certify to certain criteria. The Company does not believe that it can make such a certification. The former CEO has filed a lawsuit to compel us to make that certification and ultimately pay the liability. Final dispensation of the "SERP" is not within our control and the liability of \$16 million at September 30, 2019 may be adjusted as more information is known.

#### **Note 16 - Fair Value Measurements**

We utilize fair value measurements to record or disclose the fair value on certain assets and liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability through an orderly transaction between market participants at the measurement date. The determination of fair values of financial instruments often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation models rely on market-based parameters when available, such as interest rate yield curves or credit spreads. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, our future earnings, interest rates and other relevant inputs. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used.

#### **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 we 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 our 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.

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the financial instruments carried at fair value by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy.

	September 30, 2019			
	Level 1	Level 2	Level 3	Total Fair Value
	(Dollars in millions)			
<b>Investment securities available-for-sale</b>				
Agency - Commercial	\$ —	\$ 969	\$ —	\$ 969
Agency - Residential	—	604	—	604
Municipal obligations	—	31	—	31
Corporate debt obligations	—	64	—	64
Other MBS	—	28	—	28
Certificate of Deposit	—	1	—	1
<b>Loans held-for-sale</b>				
Residential first mortgage loans	—	4,122	—	4,122
Commercial Loan	—	—	—	—
<b>Loans held-for-investment</b>				
Residential first mortgage loans	—	8	—	8
Home equity	—	—	2	2
<b>Mortgage servicing rights</b>	—	—	285	285
<b>Derivative assets</b>				
Rate lock commitments (fallout-adjusted)	—	—	51	51
Mortgage-backed securities forwards	—	11	—	11
Interest rate swaps and swaptions	—	34	—	34
Total assets at fair value	<u>\$ —</u>	<u>\$ 5,872</u>	<u>\$ 338</u>	<u>\$ 6,210</u>
<b>Derivative liabilities</b>				
Rate lock commitments (fallout-adjusted)	\$ —	\$ —	\$ (1)	\$ (1)
Futures	—	—	—	—
Mortgage backed securities forwards	—	(11)	—	(11)
Interest rate swaps	—	(5)	—	(5)
<b>DOJ Liability</b>	—	—	(35)	(35)
<b>Contingent consideration</b>	—	—	(8)	(8)
Total liabilities at fair value	<u>\$ —</u>	<u>\$ (16)</u>	<u>\$ (44)</u>	<u>\$ (60)</u>

	<b>December 31, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>
	(Dollars in millions)			
<b>Investment securities available-for-sale</b>				
Agency - Commercial	\$ —	\$ 1,374	\$ —	\$ 1,374
Agency - Residential	—	662	—	662
Municipal obligations	—	32	—	32
Corporate debt obligations	—	42	—	42
Other MBS	—	32	—	32
<b>Loans held-for-sale</b>				
Residential first mortgage loans	—	3,732	—	3,732
<b>Loans held-for-investment</b>				
Residential first mortgage loans	—	8	—	8
Home equity	—	—	2	2
<b>Mortgage servicing rights</b>	—	—	290	290
<b>Derivative assets</b>				
Rate lock commitments (fallout-adjusted)	—	—	20	20
Mortgage-backed securities forwards	—	4	—	4
Interest rate swaps and swaptions	—	23	—	23
Total assets at fair value	<u>\$ —</u>	<u>\$ 5,909</u>	<u>\$ 312</u>	<u>\$ 6,221</u>
<b>Derivative liabilities</b>				
Futures	\$ —	\$ (1)	\$ —	\$ (1)
Mortgage-backed securities forwards	—	(31)	—	(31)
Interest rate swaps	—	(7)	—	(7)
<b>DOJ Liability</b>	—	—	(60)	(60)
<b>Contingent consideration</b>	—	—	(6)	(6)
Total liabilities at fair value	<u>\$ —</u>	<u>\$ (39)</u>	<u>\$ (66)</u>	<u>\$ (105)</u>

## Fair Value Measurements Using Significant Unobservable Inputs

The following tables include a roll forward of the Consolidated Statements of Financial Condition amounts (including the change in fair value) for financial instruments classified by us within Level 3 of the valuation hierarchy:

	Balance at Beginning of Period	Total Gains (Losses) Recorded in Earnings (1)	Purchases / Originations	Sales	Settlement	Transfers In (Out)	Balance at End of Period
(Dollars in millions)							
<b>Three Months Ended September 30, 2019</b>							
<b>Assets</b>							
Loans held-for-investment							
Home equity	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2
Mortgage servicing rights (2)	316	(58)	39	(12)	—	—	285
Rate lock commitments (net) (2)(3)	50	20	113	—	—	(133)	50
Totals	<u>\$ 368</u>	<u>\$ (38)</u>	<u>\$ 152</u>	<u>\$ (12)</u>	<u>\$ —</u>	<u>\$ (133)</u>	<u>\$ 337</u>
<b>Liabilities</b>							
DOJ Liability	\$ (35)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (35)
Contingent consideration	(7)	(4)	—	—	3	—	(8)
Totals	<u>\$ (42)</u>	<u>\$ (4)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3</u>	<u>\$ —</u>	<u>\$ (43)</u>
<b>Three Months Ended September 30, 2018</b>							
<b>Assets</b>							
Loans held-for-investment							
Home equity	\$ 3	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 3
Mortgage servicing rights (2)	257	7	100	(51)	—	—	313
Rate lock commitments (net) (2)(3)	32	(5)	60	—	—	(68)	19
Totals	<u>\$ 292</u>	<u>\$ 2</u>	<u>\$ 160</u>	<u>\$ (51)</u>	<u>\$ —</u>	<u>\$ (68)</u>	<u>\$ 335</u>
<b>Liabilities</b>							
DOJ Liability	\$ (60)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (60)
Contingent consideration	(18)	3	—	—	4	—	(11)
Totals	<u>\$ (78)</u>	<u>\$ 3</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4</u>	<u>\$ —</u>	<u>\$ (71)</u>

