

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, 2020
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

38-3150651

(State or other jurisdiction of
Incorporation or organization)

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

5151 Corporate Drive, Troy, Michigan

48098-2639

(Address of principal executive offices)

(Zip code)

(248) 312-2000

(Registrant's telephone number, including area code)

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

Common stock

FBC

New York Stock Exchange

As of November 8, 2020, 52,564,331 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, 2020
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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
ACL	Allowance for Credit Losses	Home equity	Second Mortgages, HELOANs, HELOCs
AFS	Available for Sale	HTM	Held to Maturity
Agencies	Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively	HPI	Housing Price Index
ALCO	Asset Liability Committee	LIBOR	London Interbank Offered Rate
ALLL	Allowance for Loan Losses	LGG	Loans with Government Guarantees
AOCI	Accumulated Other Comprehensive Income (Loss)	LHFI	Loans Held-for-Investment
ASU	Accounting Standards Update	LHFS	Loans Held-for-Sale
Basel III	Basel Committee on Banking Supervision Third Basel Accord	LTV	Loan-to-Value Ratio
C&I	Commercial and Industrial	Management	Flagstar Bancorp's Management
CDARS	Certificates of Deposit Account Registry Service	MBS	Mortgage-Backed Securities
CECL	Current Expected Credit Losses	MD&A	Management's Discussion and Analysis
CET1	Common Equity Tier 1	MSR	Mortgage Servicing Rights
CLTV	Combined Loan to Value Ratio	N/A	Not Applicable
Common Stock	Common Shares	N/M	Not Meaningful
CRE	Commercial Real Estate	NBV	Net Book Value
Deposit Beta	The change in the annualized cost of our deposits, compared to the change in the Federal Reserve discount rate	NYSE	New York Stock Exchange
DOJ	United States Department of Justice	OCC	Office of the Comptroller of the Currency
DOJ Liability	2012 Settlement Agreement with the Department of Justice	OCI	Other Comprehensive Income (Loss)
DTA	Deferred Tax Asset	OTTI	Other-Than-Temporary-Impairment
EVE	Economic Value of Equity	PPP	Paycheck Protection Program
Fannie Mae	Federal National Mortgage Association	QTL	Qualified Thrift Lending
FASB	Financial Accounting Standards Board	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
FDIC	Federal Deposit Insurance Corporation	REO	Real estate owned and other nonperforming assets, net
Federal Reserve	Board of Governors of the Federal Reserve System	RMBS	Residential Mortgage-Backed Securities
FHA	Federal Housing Administration	RWA	Risk Weighted Assets
FHLB	Federal Home Loan Bank	SEC	Securities and Exchange Commission
FICO	Fair Isaac Corporation	SNC	Shared National Credit
FRB	Federal Reserve Bank	SOFR	Secured Oversight Financing Rate
Freddie Mac	Federal Home Loan Mortgage Corporation	TDR	Troubled Debt Restructuring
FTE	Full Time Equivalent Employees	TPO	Third Party Originator
GAAP	United States Generally Accepted Accounting Principles	UPB	Unpaid Principal Balance
GNMA	Government National Mortgage Association	U.S. Treasury	United States Department of Treasury
HELOC	Home Equity Lines of Credit	VIE	Variable Interest Entities
HELOAN	Home Equity Loan	XBRL	eXtensible Business Reporting Language
HOLA	Home Owners Loan Act		

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 2020, 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 2019 Annual Report on Form 10-K for the year ended December 31, 2019.

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 41 of this Form 10-Q, Part II, Item 1A, Risk Factors of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2019 Annual Report on Form 10-K for the year ended December 31, 2019. Additional information about Flagstar can be found on our website at 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 6th largest bank mortgage originator in the nation and the 6th largest servicer of mortgage loans nationwide. At September 30, 2020, we had 4,871 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, 2020, 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 network of brokers and correspondents in all 50 states and our own loan officers, which includes our direct lending team, from 87 retail locations in 29 states and 3 call centers. We are also a leading national servicer of mortgage loans and provide complementary ancillary offerings including MSR lending, servicing advance lending and MSR recapture services.

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

	Three Months Ended,		Nine Months Ended,	
	September 30, 2020	June 30, 2020	September 30, 2020	September 30, 2019
(In millions and percentages)				
Selected Mortgage Statistics: (1)				
Mortgage rate lock commitments (fallout-adjusted) (2)	\$ 15,000	\$ 13,800	\$ 40,000	\$ 24,100
Mortgage loans originated	\$ 14,400	\$ 12,200	\$ 35,200	\$ 23,400
Mortgage loans sold and securitized	\$ 14,500	\$ 12,900	\$ 34,900	\$ 22,200
Selected Ratios:				
Interest rate spread (3)	2.44 %	2.52 %	2.41 %	2.57 %
Net interest margin	2.78 %	2.86 %	2.81 %	3.07 %
Adjusted net interest margin (4)	2.94 %	2.88 %	2.88 %	3.07 %
Return on average assets	3.15 %	1.77 %	1.97 %	1.08 %
Return on average common equity	41.54 %	23.47 %	25.71 %	12.90 %
Return on average tangible common equity (4)	45.42 %	26.16 %	28.58 %	15.30 %
Efficiency ratio	48.3 %	54.3 %	56.4 %	75.0 %
Effective tax provision rate	24.7 %	21.5 %	23.0 %	18.6 %
Average Balances:				
Average interest-earning assets	\$ 25,738	\$ 23,692	\$ 23,535	\$ 17,693
Average interest-paying liabilities	\$ 14,281	\$ 15,119	\$ 14,625	\$ 12,767
Average stockholders' equity	\$ 2,141	\$ 1,977	\$ 1,991	\$ 1,658

	September 30, 2020	June 30, 2020	March 31, 2020	December 31, 2019	September 30, 2019
(In millions, except per share data and percentages)					
Selected Statistics:					
Book value per common share	\$ 38.41	\$ 34.62	\$ 32.46	\$ 31.57	\$ 30.69
Tangible book value per share (4)	\$ 35.60	\$ 31.74	\$ 29.52	\$ 28.57	\$ 27.62
Number of common shares outstanding	57,150,470	56,943,979	56,729,789	56,631,236	56,510,341
Common equity-to-assets ratio	7.45 %	7.18 %	6.87 %	7.68 %	7.88 %
Tangible common equity to assets ratio (4)	6.90 %	6.58 %	6.25 %	6.95 %	7.08 %
Capitalized value of mortgage servicing rights	0.85 %	0.87 %	0.95 %	1.21 %	1.14 %
Bancorp total capital (to adjusted risk weighted assets)	11.29 %	11.32 %	11.18 %	11.52 %	11.54 %
Bank total capital (to adjusted risk weighted assets)	11.09 %	11.05 %	11.30 %	11.73 %	12.06 %
Number of bank branches	160	160	160	160	160
Number of FTE employees	4,871	4,641	4,415	4,453	4,171

- (1) Rounded to nearest hundred million.
- (2) 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.
- (3) 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.
- (4) See Non-GAAP reconciliation for further information.

Results of Operations

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

	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
	(Dollars in millions, except per share data)					
Net interest income	\$ 180	\$ 168	\$ 12	\$ 496	\$ 410	\$ 86
Provision for credit losses	32	102	(70)	148	18	130
Total noninterest income	452	378	74	988	448	540
Total noninterest expense	305	296	9	837	643	194
Provision for income taxes	73	32	41	115	37	78
Net income	\$ 222	\$ 116	\$ 106	\$ 384	\$ 160	\$ 224
Income per share						
Basic	\$ 3.90	\$ 2.04	\$ 1.86	\$ 6.76	\$ 2.83	\$ 3.93
Diluted	\$ 3.88	\$ 2.03	\$ 1.85	\$ 6.71	\$ 2.80	\$ 3.91

Overview

Net income was \$222 million, or \$3.88 per diluted share for the quarter ended September 30, 2020 compared to second quarter 2020 net income of \$116 million, or \$2.03 per diluted share. For the nine months ended September 30, 2020, net income was \$384 million, or \$6.71 per diluted share as compared to net income of \$160 million, or \$2.80 per diluted share for same period a year ago.

Net interest income increased \$12 million for the quarter ended September 30, 2020 as compared to the quarter ended June 30, 2020, driven by a \$2.0 billion increase in average earning assets led by growth in our warehouse business. The net interest margin in the third quarter 2020 was 2.78 percent, an 8 basis point decrease from the prior quarter. This was driven by an increase in LGG loans in forbearance which we have not repurchased and which do not accrue interest. Excluding the impact from these loans, adjusted net interest margin expanded 6 basis points to 2.94 percent in the third quarter, compared to adjusted net interest margin of 2.88 percent in the prior quarter. The increase in the adjusted net interest margin was primarily driven by an increase in higher spread warehouse loans and lower rates on deposit and borrowing costs.

Compared to the second quarter 2020, noninterest income increased \$74 million while noninterest expense only increased \$9 million. The increase in noninterest income was primarily due to higher net gain on loan sales and net return on mortgage servicing rights. Gain on sale margin increased 12 basis points, to 2.31 percent as compared to 2.19 percent for the second quarter 2020. The increase was primarily driven by improved execution in secondary marketing and the gain associated with the RMBS transaction we executed during the quarter. The increase in noninterest expense was primarily due to the capitalization of direct origination costs in the second quarter for the PPP loans which did not reoccur and the accelerated vesting of certain components of executive compensation that resulted from the most recent secondary share offering. Despite increased volume, mortgage expenses were flat quarter over quarter due to certain expenses in the second quarter that did not reoccur this quarter and are not expected to reoccur in the future, including certain performance-related incentives related to our Opes Advisors division.

Our provision for credit losses for the quarter ended September 30, 2020 was \$32 million, compared to \$102 million for the second quarter 2020. We have continued to add to our reserve balance as we believe the economic recovery will continue to be challenged due to the COVID-19 pandemic for an extended period of time, especially as it relates to consumer loans in forbearance and commercial real estate loans.