(1) There were no unrealized gains (losses) recorded in OCI during the three months ended September 30, 2019 and 2018.

(2) We utilized swaptions, futures, forward agency and loan sales and interest rate swaps to manage the risk associated with mortgage servicing rights and rate lock commitments. Gains and losses for individual lines do not reflect the effect of our risk management activities related to such Level 3 instruments.

(3) Rate lock commitments are reported on a fallout-adjusted basis. Transfers out of Level 3 represent the settlement value of the commitments that are transferred to LHFS, which are classified as Level 2 assets.

	Balance at Beginning of Period	Total Gains (Losses) Recorded in Earnings (1)	Purchases / Originations	Sales	Settlement	Transfers In (Out)	Balance at End of Period
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(Dollars in millions)

### Nine Months Ended September 30, 2019

#### Assets

Loans held-for-investment							
Home equity	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2
Mortgage servicing rights (2)	290	(151)	203	(57)	—	—	285
Rate lock commitments (net) (2)(3)	20	75	245	—	—	(290)	50
Totals	<u>\$ 312</u>	<u>\$ (76)</u>	<u>\$ 448</u>	<u>\$ (57)</u>	<u>\$ —</u>	<u>\$ (290)</u>	<u>\$ 337</u>

#### Liabilities

DOJ Liability	\$ (60)	\$ 25	\$ —	\$ —	\$ —	\$ —	\$ (35)
Contingent consideration	(6)	(5)	—	—	3	—	(8)
Totals	<u>\$ (66)</u>	<u>\$ 20</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3</u>	<u>\$ —</u>	<u>\$ (43)</u>

### Nine Months Ended September 30, 2018

#### Assets

Loans held-for-investment							
Home equity	\$ 4	\$ —	\$ —	\$ —	\$ (1)	\$ —	\$ 3
Mortgage servicing rights (2)	291	12	283	(273)	—	—	313
Rate lock commitments (net) (2)(3)	24	(37)	191	—	—	(159)	19
Totals	<u>\$ 319</u>	<u>\$ (25)</u>	<u>\$ 474</u>	<u>\$ (273)</u>	<u>\$ (1)</u>	<u>\$ (159)</u>	<u>\$ 335</u>

#### Liabilities

DOJ Liability	\$ (60)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (60)
Contingent consideration	(25)	8	—	—	6	—	(11)
Totals	<u>\$ (85)</u>	<u>\$ 8</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$ (71)</u>

(1) There were no unrealized gains (losses) recorded in OCI during the nine months ended September 30, 2019 and 2018.

(2) We utilized swaptions, futures, forward agency and loan sales and interest rate swaps to manage the risk associated with mortgage servicing rights and rate lock commitments. Gains and losses for individual lines do not reflect the effect of our risk management activities related to such Level 3 instruments.

(3) Rate lock commitments are reported on a fallout-adjusted basis. Transfers out of Level 3 represent the settlement value of the commitments that are transferred to LHFS, which are classified as Level 2 assets.

The following tables present the quantitative information about recurring Level 3 fair value financial instruments and the fair value measurements as of:

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
(Dollars in millions)				
<b>September 30, 2019</b>				
<b>Assets</b>				
Loans held-for-investment				
			Discount rate	7.2% -10.8% (9.0%)
Home equity	\$ 2	Discounted cash flows	Constant prepayment rate	19.3% - 29.0% (24.15%) (1)
			Constant default rate	3.0%-4.4% (3.7%)
			Option adjusted spread	2.6% - 20.6% (5.4%)
Mortgage servicing rights	\$ 285	Discounted cash flows	Constant prepayment rate	0% - 13.5% (11.2%) (1)
			Weighted average cost to service per loan	\$67 - \$95 (\$85)
Rate lock commitments (net)	\$ 50	Consensus pricing	Origination pull-through rate	80.0% - 87.2% (81.9%) (1)
<b>Liabilities</b>				
DOJ Liability	\$ (35)	Discounted cash flows	See description below	See description below
			Beta	0.6 - 1.6 (1.1)
Contingent consideration	\$ (8)	Discounted cash flows	Equity volatility	26.6% - 58.9% (40.0%) (2)

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
(Dollars in millions)				
<b>December 31, 2018</b>				
<b>Assets</b>				
Loans held-for-investment				
			Discount rate	7.2% - 10.8% (9.0%)
Home equity	\$ 2	Discounted cash flows	Constant prepayment rate	13.6% - 20.3% (16.9%) (1)
			Constant default rate	3.0% - 4.6% (3.8%)
			Option adjusted spread	2.1% - 25.9% (5.4%)
Mortgage servicing rights	\$ 290	Discounted cash flows	Constant prepayment rate	0% - 10.7% (9.6%) (1)
			Weighted average cost to service per loan	\$67 - \$95 (\$86)
Rate lock commitments (net)	\$ 20	Consensus pricing	Origination pull-through rate	75.0% - 87.2% (76.8%) (1)
<b>Liabilities</b>				
DOJ Liability	\$ (60)	Discounted cash flows	See description below	See description below
			Beta	0.6 - 1.6 (1.1)
Contingent consideration	\$ (6)	Discounted cash flows	Equity volatility	26.6% - 58.9% (40.0%) (2)

(1) Unobservable inputs were weighted by their relative fair value of the instruments.

(2) Unobservable inputs were not weighted as only one instrument exists.

### Recurring Significant Unobservable Inputs

**Home equity.** The most significant unobservable inputs used in the fair value measurement of the home equity loans are discount rates, constant prepayment rates, and default rates. The constant prepayment and default rates are based on a 12 month historical average. Significant increases (decreases) in the discount rate in isolation result in a significantly lower (higher) fair value measurement. Increases (decreases) in prepay rates in isolation result in a higher (lower) fair value and increases (decreases) in default rates in isolation result in a lower (higher) fair value.

**MSRs.** The significant unobservable inputs used in the fair value measurement of the MSRs are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation result in a significantly lower (higher) fair value measurement. Weighted average life (in years) is used to determine the change in fair value of MSRs. For September 30, 2019 and December 31, 2018, the weighted average life (in years) for the entire MSR portfolio was 3.7 and 5.2, respectively.

**DOJ Liability.** The significant unobservable inputs used in the fair value measurement of the DOJ Liability are the discount rate, asset growth rate, return on assets, dividend rate and the potential ways we might be required to begin making DOJ Liability payments and our estimates of the likelihood of these outcomes, as further discussed in Note 15 - Legal Proceedings, Contingencies and Commitments. The DOJ Liability had a fair value adjustment of \$0 and \$25 million for the three and nine months ended September 30, 2019, respectively. This reduced the liability to \$35 million based on changes in the probability of potential ways we might be required to begin making DOJ Liability payments and our estimates of the likelihood of these outcomes. Our assessment of these outcomes reflect a reduced likelihood, and longer timing, for potential future

payments. Significant increases (decreases) in the discount rate, asset growth rate and dividend rate in isolation may result in a marginally lower (higher) fair value measurement. Significant increases (decreases) in the return on assets rate in isolation may result in a marginally higher (lower) fair value measurement. Additionally, significant changes in the probability of potential payment outcomes could also impact the fair value. For further information on the fair value inputs related to the DOJ Liability, see Note 15 - Legal Proceedings, Contingencies, and Commitments.

*Rate lock commitments.* 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 our 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 result in a significantly higher (lower) fair value measurement.

*Contingent consideration.* The significant unobservable input used in the fair value of the contingent consideration is future forecasted target production volumes and forecasted profitability of the division. An increase or decrease to these inputs results in an increase or decrease of the liability.

#### Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We also have assets that are subject to measurement at fair value on a nonrecurring basis under certain conditions. The following table presents assets measured at fair value on a nonrecurring basis:

	Total (1)	Level 2	Level 3	Gains (Losses)
	(Dollars in millions)			
<b>September 30, 2019</b>				
Loans held-for-sale (2)	\$ 6	\$ 6	\$ —	\$ (1)
<b>Impaired loans held-for-investment (2)</b>				
Residential first mortgage loans	14	—	14	(5)
Repossessed assets (3)	9	—	9	(3)
Totals	<u>\$ 29</u>	<u>\$ 6</u>	<u>\$ 23</u>	<u>\$ (9)</u>
<b>December 31, 2018</b>				
Loans held-for-sale (2)	\$ 5	\$ 5	\$ —	\$ (1)
<b>Impaired loans held-for-investment (2)</b>				
Residential first mortgage loans	12	—	12	(4)
Repossessed assets (3)	7	—	7	(3)
Totals	<u>\$ 24</u>	<u>\$ 5</u>	<u>\$ 19</u>	<u>\$ (8)</u>

(1) The fair values are determined at various dates during the three months ended September 30, 2019 and the year ended December 31, 2018, respectively.

(2) Gains (losses) reflect fair value adjustments on assets for which we did not elect the fair value option.

(3) Gains (losses) reflect write downs of repossessed assets based on the estimated fair value of the specific assets.

The following table presents the quantitative information about nonrecurring Level 3 fair value financial instruments and the fair value measurements:

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)	
	(Dollars in millions)				
<b>September 30, 2019</b>					
<b>Impaired loans held-for-investment</b>					
Loans held-for-investment	\$ 14	Fair value of collateral	Loss severity discount	25% - 30% (26.1%)	(1)
Repossessed assets	\$ 9	Fair value of collateral	Loss severity discount	0% - 100% (21.1%)	(1)
<b>December 31, 2018</b>					
<b>Impaired loans held-for-investment</b>					
Loans held-for-investment	\$ 12	Fair value of collateral	Loss severity discount	25% - 30% (28.3%)	(1)
Repossessed assets	\$ 7	Fair value of collateral	Loss severity discount	0% - 100% (25.8%)	(1)

(1) Unobservable inputs were weighted by their relative fair value of the instruments.