Net Interest Income

The following tables present details on our net interest margin and net interest income on a consolidated basis:

	Three Months Ended,					
	September 30, 2020			June 30, 2020		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
(Dollars in millions)						
Interest-Earning Assets						
Loans held-for-sale	\$ 5,602	\$ 45	3.21 %	\$ 5,645	\$ 48	3.42 %
Loans held-for-investment						
Residential first mortgage	2,584	21	3.24 %	2,822	24	3.41 %
Home equity	951	9	3.77 %	1,001	9	3.78 %
Other	950	13	5.28 %	881	12	5.42 %
Total consumer loans	4,485	43	3.78 %	4,704	45	3.87 %
Commercial real estate	3,007	27	3.47 %	3,101	28	3.64 %
Commercial and industrial	1,650	14	3.25 %	2,006	17	3.34 %
Warehouse lending	5,697	56	3.92 %	3,785	38	3.88 %
Total commercial loans	10,354	97	3.68 %	8,892	83	3.67 %
Total loans held-for-investment (1)	14,839	140	3.71 %	13,596	128	3.74 %
Loans with government guarantees	2,122	5	0.89 %	858	4	1.97 %
Investment securities	2,807	16	2.29 %	3,417	21	2.42 %
Interest-earning deposits	368	—	0.11 %	176	—	0.11 %
Total interest-earning assets	25,738	206	3.16 %	23,692	201	3.38 %
Other assets	2,539			2,569		
Total assets	\$ 28,277			\$ 26,261		
Interest-Bearing Liabilities						
Retail deposits						
Demand deposits	\$ 1,824	\$ —	0.09 %	\$ 1,800	\$ 1	0.22 %
Savings deposits	3,675	3	0.34 %	3,476	4	0.52 %
Money market deposits	733	—	0.09 %	716	—	0.12 %
Certificates of deposit	1,672	8	1.62 %	1,987	10	2.00 %
Total retail deposits	7,904	11	0.53 %	7,979	15	0.78 %
Government deposits	1,403	1	0.35 %	1,088	2	0.63 %
Wholesale deposits and other	953	4	1.77 %	738	4	2.07 %
Total interest-bearing deposits	10,260	16	0.62 %	9,805	21	0.86 %
Short-term FHLB advances and other	2,328	2	0.20 %	3,753	2	0.26 %
Long-term FHLB advances	1,200	3	1.03 %	1,068	3	1.13 %
Other long-term debt	493	5	4.52 %	493	7	4.99 %
Total interest-bearing liabilities	14,281	26	0.72 %	15,119	33	0.86 %
Noninterest-bearing deposits						
Retail deposits and other	1,954			1,687		
Custodial deposits (2)	7,347			6,223		
Total non-interest bearing deposits	9,301			7,910		
Other liabilities	2,554			1,255		
Stockholders' equity	2,141			1,977		
Total liabilities and stockholders' equity	\$ 28,277			\$ 26,261		
Net interest-earning assets	11,457			8,573		
Net interest income		\$ 180		\$ 168		
Interest rate spread (3)			2.44 %			2.52 %
Net interest margin (4)			2.78 %			2.86 %
Ratio of average interest-earning assets to interest-bearing liabilities			180.2 %			156.7 %
Total average deposits	19,561			17,715		

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.

(2) Includes noninterest-bearing custodial deposits that arise due to the servicing of loans for others.

(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

	Nine Months Ended,					
	September 30, 2020			September 30, 2019		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
(Dollars in millions)						
Interest-Earning Assets						
Loans held-for-sale	\$ 5,499	\$ 142	3.44 %	\$ 3,532	\$ 119	4.48 %
Loans held-for-investment						
Residential first mortgage	2,822	72	3.40 %	3,158	85	3.61 %
Home equity	990	30	4.10 %	832	34	5.50 %
Other	882	36	5.47 %	512	25	6.51 %
Total consumer loans	4,694	138	3.94 %	4,502	144	4.29 %
Commercial real estate	3,019	90	3.90 %	2,414	102	5.56 %
Commercial and industrial	1,774	50	3.68 %	1,702	67	5.20 %
Warehouse lending	3,937	119	3.98 %	1,898	74	5.17 %
Total commercial loans	8,730	259	3.89 %	6,014	243	5.34 %
Total loans held-for-investment (1)	13,424	397	3.91 %	10,516	387	4.89 %
Loans with government guarantees	1,267	12	1.23 %	511	11	2.88 %
Investment securities	3,094	56	2.40 %	2,957	61	2.77 %
Interest-earning deposits	251	1	0.56 %	177	3	2.38 %
Total interest-earning assets	23,535	608	3.42 %	17,693	581	4.37 %
Other assets	2,457			2,184		
Total assets	\$ 25,992			\$ 19,877		
Interest-Bearing Liabilities						
Retail deposits						
Demand deposits	\$ 1,737	\$ 4	0.33 %	\$ 1,311	\$ 8	0.80 %
Savings deposits	3,513	17	0.63 %	3,181	26	1.10 %
Money market deposits	712	1	0.17 %	748	2	0.31 %
Certificates of deposit	1,970	29	1.98 %	2,561	44	2.29 %
Total retail deposits	7,932	51	0.86 %	7,801	80	1.37 %
Government deposits	1,208	6	0.68 %	1,184	13	1.49 %
Wholesale deposits and other	758	12	2.03 %	518	9	2.35 %
Total interest-bearing deposits	9,898	69	0.93 %	9,503	102	1.44 %
Short-term FHLB advances and other	3,212	16	0.65 %	2,420	44	2.45 %
Long-term FHLB advances	1,021	9	1.13 %	349	4	1.71 %
Other long-term debt	494	18	4.94 %	495	21	5.84 %
Total interest-bearing liabilities	14,625	112	1.01 %	12,767	171	1.80 %
Noninterest-bearing deposits						
Retail deposits and other	1,680			1,278		
Custodial deposits (2)	6,120			3,524		
Total non-interest bearing deposits	7,800			4,802		
Other liabilities	1,576			650		
Stockholders' equity	1,991			1,658		
Total liabilities and stockholders' equity	\$ 25,992			\$ 19,877		
Net interest-earning assets	8,910			4,926		
Net interest income		\$ 496		\$ 410		
Interest rate spread (3)			2.41 %			2.57 %
Net interest margin (4)			2.81 %			3.07 %
Ratio of average interest-earning assets to interest-bearing liabilities			160.9 %			138.6 %
Total average deposits	17,698			14,305		

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.

(2) Includes noninterest-bearing custodial deposits that arise due to the servicing of loans for others.

(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

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.

	Three Months Ended,			Nine Months Ended,		
	September 30, 2020 versus June 30, 2020			September 30, 2020 versus September 30, 2019		
	Increase (Decrease) Due to:			Increase (Decrease) Due to:		
	Rate	Volume	Total	Rate	Volume	Total
(Dollars in millions)						
Interest-Earning Assets						
Loans held-for-sale	\$	(3)	\$	—	\$	(3)
Loans held-for-investment						
Residential first mortgage		(1)	(2)	(3)	(4)	(9)
Home equity		—	—	—	(11)	7
Other		—	1	1	(7)	18
Total consumer loans		(1)	(1)	(2)	(22)	16
Commercial real estate		—	(1)	(1)	(37)	25
Commercial and industrial		—	(3)	(3)	(20)	3
Warehouse lending		(1)	19	18	(34)	79
Total commercial loans		(1)	15	14	(91)	107
Total loans held-for-investment		(2)	14	12	(113)	123
Loans with government guarantees		(5)	6	1	(15)	16
Investment securities		(1)	(4)	(5)	(8)	3
Interest-earning deposits and other		—	—	—	(3)	1
Total interest-earning assets	\$	(11)	\$	16	\$	5
					(182)	209
						27
Interest-Bearing Liabilities						
Interest-bearing deposits	\$	(6)	\$	1	\$	(5)
Short-term FHLB advances and other borrowings		1	(1)	—	(43)	15
Long-term FHLB advances		—	—	—	(4)	9
Other long-term debt		(2)	—	(2)	(3)	—
Total interest-bearing liabilities		(7)	—	(7)	(87)	28
Change in net interest income	\$	(4)	\$	16	\$	12
					(95)	181
						86

Comparison to Prior Quarter

Net interest income increased \$12 million, or 7 percent, to \$180 million for the third quarter 2020 as compared to the second quarter 2020. The increase was primarily driven by warehouse loan growth partially offset by lower net interest margin as the impact of lower interest rates on deposit and borrowing costs was more than offset by lower yields on earning assets which included \$1.3 million higher LGG loans in forbearance that have not been repurchased and do not bear interest. Average earnings assets increased \$2.0 billion, reflecting increases of \$2.5 billion in average total loans, partially offset by a \$0.6 billion decrease in average investment securities.

The net interest margin in the third quarter of 2020 was 2.78 percent, an 8 basis point decrease from the prior quarter. Excluding the impact from the loans with government guarantees discussed above, adjusted net interest margin expanded 6 basis points to 2.94 percent in the third quarter, compared to adjusted net interest margin of 2.88 percent in the prior quarter. The increase in the adjusted net interest margin was primarily driven by \$1.9 billion (51 percent) higher average warehouse loan balances as we grew our business and took advantage of the strong mortgage market along with lower rates on retail banking deposits and borrowing costs. Retail banking deposit rates decreased 22 basis points driven by the expiration of promotional rates on some of our savings deposits and the maturity of higher cost time deposits.

Loans held-for-investment averaged \$14.8 billion for the third quarter of 2020, increasing \$1.2 billion (9 percent) from the prior quarter. The increase was primarily driven by \$1.9 billion (51 percent) higher average warehouse loan balances as we grew our business and took advantage of the strong mortgage market, partially offset by \$0.5 billion (9 percent) lower average commercial loans, excluding warehouse, primarily due to a decrease in our home builder finance portfolio and the sale of the PPP loans during the third quarter.

Average total deposits were \$19.6 billion in the third quarter 2020, increasing \$1.8 billion (10 percent) from the second quarter 2020. Average custodial deposits increased \$1.1 billion (18 percent) due to higher prepayments from mortgage

refinancings, average government deposits increased \$0.3 billion (29 percent) and retail deposits increased \$0.2 billion (2 percent) primarily due to changes in consumer behavior and spending patterns since the COVID-19 pandemic began and higher cash balances being carried by commercial depositors.

Comparison to Prior Year to Date

Net interest income increased \$86 million, for the nine months ended September 30, 2020, compared to the same period in 2019. The 21 percent increase was driven by growth in average interest-earning assets led by the warehouse and LHFS portfolios. Volume growth was partially offset by a 26 basis point decline in net interest margin to 2.81 percent for the nine months ended September 30, 2020, as compared to 3.07 percent for the nine months ended September 30, 2019 primarily attributable to the interest rate cuts occurring in late 2019 and in March 2020.

Average interest-earnings assets increased \$5.8 billion due primarily to growth in the warehouse portfolio, due to increased volume from the favorable mortgage environment and improvements in market share, and the LHFS portfolio which benefited from the favorable mortgage environment due to lower market rates. Average loans with government guarantees increased \$0.8 billion due to a \$0.5 billion increase in average GNMA loans in forbearance for the nine months ended September 30, 2020. Average non-warehouse commercial portfolios increased \$677 million driven by broad-based growth across CRE and C&I throughout 2020.

Average interest-bearing liabilities increased \$1.9 billion, driven by increases of \$672 million and \$621 million in long-term and short-term FHLB borrowings, respectively, which were used to fund asset growth while taking advantage of the lower interest rate environment. Average total deposits increased \$3.4 billion driven by higher custodial deposits which resulted from growth in subservicing and higher refinance activity, and growth in retail deposits as customer balances grew due to the impact of COVID-19 on customer behavior and spending patterns.

Provision for Credit Losses

The provision for credit losses was \$32 million for the three months ended September 30, 2020, compared to \$102 million for the three months ended June 30, 2020. The decrease in the provision is primarily driven by the significant provision taken in during the second quarter of 2020 due to our forecast of economic and credit conditions as impacted by COVID-19. The additional provision in the third quarter of 2020 reflects our belief that the economy will continue to be challenged by the response to the COVID-19 pandemic for an extended period of time, especially as it relates to consumer loans in forbearance and commercial real estate loans.

The provision for credit losses and unfunded commitments was \$148 million for the nine months ended September 30, 2020, compared to \$18 million for the nine months ended September 30, 2019. The increase is reflective of the adoption of CECL in 2020 and an increase due to changes in the economic forecast used in the ACL models and judgment we applied related to those forecasts as a result of the ongoing COVID-19 pandemic.

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

Noninterest Income

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

	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
	(Dollars in millions)					
Net gain on loan sales	\$ 346	\$ 303	\$ 43	\$ 739	\$ 234	\$ 505
Loan fees and charges	45	41	4	112	70	42
Net return (loss) on mortgage servicing rights	12	(8)	20	10	9	1
Loan administration income	26	21	5	59	22	37
Deposit fees and charges	8	7	1	24	28	(4)
Other noninterest income	15	14	1	44	85	(41)
Total noninterest income	\$ 452	\$ 378	\$ 74	\$ 988	\$ 448	\$ 540

	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
	(Dollars in millions)					
Mortgage rate lock commitments (fallout-adjusted) (1)(3)	\$ 15,000	\$ 13,800	\$ 1,200	\$ 40,000	\$ 24,100	\$ 15,900
Mortgage loans originated (3)	\$ 14,400	\$ 12,200	\$ 2,200	\$ 35,200	\$ 23,400	\$ 11,800
Net margin on mortgage rate lock commitments (fallout-adjusted) (1)(2)	2.31 %	2.19 %	0.12 %	1.85 %	0.96 %	0.89 %
Mortgage loans sold and securitized (3)	\$ 14,500	\$ 12,900	\$ 1,600	\$ 34,900	\$ 22,200	\$ 12,700

- (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 the 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 \$3 million and \$2 million from loans transferred from LHFI during the nine months ended September 30, 2020 and September 30, 2019, respectively) to fallout-adjusted mortgage rate lock commitments.
- (3) Rounded to nearest hundred million.

Comparison to Prior Quarter

Noninterest income increased \$74 million for the three months ended September 30, 2020, compared to the three months ended June 30, 2020, primarily due to the following:

- Net gain on loan sales increased \$43 million to \$346 million, as compared to \$303 million in the second quarter 2020. The net gain on loan sale margin increased 12 basis points, to 2.31 percent for the third quarter 2020, as compared to 2.19 percent for the second quarter 2020. The margin increase was primarily driven by improved execution in secondary marketing and the gain associated with the RMBS transaction during the quarter. Fallout-adjusted locks increased \$1.2 billion, or 9 percent, to \$15.0 billion, as historically low interest rates continued to support a strong refinance market.
- Net return (loss) on mortgage servicing rights increased \$20 million to a \$12 million net return for the third quarter of 2020, compared to an \$8 million net loss for the second quarter 2020. The third quarter 2020 MSR return normalized following the MSR valuation decrease caused by rising prepayment speeds during the second quarter of 2020 which did not reoccur. The UPB of loans serviced for others also increased 26 percent driving a \$6 million increase in service fee income.
- Loan administration income increased \$5 million to \$26 million for the third quarter of 2020, compared to \$21 million for the second quarter 2020, largely driven by a decline in LIBOR-based fees paid to sub-servicing customers on custodial deposits and an increase in the average number of loans being subserviced and higher monthly services fees for loans in forbearance.
- Loan fees and charges increased \$4 million to \$45 million for the third quarter of 2020, compared to \$41 million for the second quarter 2020, resulting from a 19 percent increase in mortgage closings partially offset by lower ancillary fees on subserviced loans.

Comparison to Prior Year to Date

Noninterest income increased \$540 million for the nine months ended September 30, 2020, compared to the nine months ended September 30, 2019, primarily due to the following:

- Net gain on loan sales increased \$505 million, primarily due to \$15.9 billion higher fallout adjusted locks driven by the favorable mortgage environment supported by historically low interest rates. In addition, the 0.89 percent increase in gain on sale margin was driven by managing our volume level within our channels and products to fit our fulfillment capacity made possible by demand due to favorable market conditions which has led to higher closings in our retail channel, which supports a higher gain on sale.
- Loan fees and charges increased \$42 million primarily driven by an increase in retail closings along with \$14 million higher subservicing ancillary fees driven by fees related to forbearance programs.
- Loan administration income increased \$37 million, driven about equally by a decline in LIBOR-based fees paid to sub-servicing customers on custodial deposits and higher subservice fee income due to an increase in the average number of loans being subserviced and an increase in the number of loans past due which are charged a higher servicing rate.
- Other noninterest income declined \$41 million primarily due to the \$25 million DOJ Liability fair value adjustment in 2019 which did not reoccur (see Note 15 - Legal Proceedings, Contingencies and Commitments for additional information) and \$7 million of AFS investment security gains recorded in 2019 that did not reoccur in 2020 along with lower returns on other investments due to lower interest rates.
- Deposit fees and charges decreased \$4 million, to \$24 million for the nine months ended September 30, 2020, primarily driven by a decrease in non-sufficient funds fee income due to higher customer balances and fees we elected to waive to support our customers during the initial COVID-19 surge.

Noninterest Expense

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

	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
	(Dollars in millions)					
Compensation and benefits	\$ 123	\$ 116	\$ 7	\$ 341	\$ 275	\$ 66
Occupancy and equipment	47	44	3	132	118	14
Commissions	72	61	11	162	76	86
Loan processing expense	24	25	(1)	69	60	9
Legal and professional expense	9	5	4	20	18	2
Federal insurance premiums	6	7	(1)	19	14	5
Intangible asset amortization	3	4	(1)	10	11	(1)
Other noninterest expense	21	34	(13)	84	71	13
Total noninterest expense	\$ 305	\$ 296	\$ 9	\$ 837	\$ 643	\$ 194
Efficiency ratio	48.3 %	54.3 %	(6.0)%	56.4 %	75.0 %	(18.6)%
Average number of FTE	4,789	4,451	338	4,589	4,071	518

Comparison to Prior Quarter

Noninterest expense increased \$9 million for the three months ended September 30, 2020, compared to the three months ended June 30, 2020 primarily due to the following:

- Commissions increased \$11 million due to \$2.3 billion, or 19 percent, higher mortgage closings.
- Compensation and benefits expense increased \$7 million from the prior quarter. This was primarily due to a 5 percent increase in FTE, the capitalization of direct PPP loan origination costs in the second quarter which did not reoccur and the accelerated vesting of certain components of executive compensation that resulted from the most recent secondary share offering. This was partially offset by lower incentive compensation as the second quarter 2020 included a catch-up adjustment as a result of the strong financial performance.

- Other noninterest expense decreased \$13 million from the prior quarter due to certain expenses in the second quarter that did not reoccur this quarter and are not expected to reoccur in the future, including certain performance-related earn out adjustments related to our Opes Advisors acquisition.

Comparison to Prior Year to Date

Noninterest expense increased \$194 million for the nine months ended September 30, 2020, compared to the nine months ended September 30, 2019 primarily due to the following:

- Compensation and benefits increased \$66 million, primarily due to a 13 percent increase in average FTE which was impacted by bringing default servicing in house and adding variable mortgage closing capacity in response to the robust mortgage performance along with an increase in incentive compensation attributed to stronger financial results.
- Commissions and loan processing increased \$86 million and \$9 million, respectively, primarily driven by \$11.8 billion higher mortgage closings along with a shift in channel mix from TPO to retail which supports a higher gain on sale but also has higher commission rates and costs.
- Occupancy and equipment increased \$14 million primarily due to increases in IT software expenses and depreciation expense which includes certain costs associated with taking our workforce remote during 2020 in response to the COVID-19 pandemic.
- Other noninterest expense increased \$13 million primarily driven by higher mortgage related expenses including certain performance-related earn out adjustments related to our Opes Advisors acquisition.

Provision for Income Taxes

Our provision for income taxes for the three and nine months ended September 30, 2020, was \$73 million and \$115 million, respectively. Our effective tax rate was 24.7 percent for the three months ended September 30, 2020, compared to an effective tax rate of 21.5 percent for the three months ended June 30, 2020. The higher rate was the result of our higher level of income, which is taxed at higher marginal tax rates. Also contributing to the higher rate was the delay of certain tax planning strategies.

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.

As a result of management's evaluation of our segments, effective January 1, 2020, certain departments have been re-aligned between the Community Banking and Mortgage Originations segments. Specifically, a majority of the residential mortgage HFI portfolio is now part of the Mortgage Originations 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.