### Nonrecurring Significant Unobservable Inputs

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

### Fair Value of Financial Instruments

The following table presents the carrying amount and estimated fair value of financial instruments that are carried either at fair value, cost, or amortized cost:

	September 30, 2019				
	Carrying Value	Estimated Fair Value			
		Total	Level 1	Level 2	Level 3
	(Dollars in millions)				
<b>Assets</b>					
Cash and cash equivalents	\$ 353	\$ 353	\$ 353	\$ —	\$ —
Investment securities available-for-sale	1,697	1,697	—	1,697	—
Investment securities held-to-maturity	635	639	—	639	—
Loans held-for-sale	4,196	4,196	—	4,196	—
Loans held-for-investment	12,548	12,707	—	8	12,699
Loans with government guarantees	607	583	—	583	—
Mortgage servicing rights	285	285	—	—	285
Federal Home Loan Bank stock	303	303	—	303	—
Bank owned life insurance	346	346	—	346	—
Repossessed assets	9	9	—	—	9
Other assets, foreclosure claims	43	43	—	43	—
Derivative financial instruments, assets	96	96	—	45	51
<b>Liabilities</b>					
<b>Retail deposits</b>					
Demand deposits and savings accounts	\$ (6,760)	\$ (6,054)	\$ —	\$ (6,054)	\$ —
Certificates of deposit	(2,558)	(2,577)	—	(2,577)	—
Wholesale deposits	(635)	(641)	—	(641)	—
Government deposits	(1,414)	(1,350)	—	(1,350)	—
Custodial deposits	(4,378)	(4,316)	—	(4,316)	—
Federal Home Loan Bank advances	(2,979)	(2,979)	—	(2,979)	—
Long-term debt	(496)	(458)	—	(458)	—
DOJ Liability	(35)	(35)	—	—	(35)
Contingent consideration	(8)	(8)	—	—	(8)
Derivative financial instruments, liabilities	(17)	(17)	—	(17)	—

December 31, 2018						
Carrying Value	Estimated Fair Value					
	Total	Level 1	Level 2	Level 3		
(Dollars in millions)						
<b>Assets</b>						
Cash and cash equivalents	\$ 408	\$ 408	\$ 408	\$ —	\$ —	
Investment securities available-for-sale	2,142	2,142	—	2,142	—	
Investment securities held-to-maturity	703	681	—	681	—	
Loans held-for-sale	3,869	3,870	—	3,870	—	
Loans held-for-investment	9,088	8,966	—	8	8,958	
Loans with government guarantees	392	374	—	374	—	
Mortgage servicing rights	290	290	—	—	290	
Federal Home Loan Bank stock	303	303	—	303	—	
Bank owned life insurance	340	340	—	340	—	
Repossessed assets	7	7	—	—	7	
Other assets, foreclosure claims	50	50	—	50	—	
Derivative financial instruments, assets	47	47	—	27	20	
<b>Liabilities</b>						
<b>Retail deposits</b>						
Demand deposits and savings accounts	\$ (6,467)	\$ (5,475)	\$ —	\$ (5,475)	\$ —	
Certificates of deposit	(2,387)	(2,379)	—	(2,379)	—	
Wholesale deposits	(583)	(585)	—	(585)	—	
Government deposits	(1,202)	(1,145)	—	(1,145)	—	
Custodial deposits	(1,741)	(1,664)	—	(1,664)	—	
Federal Home Loan Bank advances	(3,394)	(3,383)	—	(3,383)	—	
Long-term debt	(495)	(463)	—	(463)	—	
DOJ Liability	(60)	(60)	—	—	(60)	
Contingent consideration	(6)	(6)	—	—	(6)	
Derivative financial instruments, liabilities	(39)	(39)	—	(39)	—	

### Fair Value Option

We elected the fair value option for certain items as discussed throughout the Notes to the Consolidated Financial Statements to more closely align the accounting method with the underlying economic exposure. Interest income on LHFS 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 fair value option has been elected:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(Dollars in millions)				
<b>Assets</b>				
Loans held-for-sale				
Net gain (loss) on loan sales	\$ 97	\$ 7	\$ 272	\$ (61)
Loans held-for-investment				
Other noninterest income	\$ 1	\$ —	\$ 1	\$ —
<b>Liabilities</b>				
DOJ Litigation Settlement				
Other noninterest income	\$ —	\$ —	\$ 25	\$ —

The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding for assets and liabilities for which the fair value option has been elected:

	September 30, 2019			December 31, 2018		
	UPB	Fair Value	Fair Value Over / (Under) UPB	UPB	Fair Value	Fair Value Over / (Under) UPB
(Dollars in millions)						
<b>Assets</b>						
<b>Nonaccrual loans</b>						
Loans held-for-sale	\$ 11	\$ 12	\$ 1	\$ 6	\$ 6	\$ —
Loans held-for-investment	5	5	—	4	3	(1)
Total nonaccrual loans	\$ 16	\$ 17	\$ 1	\$ 10	\$ 9	\$ (1)
<b>Other performing loans</b>						
Loans held-for-sale	\$ 3,976	\$ 4,110	\$ 134	\$ 3,601	\$ 3,726	\$ 125
Loans held-for-investment	7	5	(2)	8	7	(1)
Total other performing loans	\$ 3,983	\$ 4,115	\$ 132	\$ 3,609	\$ 3,733	\$ 124
<b>Total loans</b>						
Loans held-for-sale	\$ 3,987	\$ 4,122	\$ 135	\$ 3,607	\$ 3,732	\$ 125
Loans held-for-investment	12	10	(2)	12	10	(2)
Total loans	\$ 3,999	\$ 4,132	\$ 133	\$ 3,619	\$ 3,742	\$ 123
<b>Liabilities</b>						
DOJ Liability (1)	\$ (118)	\$ (35)	\$ 83	\$ (118)	\$ (60)	\$ 58

(1) We are obligated to pay \$118 million in installment payments upon meeting certain performance conditions, as described in Note 15 - Legal Proceedings, Contingencies and Commitments.

#### Note 17 - Segment Information

Our operations are conducted through three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. The Other segment 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 are 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.

As a result of Management's evaluation of our segments, effective January 1, 2019, certain departments have been re-aligned between the Community Banking and Other segment. The income and expenses relating to these changes are reflected in our financial statements and all prior period segment financial information has been recast to conform to the current presentation.

The Community Banking segment originates loans, provides deposits and fee based services to consumer, business, and mortgage lending customers through its Branch Banking, Business Banking and Commercial Banking, Government Banking, Warehouse Lending and LHFI Portfolio groups. Products offered through these groups include checking accounts, savings accounts, money market accounts, certificates of deposit, consumer loans, commercial loans, commercial real estate loans, equipment finance and leasing, home builder finance loans and warehouse lines of credit. Other financial services available include consumer and corporate card services, customized treasury management solutions, merchant services and capital markets services such as loan syndications, and investment and insurance products and services.

Within the Community Banking segment, revenue from contracts with customers includes deposit account and other banking income, interchange fees and investment and insurance income. During the three and nine months ended September 30, 2019, respectively, deposit account and other banking income, which includes fees for outgoing wires, overdrafts, stop payments and ATM fees totaled \$7 million and \$20 million, interchange fees totaled \$3 million and \$8 million, and investment and insurance income totaled \$1 million and \$4 million. These fees are recognized when obligations, under the terms of the contract with our customer, are satisfied, which generally occurs when services are performed. Revenue is measured as the amount of consideration we expect to receive in exchange for providing services. At September 30, 2019 and December 31, 2018, we had no significant revenue related receivables or contract liabilities.

The Mortgage Originations segment originates and acquires one-to-four family residential mortgage loans to sell or hold on our balance sheet. Loans originated-to-sell comprise the majority of the lending activity. These loans are originated through mortgage branches, call centers, the Internet and third party counterparties. The Mortgage Origination segment recognizes interest income on loans that are held for sale and the gains from sales associated with these loans, whereas the interest income on LHFI and a loss on sales for the purchase of these loans is recognized in the Community Banking segment.

The Mortgage Servicing segment services and subservices mortgage and other consumer loans for others on a fee for service basis and may also collect ancillary fees and earn income through the use of noninterest-bearing escrows. Revenue for those serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the status of the underlying loans. The Mortgage Servicing segment also services loans for our LHFI portfolio in the Community Banking segment and our own LHFS portfolio in the Mortgage Originations segment, for which it earns revenue via an intercompany service fee allocation.

The Other segment includes the treasury functions, which include the impact of interest rate risk management, balance sheet funding activities and the administration of the investment securities portfolios, as well as miscellaneous other expenses of a corporate nature. 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 Community Banking, Mortgage Originations or Mortgage Servicing operating segments.

Revenues are comprised of net interest income (before the provision (benefit) for loan losses) and noninterest income. Noninterest expenses and provision (benefit) for income taxes, 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, 2019				
	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
	(Dollars in millions)				
<b>Summary of Operations</b>					
Net interest income	\$ 115	\$ 27	\$ 5	\$ (1)	\$ 146
Net gain (loss) on loan sales	(8)	118	—	—	110
Other noninterest income (loss)	17	15	40	(11)	61
Total net interest income and noninterest income (loss)	124	160	45	(12)	317
(Provision) benefit for loan losses	—	(1)	—	—	(1)
Compensation and benefits	(26)	(30)	(7)	(35)	(98)
Other noninterest expense and directly allocated overhead	(44)	(72)	(24)	—	(140)
Total noninterest expense	(70)	(102)	(31)	(35)	(238)
Income (loss) before indirect overhead allocations and income taxes	54	57	14	(47)	78
Overhead allocations	(10)	(10)	(4)	24	—
Provision (benefit) for income taxes	9	10	2	(6)	15
Net income (loss)	\$ 35	\$ 37	\$ 8	\$ (17)	\$ 63
Intersegment (expense) revenue	\$ (6)	\$ 8	\$ 6	\$ (8)	\$ —