Before the adoption of CECL on January 1, 2020, we charged the lines of business for the net charge-offs that occurred during the period. The difference between total net charge-offs and the consolidated provision for credit losses was assigned to the "Other" segment. This amount assigned to the "Other" segment was then allocated back to the lines of business through other noninterest expense.

This year, with the adoption of CECL, we still charge the lines of business for the net charge-offs that occur. In addition to this amount, we charge them for the change in loan balances during the period, applied at the budgeted credit loss factor. The difference between the consolidated provision for credit losses and the sum of total net charge-offs and the change in loan balances is still assigned to the "Other" segment, although now that amount includes the changes related to the economic forecasts, model changes, qualitative adjustments and credit downgrades. As in the prior methodology, the amount assigned to the "Other" segment continues to be allocated back to the lines of business through other noninterest expense.

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 provide 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 driven by our warehouse portfolio which has benefited from the robust mortgage market in the first nine months of 2020. Our relationship-based approach and speed of execution also enabled us to add new customers as well as increase lines for existing customers during the quarter. In addition, we continue to maintain our disciplined underwriting in this business. In the 12 months ended September 30, 2020, our commercial loan portfolio has grown 59 percent to \$12.1 billion while our consumer loan portfolio has decreased 11 percent to \$4.4 billion. Average deposits for the nine months ended September 30, 2020 increased to \$10.8 billion, compared to \$10.2 billion for the same period in 2019 driven primarily by higher customer balances.

Community Banking	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
(Dollars in millions)						
Summary of Operations						
Net interest income	\$ 158	\$ 133	\$ 25	\$ 395	\$ 296	\$ 99
Provision (benefit) for credit losses	(2)	(3)	1	3	17	(14)
Net interest income after provision for credit losses	160	136	24	392	279	113
Net gain (loss) on loan sales	2	—	2	2	(10)	12
Loan fees and charges	—	—	—	1	1	—
Loan administration expense	(1)	(1)	—	(2)	(3)	1
Other noninterest income	15	12	3	43	46	(3)
Total noninterest income	16	11	5	44	34	10
Compensation and benefits	28	24	4	79	77	2
Commissions	1	—	1	2	1	1
Loan processing expense	1	1	—	4	5	(1)
Other noninterest expense	63	124	(61)	231	125	106
Total noninterest expense	93	149	(56)	316	208	108
Income before indirect overhead allocations and income taxes	83	(2)	85	120	105	15
Indirect overhead allocation	(11)	(11)	—	(31)	(30)	(1)
Provision (benefit) for income taxes	15	(3)	18	19	16	3
Net income	\$ 57	\$ (10)	\$ 67	\$ 70	\$ 59	\$ 11
Key Metrics						
Average number of FTE employees	1,253	1,266	(13)	1,282	1,316	(34)

Comparison to Prior Quarter

The Community Banking segment reported net income of \$57 million for the three months ended September 30, 2020, compared to net loss of \$10 million for the three months ended June 30, 2020. The \$67 million increase was driven by the following:

- Other noninterest expense decreased \$61 million primarily driven by a decrease in the intersegment expense allocation from the impact of the degradation of economic forecasts and credit downgrades on the provision for credit losses.
- Net interest income increased \$25 million primarily driven by warehouse loan growth and the impact of lower interest rates on borrowing costs, especially core deposits due to the expiration of promotional rates on some of our savings deposits and the maturity of higher cost time deposits, partially offset by lower yields on earning assets.
- Compensation and benefits expense increased \$4 million primarily due to the capitalization of direct PPP loan origination costs in the second quarter which did not reoccur.

Comparison to Prior Year to Date

The Community Banking segment reported net income of \$70 million for the nine months ended September 30, 2020, compared to \$59 million for the nine months ended September 30, 2019. The increase was driven by the following:

- Net interest income increased \$99 million driven by higher average loan and deposit balances, led by our warehouse business partially offset by lower margins due to rate cuts that have occurred over the past year.
- Provision (benefit) for credit losses was \$14 million lower primarily due to lower net charge-offs as 2019 included the charge-off of the Live Well commercial loan.
- Noninterest income increased \$10 million as during 2020 the Community Banking segment has not repurchased any residential HELOC loans from the Mortgage Originations segment. In 2019, HELOC purchases from the Mortgage Originations segment resulted in upfront losses for the Community Banking segment.
- Noninterest expense increased \$108 million primarily driven by higher intersegment expense allocation from the impact of the degradation in the economic forecasts and credit downgrades on the provision for credit losses.

Mortgage Originations

We are a leading national originator of residential first mortgages. Our Mortgage Originations 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 and retain certain mortgage loans in our LHFI portfolio which generate interest income in the Mortgage Originations segment.

Mortgage Originations	Three Months Ended,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
(Dollars in millions)						
Summary of Operations						
Net interest income	\$ 49	\$ 56	\$ (7)	\$ 147	\$ 103	\$ 44
Provision (benefit) for credit losses	(3)	(2)	(1)	(8)	(3)	(5)
Net interest income after provision for credit losses	52	58	(6)	155	106	49
Net gain on loan sales	344	303	41	737	243	494
Loan fees and charges	29	22	7	68	47	21
Loan administration expense	(10)	(8)	(2)	(25)	(16)	(9)
Net return (loss) on mortgage servicing rights	12	(8)	20	10	9	1
Other noninterest income	3	1	2	5	9	(4)
Total noninterest income	378	310	68	795	292	503
Compensation and benefits	42	38	4	111	79	32
Commissions	71	61	10	160	75	85
Loan processing expense	15	14	1	39	23	16
Other noninterest expense	32	56	(24)	114	63	51
Total noninterest expense	160	169	(9)	424	240	184
Income before indirect overhead allocations and income taxes	270	199	71	526	158	368
Indirect overhead allocation	(18)	(15)	(3)	(45)	(30)	(15)
Provision for income taxes	53	39	14	101	26	75
Net income	\$ 199	\$ 145	\$ 54	\$ 380	\$ 102	\$ 278

Key Metrics

Mortgage rate lock commitments (fallout-adjusted) (1)(2)	\$ 15,000	\$ 13,800	\$ 1,200	\$ 40,000	\$ 24,100	\$ 15,900
Average number of FTE employees	1,758	1,599	159	1,675	1,406	269

- (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.
- (2) Rounded to nearest hundred million.

Comparison to Prior Quarter

The Mortgage Originations segment reported net income of \$199 million for the three months ended September 30, 2020 as compared to \$145 million for the three months ended June 30, 2020. The increase was driven by the following:

- Net gain on loan sales increased \$41 million, to \$344 million, as compared to \$303 million in the second quarter 2020. The net gain on loan sale margin increased 12 basis points, to 2.31 percent for the third quarter 2020, as compared to 2.19 percent for the second quarter 2020. The increase was primarily driven by improved execution in secondary marketing and the gain associated with the RMBS transaction we executed during the quarter. Fallout-adjusted locks increased \$1.2 billion, or 9 percent, to \$15.0 billion, as historically low interest rates continued to support a strong refinance market.
- Net return (loss) on mortgage servicing rights increased \$20 million, to a \$12 million net gain for the third quarter of 2020, compared to an \$8 million net loss for the second quarter 2020. The third quarter 2020 MSR return normalized following the MSR valuation decrease caused by rising prepayment speeds in the second quarter of 2020.
- Loan fees and charges, commissions and loan processing expense all increased due to \$2.3 billion higher mortgage closings in the third quarter of 2020.

- Other noninterest expense decreased \$24 million primarily driven by certain performance-related earn out adjustments related to our Opes Advisors acquisition in the second quarter of 2020 along with a decrease in the intersegment expense allocation of \$8 million from the impact of the degradation of economic forecasts and credit downgrades on the provision for credit losses.
- Net interest income declined \$7 million driven about equally by lower average HFS and HFI mortgage balances as deliveries and payoffs outpaced new closings and yields continued to decline in line with market rates.

Comparison to Prior Year to Date

The Mortgage Originations segment reported net income of \$380 million for the nine months ended September 30, 2020 and \$102 million for the nine months ended September 30, 2019. The increase was driven by the following:

- Net gain on loan sales increased \$494 million, to \$737 million, as compared to \$243 million in the first nine months of 2019. Fallout adjusted locks increased \$15.9 billion, or 65 percent, to \$40.0 billion, primarily driven by low interest rates that fueled a strong refinance market. The net gain on loan sale margin increased 89 basis points to 1.85 percent for the first nine months of 2020, as compared to 0.96 percent for the first nine months of 2019 reflecting our management of volume level to fit our fulfillment capacity driven by demand due to market conditions, in addition to a higher mix of retail closings (29 percent during the first nine months of 2020 compared to 20 percent for the first nine months of 2019).
- Net interest income increased \$44 million primarily due to \$2.0 billion higher average LHFS balances resulting from increased mortgage production.
- Loan fees and charges, commissions and loan processing expense all increased due to \$11.8 billion higher closings and increased retail mix in the first half of 2020.
- Other noninterest expense increased \$51 million primarily driven by an increase in the intersegment expense allocation from the impact of the degradation of economic forecasts and credit downgrades on the provision for credit losses.

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 ancillary fees and earn income through the use of noninterest bearing escrows. The loans we service generate custodial deposits which provide a stable funding source which support interest-earning asset generation in the Community Banking and Mortgage Originations segments. Revenue for serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the delinquency status of the underlying loans. The Mortgage Servicing segment also services residential mortgages 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,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
(Dollars in millions)						
Summary of Operations						
Net interest income	\$ 5	\$ 4	\$ 1	\$ 14	\$ 11	\$ 3
Loan fees and charges	\$ 16	\$ 19	\$ (3)	\$ 43	\$ 22	\$ 21
Loan administration income	40	36	4	112	91	21
Total noninterest income	56	55	1	155	113	42
Compensation and benefits	12	11	1	33	19	14
Loan processing expense	8	9	(1)	24	30	(6)
Other noninterest expense	21	17	4	57	43	14
Total noninterest expense	41	37	4	114	92	22
Income before indirect overhead allocations and income taxes	20	22	(2)	55	32	23
Indirect overhead allocation	(4)	(6)	2	(15)	(13)	(2)
Provision for income taxes	3	3	—	8	4	4
Net income	\$ 13	\$ 13	\$ —	\$ 32	\$ 15	\$ 17

Key Metrics

Average number of residential loans serviced (1)	1,073,000	1,062,000	11,000	1,098,000	979,000	119,000
Average number of FTE employees	582	520	62	541	275	266

(1) Rounded to nearest thousand.

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

	September 30, 2020		June 30, 2020		March 31, 2020		December 31, 2019		September 30, 2019	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts
(Dollars in millions)										
Loan servicing										
Subserviced for others (2)	\$ 180,981	893,559	\$ 174,517	854,693	\$ 193,037	916,989	\$ 194,638	918,662	\$ 171,145	826,472
Serviced for others (3)	37,908	148,868	29,846	122,779	23,439	102,338	24,003	105,469	25,039	106,992
Serviced for own loan portfolio (4)	8,469	62,486	9,211	64,142	8,539	63,085	9,536	66,526	8,058	60,088
Total loans serviced	\$ 227,358	1,104,913	\$ 213,574	1,041,614	\$ 225,015	1,082,412	\$ 228,177	1,090,657	\$ 204,242	993,552

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

(2) Loans subserviced for a fee for non-Flagstar owned loans or MSR. Includes temporary short-term subservicing performed as a result of sales of servicing-released MSR.

(3) Loans for which Flagstar owns the MSR.

(4) Includes LHF1 (residential first mortgage, home equity and other consumer), LHFS (residential first mortgage) and loans with government guarantees (residential first mortgage).

Comparison to Prior Quarter

The Mortgage Servicing segment reported net income of \$13 million for the three months ended September 30, 2020, consistent with net income reported for the three months ended June 30, 2020. Loan administration income increased \$4 million, driven by an increase in the average number of subserviced loans and higher monthly service fees for loans in forbearance. This was mostly offset by a \$3 million decrease in loan fees and charges driven by lower ancillary fees.

Comparison to Prior Year to Date

The Mortgage Servicing segment reported net income of \$32 million for the nine months ended September 30, 2020, compared to net income of \$15 million for the nine months ended September 30, 2019. The \$17 million increase in net income was driven by a \$42 million increase in noninterest income, a result of a decline in LIBOR-based fees paid to sub-servicing customers on custodial deposits, higher ancillary income driven by increases in forbearance and loss mitigation activities, and higher subservice fee income due to an increase in the average number of subserviced loans as well as an increase in the number of delinquent loans which carry a higher servicing charge. This was partially offset by a \$14 million increase in compensation and benefits expense primarily due to business growth, including bringing default servicing in-house in late 2019. Other noninterest expense increased \$14 million driven by an increase in loans serviced and other fees, including software costs and corporate allocations.

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. The Other segment charges each operating segment a daily funds transfer pricing rate on their average assets which resets more rapidly than the underlying borrowing costs resulting in an asset sensitive position. 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,			Nine Months Ended,		
	September 30, 2020	June 30, 2020	Change	September 30, 2020	September 30, 2019	Change
	(Dollars in millions)					
Summary of Operations						
Net interest income	\$ (32)	\$ (25)	\$ (7)	\$ (60)	\$ —	\$ (60)
Provision for credit losses	37	107	(70)	153	4	149
Net interest income after provision for credit losses	(69)	(132)	63	(213)	(4)	(209)
Net gain on loan sales	—	—	—	—	1	(1)
Loan administration income (expense)	(3)	(6)	3	(26)	(50)	24
Other noninterest income	5	8	(3)	20	58	(38)
Total noninterest income	2	2	—	(6)	9	(15)
Compensation and benefits	41	43	(2)	118	100	18
Loan processing expense	—	1	(1)	2	2	—
Other noninterest expense	(30)	(103)	73	(137)	1	(138)
Total noninterest expense	11	(59)	70	(17)	103	(120)
Income before indirect overhead allocations and income taxes	(78)	(71)	(7)	(202)	(98)	(104)
Indirect overhead allocation	33	32	1	91	73	18
Provision for income taxes	2	(7)	9	(13)	(9)	(4)
Net income (loss)	\$ (47)	\$ (32)	\$ (15)	\$ (98)	\$ (16)	\$ (82)
Key Metrics						
Average number of FTE employees	1,163	1,142	21	1,163	1,056	107

Comparison to Prior Quarter

The Other segment reported a net loss of \$47 million, for the three months ended September 30, 2020, compared to a net loss of \$32 million for the three months ended June 30, 2020. The \$15 million higher loss was primarily driven by a decrease in net interest income as a result of the Bank's overall asset sensitive position and the lower average rates throughout the third quarter. The provision for credit losses decreased \$70 million as a result of the significant provision taken in second quarter of 2020 due to our forecast of economic and credit conditions as impacted by COVID-19. The additional provision in the third quarter of 2020 reflects our belief that the economy will continue to be challenged by the response to the COVID-19 pandemic for an extended period of time, especially as it relates to consumer loan forbearance and the commercial real estate sector. The provision for credit losses is directly allocated to the other applicable segments through other noninterest expense. The majority of all other activity within the Other segment largely offsets and is allocated back to the operating segments, recorded as contra other noninterest expense.

Comparison to Prior Year to Date

The Other segment reported a net loss of \$98 million, for the nine months ended September 30, 2020, compared to net loss of \$16 million for the nine months ended September 30, 2019. The \$82 million decrease was primarily due to a \$60 million decrease in net interest income as a result of the Bank's overall asset sensitive position and the lower average rates during the nine months ended September 30, 2020 as compared to the nine months ended September 30, 2019. The nine months ended September 30, 2019 also includes a \$25 million benefit from the DOJ Liability fair value adjustment. The provision for credit losses increased \$149 million primarily due to changes in the forecasts of economic conditions and impacts of COVID-19. With the adoption of CECL on January 1, 2020, the difference between the consolidated provision for credit losses and the sum of total net charge-offs and the change in loan balances is still assigned to the Other segment. However, this amount now includes changes related to the economic forecasts, model changes, qualitative adjustments and credit downgrades. The provision for credit losses is then directly allocated to the other applicable segments through other noninterest expense. The majority of all other activity within the Other segment largely offsets and is allocated back to the operating segments, recorded as contra other noninterest expense.

Risk Management

Certain risks are inherent in our business and include, but are not limited to, operational, strategic, credit, regulatory compliance, legal, reputational, liquidity, market and cybersecurity. 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 Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2019 and in Part II, Item 1A of this Quarterly Report on Form 10-Q. 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 manage credit risk using a thorough process designed to ensure we make prudent and consistent credit decisions. The process was developed with a focus on utilizing risk-based limits and credit concentrations while emphasizing diversification on a geographic, industry and customer level. The process utilizes documented underwriting guidelines, comprehensive documentation standards, and ongoing portfolio monitoring including the timely review and resolution of credits experiencing deterioration. These activities, along with the management of credit policies and credit officers' delegated authority, are centrally managed by our credit risk team.

We maintain credit limits in compliance with regulatory requirements. Under 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 plus Tier 2 capital and any portion of the allowance for credit losses not included in the Tier 2 capital. This limit was \$371 million as of September 30, 2020. 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. During 2020, the Board approved the extension of short-term “overlines” to certain warehouse borrowers as all advances are fully collateralized by residential mortgage loans and this asset class has had very low levels of historical loss, resulting in a temporary increase of the warehouse borrower limit to \$175 million. 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. At September 30, 2020, we had \$12.1 billion in our commercial loan portfolio with our warehouse lending and home builder finance businesses accounting for 63 percent of the total. Of the remaining commercial loans in our portfolio, the majority of CRE and C&I loans were with customers who have established relationships within our core banking footprint.

Credit risk within the commercial loan portfolio is managed using concentration limits based on line of business, industry, geography and product type. This is managed through the use of strict underwriting guidelines detailed in credit policies, ongoing loan level reviews, monitoring of the concentration limits and continuous portfolio risk management reporting. The commercial credit policy outlines the risks and underwriting requirements and provides a framework for all credit and lending activities. Our commercial loan credit policies consider maturity and amortization terms, maximum LTVs, minimum debt service coverage ratios, construction loan monitoring procedures, appraisal requirements, pro-forma analysis requirements and thresholds for product specific advance rates.

We typically originate loans on a recourse basis with full or partial guarantees. On a limited basis, we may approve loans without recourse if sufficient consideration is provided in the loan structure. Non-recourse loans primarily have low LTVs, strong cash flow coverage or other mitigating factors supporting the lack of a guaranty. These guidelines also require an appraisal of pledged collateral prior to closing and on an as-needed basis when market conditions justify. We contract with a variety of independent licensed professional firms to conduct appraisals that are in compliance with our internal commercial credit and appraisal policies and regulatory requirements.

Our commercial loan portfolio includes leveraged lending. The Bank defines a transaction as leveraged when two or more of the following conditions exist: 1) proceeds from the loan are used for buyouts, acquisitions, recapitalization or capital distributions, 2) the borrower's total funded debt to EBITDA ratio is greater than four or Senior Funded Debt to EBITDA ratio is greater than three, 3) the borrower has a high debt to net worth ratio within its industry or sector as defined by internal limits, and 4) debt leverage significantly exceeds industry norms or historical levels for leverage as defined by internal limits. Leveraged lending transactions typically result in leverage ratios that are significantly above industry norms or historical levels. Our leveraged lending portfolio and other loan portfolios with above-average default probabilities tend to behave similarly during a downturn in the general economy or a downturn within a specific sector. Consequently, we take steps to avoid undue concentrations by setting limits consistent with our appetite for risk and our financial capacity. In addition, there are specific underwriting conditions set for our leveraged loan portfolio and there is additional emphasis on certain items beyond the standard underwriting process including synergies, collateral shortfall and projections.

Our commercial loan portfolio also includes loans that are part of the SNC Program. A SNC is defined as any loan or loan commitment of at least \$100 million that is shared by three or more federally regulated institutions. On an annual basis, a joint regulatory task force performs a risk assessment of all SNCs. When completed, these risk ratings are shared and our risk rating must be no better than the risk rating listed in the SNC assessment. Exposure and credit quality for SNCs are carefully monitored and reported internally.

For our commercial real estate portfolio, including owner and nonowner-occupied properties and home builder finance lending, we obtain independent appraisals as part of our underwriting and monitoring process. These appraisals are reviewed by an internal appraisal group that is independent from our sales and credit teams.