**Average balances**

Loans held-for-sale	\$ 20	\$ 3,766	\$ —	\$ —	\$ 3,786
Loans with government guarantees	—	574	—	—	574
Loans held-for-investment (2)	11,710	33	—	—	11,743
Total assets	12,184	5,378	38	3,597	21,197
Deposits	10,513	—	4,556	748	15,817

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

	Three Months Ended September 30, 2018				
	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
	(Dollars in millions)				
<b>Summary of Operations</b>					
Net interest income	\$ 81	\$ 36	\$ 2	\$ 5	\$ 124
Net gain (loss) on loan sales	(3)	46	—	—	43
Other noninterest income	10	30	24	—	64
Total net interest income and noninterest income	88	112	26	5	231
(Provision) benefit for loan losses	(1)	—	—	3	2
Compensation and benefits	(17)	(26)	(4)	(29)	(76)
Other noninterest expense and directly allocated overhead	(27)	(41)	(18)	(11)	(97)
Total noninterest expense	(44)	(67)	(22)	(40)	(173)
Income (loss) before indirect overhead allocations and income taxes	43	45	4	(32)	60
Overhead allocations	(9)	(16)	(5)	30	—
Provision (benefit) for income taxes	7	6	—	(1)	12
Net income (loss)	\$ 27	\$ 23	\$ (1)	\$ (1)	\$ 48
Intersegment (expense) revenue	\$ 1	\$ 4	\$ 5	\$ (10)	\$ —

**Average balances**

Loans held-for-sale	\$ 10	\$ 4,383	\$ —	\$ —	\$ 4,393
Loans with government guarantees	—	292	—	—	292
Loans held-for-investment (2)	8,868	11	—	29	8,908
Total assets	9,028	5,676	29	3,878	18,611
Deposits	9,170	—	2,072	94	11,336

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

**Nine Months Ended September 30, 2019**

	<b>Community Banking</b>	<b>Mortgage Originations</b>	<b>Mortgage Servicing</b>	<b>Other (1)</b>	<b>Total</b>
	(Dollars in millions)				
<b>Summary of Operations</b>					
Net interest income	\$ 326	\$ 73	\$ 11	\$ —	\$ 410
Net gain (loss) on loan sales	(23)	257	—	—	234
Other noninterest income	44	49	113	8	214
Total net interest income and noninterest income	347	379	124	8	858
(Provision) benefit for loan losses	(18)	(1)	—	1	(18)
Compensation and benefits	(74)	(83)	(19)	(99)	(275)
Other noninterest expense and directly allocated overhead	(131)	(161)	(73)	(3)	(368)
Total noninterest expense	(205)	(244)	(92)	(102)	(643)
Income (loss) before indirect overhead allocations and income taxes	124	134	32	(93)	197
Overhead allocations	(30)	(30)	(13)	73	—
Provision (benefit) for income taxes	20	22	4	(9)	37
Net income (loss)	\$ 74	\$ 82	\$ 15	\$ (11)	\$ 160
Intersegment (expense) revenue	\$ (18)	\$ 24	\$ 19	\$ (25)	\$ —

**Average balances**

Loans held-for-sale	\$ 37	\$ 3,495	\$ —	\$ —	\$ 3,532
Loans with government guarantees	—	511	—	—	511
Loans held-for-investment (2)	10,495	21	—	—	10,516
Total assets	10,950	5,018	47	3,862	19,877
Deposits	10,247	—	3,536	522	14,305

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.

**Nine Months Ended September 30, 2018**

	<b>Community Banking</b>	<b>Mortgage Originations</b>	<b>Mortgage Servicing</b>	<b>Other (1)</b>	<b>Total</b>
	(Dollars in millions)				
<b>Summary of Operations</b>					
Net interest income	\$ 231	\$ 100	\$ 5	\$ 9	\$ 345
Net gain (loss) on loan sales	(10)	176	—	—	166
Other noninterest income	27	76	65	7	175
Total net interest income and noninterest income	248	352	70	16	686
(Provision) benefit for loan losses	(2)	(1)	—	6	3
Compensation and benefits	(51)	(83)	(13)	(89)	(236)
Other noninterest expense and directly allocated overhead	(81)	(129)	(49)	(28)	(287)
Total noninterest expense	(132)	(212)	(62)	(117)	(523)
Income (loss) before indirect overhead allocations and income taxes	114	139	8	(95)	166
Overhead allocations	(29)	(51)	(15)	95	—
Provision (benefit) for income taxes	18	18	(2)	(1)	33
Net income (loss)	\$ 67	\$ 70	\$ (5)	\$ 1	\$ 133
Intersegment (expense) revenue	\$ (1)	\$ 6	\$ 14	\$ (19)	\$ —

**Average balances**

Loans held-for-sale	\$ 11	\$ 4,254	\$ —	\$ —	\$ 4,265
Loans with government guarantees	—	288	—	—	288
Loans held-for-investment (2)	8,250	9	—	29	8,288
Total assets	8,425	5,477	30	3,902	17,834
Deposits	8,581	—	1,800	—	10,381

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

(2) Includes adjustment made to reclassify operating lease assets to loans held-for-investment.