The home builder finance group is a national relationship-based lending platform that focuses on markets with strong housing fundamentals and higher population growth potential. The team primarily originates construction and development loans. We generally lend in metropolitan areas or counties where verifiable market statistics and data are readily available to

support underwriting and ongoing monitoring. We also evaluate the jurisdictions and laws, demographic trends (age, population and income), housing characteristics and economic indicators (unemployment, economic growth, household income trends) for the geographies where our borrowers primarily operate. We engage independent licensed professionals to supply market studies and feasibility reports, environmental assessments and project site inspections to complement the procedures we perform internally. Further, we perform ongoing monitoring of the projects including periodic inspections of collateral and annual portfolio and individual credit reviews.

The consumer loan portfolio has been built on strong underwriting criteria and within concentration limits intended to diversify our risk profile. We have built our consumer loan portfolio by adding high quality first mortgage loans to our balance sheet making up 57 percent of our total consumer loan portfolio at September 30, 2020.

Loans held-for-investment

The following table summarizes amortized cost of our loans held-for-investment by category:

	September 30, 2020	% of Total	December 31, 2019	% of Total	Change
	(Dollars in millions)				
Consumer loans					
Residential first mortgage	\$ 2,472	15.0 %	\$ 3,154	26.0 %	\$ (682)
Home equity (1)	924	5.6 %	1,024	8.4 %	(100)
Other	973	5.9 %	729	6.0 %	244
Total consumer loans	4,369	26.5 %	4,907	40.5 %	(538)
Commercial loans					
Commercial real estate	2,996	18.2 %	2,828	23.3 %	168
Commercial and industrial	1,520	9.2 %	1,634	13.5 %	(114)
Warehouse lending	7,591	46.1 %	2,760	22.8 %	4,831
Total commercial loans	12,107	73.5 %	7,222	59.5 %	4,885
Total loans held-for-investment	\$ 16,476	100.0 %	\$ 12,129	100.0 %	\$ 4,347

(1) Includes second mortgages, HELOCs and HELOANs.

Prior to March 2020 we had continued to strengthen our Community Banking segment by growing our consumer and commercial real estate LHF. Due to the COVID-19 pandemic, subsequent to March 2020 we have focused on managing credit in our CRE and C&I portfolios while growing our lower-risk, higher return warehouse lending portfolio. This drove growth in our commercial loan portfolio of \$4.9 billion, or 68 percent, from December 31, 2019 to September 30, 2020. Our consumer loan portfolio decreased \$538 million, or 11 percent, from December 31, 2019 to September 30, 2020 as a \$244 million increase in other consumer loans was more than offset by a \$682 million decrease in residential first mortgage loans due to higher refinance activity and lower new closings to the HFI portfolio.

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 LHF 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, 2020, loans in this portfolio had an average current FICO score of 738 and an average LTV of 52 percent.

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

	September 30, 2020	December 31, 2019
	(Dollars in millions)	
Estimated LTVs (1)		
Less than 80% and current FICO scores (2):		
Equal to or greater than 660	\$ 1,676	\$ 2,263
Less than 660	92	93
80% and greater and current FICO scores (2):		
Equal to or greater than 660	624	687
Less than 660	80	111
Total	<u>\$ 2,472</u>	<u>\$ 3,154</u>
Geographic region		
California	\$ 908	\$ 1,205
Michigan	420	442
Texas	169	205
Washington	148	181
Florida	116	214
Colorado	69	68
Arizona	61	79
Illinois	59	95
New York	56	84
New Jersey	38	49
Other	428	532
Total	<u>\$ 2,472</u>	<u>\$ 3,154</u>

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

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

The following table presents amortized cost of our total residential first mortgage LHFH as of September 30, 2020, by year of closing:

	2020	2019	2018	2017	2016 and Prior	Total
	(Dollars in millions)					
Residential first mortgage loans	\$ 274	\$ 676	\$ 305	\$ 366	\$ 851	\$ 2,472
Percent of total	11.1 %	27.3 %	12.3 %	14.8 %	34.5 %	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, 2020, HELOCs and HELOANs in a first lien position totaled \$189 million. As of September 30, 2020, loans in this portfolio had an average current FICO score of 746 and an average CLTV of 54 percent.

Other consumer loans. Our other consumer loan portfolio consists of secured and unsecured loans originated through our indirect lending business, third party closings and our Community Banking segment.

The following table presents amortized cost of our other consumer loan portfolio by purchase type:

	September 30, 2020		December 31, 2019	
	Balance	% of Portfolio	Balance	% of Portfolio
	(Dollars in millions)			
Indirect lending	\$ 710	73 %	\$ 577	79 %
Point of Sale	202	21 %	63	9 %
Other	61	6 %	89	12 %
Total other consumer loans	<u>\$ 973</u>	<u>100 %</u>	<u>\$ 729</u>	<u>100 %</u>

At September 30, 2020, other consumer loans increased to \$973 million compared to \$729 million at December 31, 2019. The increase is primarily due to growth in our high quality, dealer relationship based, non-auto indirect lending business of which 68 percent is secured by boats and 32 percent secured by recreational vehicles and our point of sale portfolio. As of September 30, 2020, loans in our indirect portfolio had an average current FICO score of 749. Point of sale loans include loans originated in conjunction with certain 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 centers and single tenant locations, which include pharmacies and hardware 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, 2020, our average LTV and average debt service coverage for our CRE portfolio, excluding owner-occupied real estate, was 53 percent and 2.35 times, respectively. Our CRE loans primarily earn interest at a variable rate.

Our national home builder finance program within our commercial portfolio contained \$2.0 billion in commitments with \$849 million in outstanding loans as of September 30, 2020. Certain of these loans are collateralized and included in our CRE portfolio while the remaining loans are unsecured and included in our C&I portfolio.

As of September 30, 2020, our CRE portfolio included \$187 million of SNCs and one leveraged lending loan of \$4 million. The SNC portfolio had seventeen borrowers with an average UPB of \$22 million and an average commitment of \$34 million. There were no nonperforming SNC or leveraged loans as of September 30, 2020, and no SNC or leveraged loans outstanding were rated as special mention or substandard.

The following table presents amortized cost of our total CRE LHFI by collateral location and collateral type:

	MI	TX	CA	CO	FL	Other	Total	% by collateral type
	(Dollars in millions)							
September 30, 2020								
Home builder	\$ 28	\$ 171	\$ 138	\$ 142	\$ 107	\$ 181	\$ 767	25.6 %
Owner occupied	305	4	27	—	1	50	387	12.9 %
Multi family	208	79	35	9	13	145	489	16.3 %
Retail (1)	163	—	6	4	—	111	284	9.5 %
Office	181	19	—	—	2	55	257	8.6 %
Hotel	136	—	25	—	—	94	255	8.5 %
Senior living facility	75	25	—	—	4	61	165	5.5 %
Industrial	52	—	25	—	6	25	108	3.6 %
Parking garage/lot	48	9	1	—	1	33	92	3.1 %
Land-residential (2)	3	—	7	—	4	5	19	0.6 %
Shopping Mall	4	—	14	—	—	—	18	0.6 %
Single family residence (3)	1	—	—	—	—	2	3	0.1 %
All other (4)	15	48	21	3	18	47	152	5.1 %
Total	\$ 1,219	\$ 355	\$ 299	\$ 158	\$ 156	\$ 809	\$ 2,996	100.0 %
Percent by state	40.7 %	11.8 %	10.0 %	5.3 %	5.2 %	27.0 %	100.0 %	

- (1) Includes multipurpose retail space, neighborhood centers, shopping centers and single-use retail space.
- (2) Loans secured by land. Land residential includes development and unimproved vacant land.
- (3) Loans secured by 1-4 single family residence properties.
- (4) All other primarily includes: mini-storage facilities, data centers, movie theaters, etc.

Commercial and industrial loans. Commercial and industrial LHFI facilities 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.

As of September 30, 2020, our C&I portfolio included \$645 million of SNCs. We are the lead bank on 26 percent of the SNCs. The services sector and the financial and insurance sector comprised the majority of the portfolio's NBV with 28 and 39 percent of the balance, respectively. The SNC portfolio had forty-nine borrowers with an average UPB of \$13 million and an

average commitment of \$25 million. There were no nonperforming loans or loans rated as special mention as of September 30, 2020, and loans totaling \$26 million of amortized cost were rated as substandard.

As of September 30, 2020, our C&I portfolio included \$327 million of leveraged lending, of which \$212 million were SNCs. The manufacturing sector comprised 49 percent of the leveraged lending portfolio, and the financial and insurance sector comprised 25 percent. There were no nonperforming loans as of September 30, 2020, and loans totaling \$21 million and \$25 million were rated as special mention and substandard, respectively. Included in Financial & Insurance within our C&I portfolio, are \$151 million in loans outstanding to 4 borrowers that are collateralized by MSR assets. Our amounts outstanding to those borrowers range from \$10 million to \$60 million and the ratio of the loan outstanding to the fair market value of the collateral ranges from 21 percent to 48 percent.

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

	MI	CA	OH	IN	WI	TX	MN	NY	SC	CT	Other	Total	% by industry
(Dollars in millions)													
September 30, 2020													
Financial & Insurance	\$ 92	\$ 19	\$ 21	\$ 13	\$ —	\$ 31	\$ 60	\$ 67	\$ 60	\$ 5	\$ 125	\$ 493	32.4 %
Services	103	39	2	7	—	28	21	—	—	42	88	330	21.7 %
Manufacturing	158	6	28	1	7	12	—	—	—	—	52	264	17.4 %
Home Builder Finance	—	12	—	—	—	58	—	—	—	—	1	71	4.7 %
Rental & Leasing	80	—	13	—	—	—	—	—	—	—	30	123	8.1 %
Distribution	80	20	1	2	—	—	—	—	—	—	14	117	7.7 %
Healthcare	2	14	1	—	—	8	—	—	—	—	13	38	2.5 %
Government & Education	28	6	—	20	—	—	—	—	—	13	—	67	4.4 %
Servicing Advances	—	—	—	—	—	—	—	—	—	—	10	10	0.7 %
Commodities	3	—	—	1	—	—	—	—	—	—	3	7	0.5 %
Total	\$ 546	\$ 116	\$ 66	\$ 44	\$ 7	\$ 137	\$ 81	\$ 67	\$ 60	\$ 60	\$ 336	\$ 1,520	100.0 %
Percent by state	36.1 %	7.6 %	4.3 %	2.9 %	0.5 %	9.0 %	5.3 %	4.4 %	3.9 %	3.9 %	22.1 %	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. In response to COVID-19, we have increased credit requirements for government loans and lowered the advance rate for loans that we believe have higher risk, as well as not accepting jumbo or non-qualified mortgage loans as collateral.