## Note 18 - Recently Issued Accounting Pronouncements

### Adoption of New Accounting Standards

The following ASUs have been adopted which impact our significant accounting policies and/or have a significant financial impact:

**Leases** - Effective January 1, 2019, we adopted the requirements of ASU 2016-02, Leases (Topic 842) and all related amendments. The Company elected to apply the practical expedient of forgoing the restatement of comparative periods. In addition, we elected the practical expedients permitted under transition guidance to not reassess leases entered into prior to adoption. As permitted under ASC 842, the Company made an accounting policy election to exempt leases with an initial term of twelve months or less from balance sheet recognition. Instead, short-term leases are expensed over the lease term with no impact to the balance sheet.

At September 30, 2019, our inventory of leases included various bank branches, ATM locations and retail home lending offices. Many of our leases contain options to extend or terminate early and we consider these options when evaluating the lease term to determine if they are reasonably certain to be exercised based on all relevant economic and financial factors. All leases are classified as operating leases based on their terms.

The following table reflects information relating to our operating leases:

	<b>September 30, 2019</b>	
	(Dollars in millions)	
<b>Operating Leases (1)</b>		
Weighted-average remaining lease term (years)		3.9
Weighted-average discount rate		2.86%
Right-of-use asset (2)	\$	21
Lease liability (3)	\$	22

- (1) For the three and nine months ended September 30, 2019, the lease expense on operating leases was \$3 million and \$9 million, respectively, which includes a de-minimis amount of short-term lease expense and variable lease expense.
- (2) Recorded in premises and equipment on the Consolidated Statements of Financial Condition
- (3) Recorded in other liabilities on the Consolidated Statements of Financial Condition.

The following table presents our undiscounted cash flows on our operating lease liabilities as of September 30, 2019 and our minimum contractual obligations on our operating leases as of December 31, 2018:

	<b>September 30, 2019</b>		<b>December 31, 2018</b>	
	(Dollars in millions)			
Within one year	\$	9	\$	9
After one year and within two years		7		6
After two years and within three years		5		4
After three years and within four years		2		2
After four years and within five years		1		1
After five years		2		3
<b>Total (1)</b>	<b>\$</b>	<b>26</b>	<b>\$</b>	<b>25</b>

- (1) The difference between the total undiscounted cash payments on operating leases and the lease liability is solely the effect of discounting.

We adopted the following accounting standard updates (ASU) during 2019, none of which had a material impact to our financial statements:

Standard	Description	Effective Date
ASU 2019-07	SEC Final Rule Releases: Codification Updates	July 26, 2019
ASU 2019-01	Leases (Topic 842): Codification Improvements	January 1, 2019
ASU 2018-20	Leases (Topic 842): Narrow-Scope Improvements for Lessors	January 1, 2019
ASU 2018-16	Derivatives and hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes	January 1, 2019
ASU 2018-11	Leases (Topic 842): Targeted Improvements	January 1, 2019
ASU 2018-10	Codification Improvements to Topic 842, Leases	January 1, 2019
ASU 2018-07	Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting	January 1, 2019
ASU 2017-11	Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Non-controlling Interests with a Scope.	January 1, 2019
ASU 2017-08	Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities	January 1, 2019
ASU 2017-06	Plan Accounting - Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting	January 1, 2019

### Significant Accounting Standard Issued But Not Yet Adopted

**Credit Losses** - In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The ASU alters the current method for recognizing credit losses within the reserve account. Currently, we use the incurred loss method, whereas the new guidance requires financial assets to be presented at the net amount expected to be collected (i.e., net of expected credit losses). The measurement of expected credit losses should be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, for which the initial impact is recorded in equity and any adverse effects may be phased into regulatory capital over a three year transition period.

Our cross-functional implementation team continues to execute on its project plan to adopt this standard in the first quarter of 2020. We designed and implemented our credit loss models using an industry leading vendor. These models are fully functional and we began running a parallel production process in the third quarter of 2019 which will continue through implementation. We have identified and designed our internal controls over financial reporting which are in place as part of our parallel runs. The new or modified controls are primarily focused on our new models, forecasting and data integrity. We continue to review, challenge and refine our models and process as we complete our implementation.

Based on our current results and economic forecasts as of September 30, 2019, the estimated impact including our reserve for unfunded loan commitments is a pre-tax increase of 30 to 40 percent of our allowance for credit losses and reserve for unfunded commitments. We continue to evaluate our models, the qualitative framework, assumptions and judgment applied which could have an impact on our final CECL estimates at implementation. Additionally, that estimate may be impacted by economic conditions, credit characteristics of our portfolio and final asset balances at the time of adoption.

We do not expect any material allowance on held to maturity securities since the majority of this portfolio consists of agency-backed securities that have an immaterial risk of credit loss.

### Insignificant Accounting Standards Issued But Not Yet Adopted

The following ASUs have been issued and are not expected to have a material impact on our Consolidated Financial Statements and/or significant accounting policies outside of what has been disclosed in the prior section:

<b>Standard</b>	<b>Description</b>	<b>Effective Date</b>
ASU 2019-05	Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief	January 1, 2020
ASU 2019-04	Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments	January 1, 2020
ASU 2018-19	Codification Improvements to Topic 326, Financial Instruments—Credit Losses	January 1, 2020
ASU 2018-18	Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606	January 1, 2020
ASU 2018-17	Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities	January 1, 2020
ASU 2018-15	Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)	January 1, 2020
ASU 2017-04	Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment	January 1, 2020

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

A discussion regarding our management of market risk is included in "Market Risk" in this report in "Management's Discussion and Analysis of Financial Condition and Results of Operations" which is incorporated herein by reference.