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, 2020 was \$10.0 billion, of which \$7.6 billion was outstanding, compared to \$4.8 billion at September 30, 2019, of which \$3.2 billion was outstanding.

Credit Quality

Our focus on effectively managing credit risk through our careful underwriting standards and processes has resulted in strong trends in certain credit quality characteristics in our loan portfolios. The credit quality of our loan portfolios is demonstrated by low delinquency levels, minimal charge-offs and low levels of nonperforming loans.

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 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:

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
	(Dollars in millions)	
LHFI		
Residential first mortgage	\$ 22	\$ 13
Commercial and industrial	10	—
Home equity	2	2
Other consumer	2	1
Total nonperforming LHFI	<u>36</u>	<u>16</u>
TDRs		
Residential first mortgage	7	8
Home equity	2	2
Total nonperforming TDRs	<u>9</u>	<u>10</u>
Total nonperforming LHFI and TDRs (1)	<u>45</u>	<u>26</u>
Real estate and other nonperforming assets, net	6	10
LHFS	6	5
Total nonperforming assets	<u>\$ 57</u>	<u>\$ 41</u>
Nonperforming assets to total assets (2)	0.17 %	0.15 %
Nonperforming LHFI and TDRs to LHFI	0.28 %	0.21 %
Nonperforming assets to LHFI and repossessed assets (2)	0.31 %	0.30 %

(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:

	<u>Three Months Ended,</u>		<u>Nine Months Ended,</u>	
	<u>September 30,</u>	<u>June 30,</u>	<u>September 30,</u>	<u>September 30,</u>
	<u>2020</u>	<u>2020</u>	<u>2020</u>	<u>2019</u>
	(Dollars in millions)			
Beginning balance	\$ 33	\$ 29	\$ 26	\$ 22
Additions	17	12	39	82
Reductions	1	—	1	—
Principal payments	(3)	(1)	(11)	(41)
Charge-offs	(2)	(1)	(4)	(34)
Return to Performing Status	(1)	(6)	(6)	(1)
Transfers to REO	—	—	—	(2)
Total nonperforming LHFI and TDRs (1)	<u>\$ 45</u>	<u>\$ 33</u>	<u>\$ 45</u>	<u>\$ 26</u>

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

Delinquencies

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

	September 30, 2020		December 31, 2019	
	Amount	% of LHFI	Amount	% of LHFI
(Dollars in millions)				
Performing loans past due 30-89:				
Consumer loans				
Residential first mortgage	\$ 8	0.05 %	\$ 9	0.08 %
Home equity	1	0.01 %	1	0.01 %
Other consumer	4	0.02 %	4	0.03 %
Total consumer loans	13	0.08 %	14	0.12 %
Total performing loans past due 30-89 days	\$ 13	0.08 %	\$ 14	0.12 %

For further information, see Note 4 - Loans Held-for-Investment.

Payment Deferrals

Beginning in March 2020, as a response to COVID-19, we offered our consumer borrowers principal and interest payment deferrals, forbearance and/or extensions. Consumer borrowers were not required to provide proof of hardship to be granted forbearance or payment deferral. Typically payment history is the primary tool used to identify consumer borrowers who are experiencing financial difficulty. Forbearance or payment deferrals make this determination more challenging. In addition, consumer borrowers who have requested forbearance or payment deferrals are not being aged and remain in the aging category they were in prior to forbearance or payment deferral.

The table below summarizes borrowers in our consumer loan portfolios that are in forbearance or were granted a payment deferral:

	As of September 30, 2020			As of June 30, 2020		
	Number of Borrowers	UPB	Percent of Portfolio	Number of Borrowers	UPB	Percent of Portfolio
(Dollars in millions)						
Loans Held-For-Investment						
Consumer loans						
Residential first mortgage	819	\$ 255	10.4 %	885	\$ 292	10.8 %
Home equity	821	62	6.9 %	1,015	87	9.0 %
Other consumer	887	40	4.2 %	1,408	50	5.8 %
Total consumer loan deferrals/forbearance	2,527	\$ 357	8.3 %	3,308	\$ 429	9.5 %
Loans Held-For-Sale						
Residential first mortgage	142	\$ 71	1.6 %	302	\$ 126	4.0 %

As of September 30, 2020, commercial borrowers requested and were granted \$47 million of payment deferrals, and, of that amount, \$19 million are deferrals of both principal and interest payments, \$12 million are deferrals of principal only, and \$16 million are deferrals of interest only. Commercial borrowers who have requested payment deferrals are not being aged and remain in the aging category they were in prior to payment deferral.

The table below summarizes borrowers in our commercial loan portfolios that have requested and received payment deferral:

	As of September 30, 2020			As of June 30, 2020		
	Number of Borrowers	UPB	Percent of Portfolio	Number of Borrowers	UPB	Percent of Portfolio
(Dollars in millions)						
Loans Held-For-Investment						
Automotive	1	\$ 1	1.5 %	8	\$ 44	28.4 %
Leisure & entertainment	2	—	0.1 %	13	15	12.1 %
Healthcare	—	—	— %	14	4	9.0 %
Other	11	7	0.6 %	70	108	6.6 %
Total C&I deferrals	14	8	0.6 %	105	171	13.3 %
Hotel	3	28	10.8 %	12	132	56.3 %
Retail	—	—	— %	24	91	29.1 %
Senior housing	—	—	— %	1	7	5.0 %
Other	7	11	0.4 %	98	148	6.4 %
Total CRE deferrals	10	39	1.3 %	135	378	12.5 %
Warehouse deferrals	—	—	— %	—	—	— %
Total commercial loan deferrals (1)	24	\$ 47	1.0 %	240	\$ 549	11.0 %

(1) Percent shown excludes warehouse loans.

The table below summarizes the percent of our residential loan servicing portfolio in forbearance as of September 30, 2020:

	Loans in Forbearance							
	Total Population		Borrowers making July, August and September Payments		Remaining Borrowers		Total Loans in Forbearance	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Percent of UPB	Percent of Accounts
(Dollars in millions)								
Loan servicing								
Subserviced for others (2)	\$ 180,981	893,559	\$ 5,654	26,529	\$ 15,103	67,192	11.5 %	10.5 %
Serviced for others (3) (4)	37,908	148,868	950	3,908	3,081	12,217	10.6 %	10.8 %
Serviced for own loan portfolio (5)	8,469	62,486	196	1,792	468	1,886	7.8 %	5.9 %
Total loans serviced	\$ 227,358	1,104,913	\$ 6,800	32,229	\$ 18,652	81,295	11.2 %	10.3 %

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

(2) Loans subserviced for a fee for non-Flagstar owned loans or MSR. Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs.

(3) Loans for which Flagstar owns the MSR.

(4) Of the \$1.8 billion of GNMA repurchase options on the balance sheet as of September 30, 2020, \$1.7 billion relates to loans in forbearance and are included in remaining borrowers.

(5) Includes LHF1 (residential first mortgage, home equity and other consumer), LHFS (residential first mortgage), and loans with government guarantees (residential first mortgage).

The table below summarizes the percent of our residential loan servicing portfolio in forbearance as of June 30, 2020:

	Loans in Forbearance							
	Total Population		Borrowers making April, May and June Payments		Remaining Borrowers		Total Loans in Forbearance	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Percent of UPB	Percent of Accounts
(Dollars in millions)								
Loan servicing								
Subserviced for others (2)	\$ 174,384	854,216	\$ 7,145	32,403	\$ 13,808	59,692	12.0 %	10.8 %
Serviced for others (3)	29,979	123,256	1,261	5,058	3,018	11,661	14.3 %	13.6 %
Serviced for own loan portfolio (4)	9,211	64,142	237	1,895	473	1,850	7.7 %	5.8 %
Total loans serviced	\$ 213,574	1,041,614	\$ 8,643	39,356	\$ 17,299	73,203	12.1 %	10.8 %

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

(2) Loans subserviced for a fee for non-Flagstar owned loans or MSRs. Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs.

(3) Loans for which Flagstar owns the MSR. Remaining borrowers includes \$1.1 billion of GNMA repurchase options related to loans in forbearance.

(4) Includes LHF1 (residential first mortgage, home equity and other consumer), LHFS (residential first mortgage), loans with government guarantees (residential first mortgage), and repossessed assets.

As the MSR owner for loans serviced for others, the Agencies require us to advance payments on past due loans as follows:

	Principal and Interest	Taxes and Insurance
Fannie Mae and Freddie Mac	4 months	No time limit
GNMA	No time limit	No time limit

We anticipate servicing advances for these loans in forbearance to increase throughout the remainder of 2020. We believe that we have ample liquidity to handle the increase in servicing advances. We initially provide advances on a short-term basis for loans we subservice and are reimbursed by the MSR owner. Our advance receivable for our subserviced loans is therefore insignificant.

Troubled debt restructurings (held-for-investment)

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.

Beginning in March 2020, as a response to COVID-19, we offered our consumer and commercial customers principal and interest payment deferrals and extensions. We considered these programs in the context of whether or not the short-term modifications of these loans would constitute a TDR. We considered the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), interagency guidance and related guidance from the FASB, which provided that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not required to be accounted for as TDRs. As a result, we have determined that these loans are not TDRs. We believe our application of the referenced guidance and accounting for these programs is appropriate.

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

	September 30, 2020	December 31, 2019
	(Dollars in millions)	
Performing TDRs		
Consumer Loans		
Residential first mortgage	\$ 20	\$ 20
Home equity	14	18
Commercial Real Estate	5	—
Total performing TDRs	39	38
Nonperforming TDRs		
Nonperforming TDRs	4	3
Nonperforming TDRs, performing for less than six months	5	7
Total nonperforming TDRs	9	10
Total TDRs	\$ 48	\$ 48

At September 30, 2020 our total TDR loans were consistent with December 31, 2019, primarily due to the addition of a commercial real estate loan offset by principal payments and payoffs. Of our total TDR loans, 81 percent and 79 percent were in performing status at September 30, 2020 and December 31, 2019, respectively. For further information, see Note 4 - Loans Held-for-Investment.