### **Item 4. Controls and Procedures**

- (a) *Evaluation of Disclosure Controls and Procedures.* As of September 30, 2019, pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), an evaluation was performed by the Company's management, including our principal executive and financial officers, regarding the design and effectiveness of our disclosure controls and procedures. Based upon that evaluation, the principal executive and financial officers have concluded that our current disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms as of September 30, 2019.
- (b) *Changes in Internal Controls.* There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(d) of the Exchange Act) during the three months ended September 30, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **Item 1. Legal Proceedings**

From time to time, the Company is party to legal proceedings incidental to its business. For further information, see Note 15 - Legal Proceedings, Contingencies and Commitments.

### **Item 1A. Risk Factors**

The Company believes that there have been no material changes to the risk factors previously disclosed in response to Item 1A. to Part I, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

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

#### **Sale of Unregistered Securities**

The Company made no sales of unregistered securities during the quarter ended September 30, 2019.

#### **Issuer Purchases of Equity Securities**

The Company made no purchases of its equity securities during the quarter ended September 30, 2019.

### **Item 3. Defaults upon Senior Securities**

The Company had no defaults on senior securities.

### **Item 4. Mine Safety Disclosures**

None.

### **Item 5. Other Information**

None.

## Item 6. Exhibits

Exhibit No.	Description
3.1*	<a href="#"><u>Second Amended and Restated Articles of Incorporation of Flagstar Bancorp, Inc. (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, for the period ended June 30, 2017, and incorporated herein by reference).</u></a>
3.2*	<a href="#"><u>Sixth Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q, for the period ended September 30, 2016, and incorporated herein by reference).</u></a>
4.1*	<a href="#"><u>Indenture, dated July 11, 2016, between Flagstar Bancorp, Inc. as Issuers and Wilmington Trust, National Association, as Trustee and Collateral Agent, including the form of 6.125% senior secured note due 2021 (previously filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, dated July 11, 2016, and incorporated herein by reference).</u></a>
4.3*	<a href="#"><u>Form of 6.125% Global Note due 2021 (previously filed as Exhibit 4.3 to the Company's Registration Statement on Form S-4, dated October 7, 2016, and incorporated herein by reference).</u></a>
31.1	<a href="#"><u>Section 302 Certification of Chief Executive Officer</u></a>
31.2	<a href="#"><u>Section 302 Certification of Chief Financial Officer</u></a>
32.1	<a href="#"><u>Section 906 Certification, as furnished by the Chief Executive Officer</u></a>
32.2	<a href="#"><u>Section 906 Certification, as furnished by the Chief Financial Officer</u></a>
101	Financial statements from Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2019, formatted in XBRL: (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements.

\* Incorporated herein by reference

+ Constitutes a management contract or compensation plan or arrangement

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FLAGSTAR BANCORP, INC.  
Registrant

Date: November 4, 2019

/s/ Alessandro DiNello

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Alessandro DiNello  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ James K. Cirolì

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James K. Cirolì  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

## EXHIBIT INDEX

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+ Constitutes a management contract or compensation plan or arrangement

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## Section 2: EX-31.1 (EXHIBIT 31.1)

### EXHIBIT 31.1

#### SECTION 302 CERTIFICATION

I, Alessandro P. DiNello, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Flagstar Bancorp, Inc. (the "registrant");
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the



preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;

- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrants' internal control over financial reporting that occurred during the registrants' most recent fiscal quarter (the registrants' fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 4, 2019

/s/ Alessandro P. DiNello

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Alessandro P. DiNello  
President and Chief Executive Officer (Principal Executive Officer)

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## Section 3: EX-31.2 (EXHIBIT 31.2)

### EXHIBIT 31.2

#### SECTION 302 CERTIFICATION

I, James K. Cirolì, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Flagstar Bancorp, Inc. (the "registrant");
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

- d) disclosed in this report any change in the registrants' internal control over financial reporting that occurred during the registrants' most recent fiscal quarter (the registrants' fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 4, 2019

/s/ James K. Cirolì

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James K. Cirolì Executive Vice President and Chief Financial Officer (Principal Financial Officer)

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## Section 4: EX-32.1 (EXHIBIT 32.1)

### EXHIBIT 32.1

#### SECTION 906 CERTIFICATION

In connection with the annual report of Flagstar Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Alessandro P. DiNello, President and Chief Executive Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 4, 2019

/s/ Alessandro P. DiNello

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Alessandro P. DiNello President and Chief Executive Officer (Principal Executive Officer)

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## Section 5: EX-32.2 (EXHIBIT 32.2)

### EXHIBIT 32.2

#### SECTION 906 CERTIFICATION

In connection with the annual report of Flagstar Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James K. Cirolì, Chief Financial Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 4, 2019

/s/ James K. Cirolì

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James K. Cirolì  
Executive Vice President and Chief Financial Officer (Principal  
Financial Officer)

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