Allowance for Credit Losses

The following tables present the changes in the allowance for credit losses balance for the three and nine months ended September 30, 2020:

	Three Months Ended September 30, 2020								
	Residential First Mortgage	Home Equity	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total LHF Portfolio (1)	Unfunded Commitments	Total ACL
	(Dollars in millions)								
Beginning allowance balance	\$ 60	\$ 28	\$ 34	\$ 83	\$ 23	\$ 1	\$ 229	\$ 21	\$ 250
Provision (benefit) for credit losses:									
Loan volume	(4)	(1)	3	—	(4)	1	(5)	4	(1)
Economic forecast (2)	(3)	(3)	(1)	—	—	—	(7)	—	(7)
Credit (3)	(7)	1	(4)	13	12	—	15	—	15
Qualitative factor adjustments (4)	6	3	5	(7)	11	3	21	—	21
Charge-offs	(2)	(1)	(1)	—	—	—	(4)	—	(4)
Provision for charge-offs	2	1	1	—	—	—	4	—	4
Recoveries	—	1	1	—	—	—	2	—	2
Ending allowance balance	\$ 52	\$ 29	\$ 38	\$ 89	\$ 42	\$ 5	\$ 255	\$ 25	\$ 280

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

(2) Includes changes in the lifetime loss rate based on current economic forecasts as compared to forecasts used in the prior quarter.

(3) Includes changes in the probability of default and severity of default based on current borrower and guarantor characteristics, as well as individually evaluated reserves.

(4) Includes \$10 million of unallocated reserve attributed to various portfolios for presentation purposes.

Nine Months Ended September 30, 2020

	Residential First Mortgage	Home Equity	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total LHFI Portfolio (1)	Unfunded Commitments	Total ACL
(Dollars in millions)									
Beginning balance ALLL	\$ 22	\$ 14	\$ 6	\$ 38	\$ 22	\$ 5	\$ 107	\$ 3	\$ 110
Impact of adopting ASC 326	25	12	10	(14)	(6)	(4)	23	7	30
Beginning allowance balance	47	26	16	24	16	1	130	10	140
Provision (benefit) for credit losses:									
Loan volume	(8)	(2)	8	2	(1)	1	—	4	4
Economic forecast (2)	11	—	5	15	(3)	—	28	11	39
Credit (3)	(4)	(1)	2	23	12	—	32	—	32
Qualitative factor adjustments (4)	6	3	5	25	18	3	60	—	60
Charge-offs	(5)	(3)	(4)	—	—	—	(12)	—	(12)
Provision for charge-offs	5	3	4	—	—	—	12	—	12
Recoveries	—	3	2	—	—	—	5	—	5
Ending allowance balance	\$ 52	\$ 29	\$ 38	\$ 89	\$ 42	\$ 5	\$ 255	\$ 25	\$ 280

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

(2) Includes changes in the lifetime loss rate based on current economic forecasts as compared to forecasts used in the prior quarter.

(3) Includes changes in the probability of default and severity of default based on current borrower and guarantor characteristics, as well as individually evaluated reserves.

(4) Includes \$10 million of unallocated reserve attributed to various portfolios for presentation purposes.

The allowance for credit losses was \$280 million at September 30, 2020, compared to \$250 million at June 30, 2020. The increase in the allowance is primarily reflective of changes in our economic forecast and judgment we applied related to those forecasts and underlying borrower credit as a result of the ongoing COVID-19 pandemic between June 30, 2020 and September 30, 2020. We utilized the Moody's September scenarios in our forecast: a growth forecast, weighted at 30 percent; a baseline forecast, weighted at 40 percent; and an adverse forecast, weighted at 30 percent. The resulting composite forecast for the third quarter 2020 was roughly equivalent to the scenario used in the second quarter 2020. Unemployment ends the year at 10 percent and recovers only slightly in 2021. GDP recovers only slightly by the end of the year from current levels and does not return to near pre-COVID level until 2024. HPI decreases 2 percent from mid-2020 through 2021. We judgmentally increased the qualitative reserves by \$21 million, guided by the model output from Moody's adverse scenario, our judgment relating to industries and borrowers we believe could be more exposed to the stressful conditions in our forecast, uncertainty related to loans in forbearance and our judgment regarding economic uncertainty including the impact from the upcoming national election and additional government stimulus.

The allowance as a percentage of LHFI was 1.7 percent at September 30, 2020 compared to 0.9 percent at December 31, 2019. Excluding warehouse, the allowance as a percentage of LHFI was 3.1 percent at September 30, 2020 compared to 1.1 percent at December 31, 2019. The increase in the allowance, as a percentage of LHFI is reflective of the additional increases to the allowance to reflect the change in economic and credit forecast used during that period. At September 30, 2020, we had a 2.8 percent and 1.3 percent allowance coverage on our consumer loan portfolio and our commercial loan portfolio, respectively.

The following tables set forth certain information regarding the allocation of our allowance to each loan category, including the allowance amount as a percentage of amortized cost and average loan life:

September 30, 2020					
	LHFI Portfolio (1)	Percent of Portfolio	Allowance Amount (2)	Allowance as a Percent of Loan Portfolio	Weighted Average Loan Life
Consumer loans					
Residential first mortgage	\$ 2,459	14.9 %	\$ 52	2.1 %	4
Home equity	922	5.6 %	29	3.1 %	3
Other consumer	973	5.9 %	39	4.0 %	3
Total consumer loans	4,354	26.5 %	120	2.8 %	
Commercial loans					
Commercial real estate	\$ 2,996	18.2 %	\$ 106	3.5 %	2
Commercial and industrial	1,520	9.2 %	47	3.1 %	2
Warehouse lending	7,591	46.1 %	7	0.1 %	—
Total commercial loans	12,107	73.5 %	160	1.3 %	
Total consumer and commercial loans	\$ 16,461	100.0 %	\$ 280	1.7 %	
Total consumer and commercial loans excluding warehouse	\$ 8,870	53.9 %	\$ 273	3.1 %	

(1) Excludes loans carried under the fair value option

(2) Includes allowance for loan losses and reserve for unfunded commitments

December 31, 2019					
	LHFI Portfolio (1)	Percent of Portfolio	Allowance Amount (2)	Allowance as a Percent of Loan Portfolio	Weighted Average Loan Life
Consumer loans					
Residential first mortgage	\$ 3,145	26.0 %	\$ 22	0.7 %	5
Home equity	1,021	8.4 %	14	1.4 %	3
Other consumer	729	6.0 %	6	0.8 %	2
Total consumer loans	4,895	40.4 %	42	0.9 %	
Commercial loans					
Commercial real estate	\$ 2,828	23.3 %	\$ 40	1.4 %	2
Commercial and industrial	1,634	13.5 %	23	1.4 %	1
Warehouse lending	2,760	22.8 %	5	0.2 %	—
Total commercial loans	7,222	59.6 %	68	0.9 %	
Total consumer and commercial loans	\$ 12,117	100.0 %	\$ 110	0.9 %	
Total consumer and commercial loans excluding warehouse	\$ 9,357	77.2 %	\$ 105	1.1 %	

(1) Excludes loans carried under the fair value option

(2) Includes allowance for loan losses and reserve for unfunded commitments

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 closing 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 ALCO, which is composed of our executive officers and certain members of other management, monitors interest rate risk on an ongoing 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, 2020				
Scenario	Net interest income		\$ Change	% Change
	(Dollars in millions)			
100	\$	677	\$ 80	13.5 %
Constant	\$	596	—	— %
(100)		N/M	N/M	N/M
December 31, 2019				
Scenario	Net interest income		\$ Change	% Change
	(Dollars in millions)			
100	\$	592	\$ 34	6.0 %
Constant	\$	559	—	— %
(100)	\$	520	\$(39)	(6.9)%

In the net interest income simulations, our balance sheet exhibits asset sensitivity. When interest rates rise our net interest income increases. Conversely, when interest rates fall our net interest income decreases. At September 30, 2020, the \$37 million increase in net interest income in the constant scenario as compared to that at December 31, 2019 was primarily driven by the growth in our interest earning assets partially offset by lower short-term market rates.

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 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 provides 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, 2020					December 31, 2019					Policy Limits
Scenario	EVE	EVE %	\$ Change	% Change	Scenario	EVE	EVE %	\$ Change	% Change	
(Dollars in millions)										
300	\$ 3,643	12.4 %	\$ 710	24.2 %	300	\$ 3,147	13.6 %	\$ 150	5.0 %	22.5 %
200	\$ 3,495	11.9 %	\$ 562	19.2 %	200	\$ 3,152	13.7 %	\$ 155	5.2 %	15.0 %
100	\$ 3,287	11.2 %	\$ 354	12.1 %	100	\$ 3,103	13.5 %	\$ 106	3.5 %	7.5 %
Current	\$ 2,933	10.0 %	—	— %	Current	\$ 2,997	13.0 %	—	— %	— %
(100)	N/M	N/M	N/M	N/M	(100)	\$ 2,832	12.3 %	\$ (165)	(5.5)%	7.5 %

Our balance sheet exhibits asset sensitivity in various interest rate scenarios. The increase in EVE as rates raise is the result of the amount of assets that would be expected to reprice exceeding the amount of liabilities repriced. This increased as of September 30, 2020 compared to December 31, 2019 due to the addition of pay fixed interest rate swaps. At September 30, 2020 and December 31, 2019, 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 closing 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 closing 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, operating expenses and the payment of cash dividends which were increased to \$0.05 per share in the first quarter 2020. The Company holds \$246 million of senior notes which are scheduled to mature on July 15, 2021. At September 30, 2020, the Company held \$305 million of cash on deposit at the Bank, for future cash outflows for an

amount sufficient to service the senior notes, repay the senior notes at maturity, pay dividends and cover the operating expenses of the Company.

The OCC and the FRB regulate all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. Whether an application or notice is required is based on a number of factors including whether the institution qualifies for expedited treatment under the OCC rules and regulations or if the total amount of all capital distributions (including each proposed capital distribution) for the applicable calendar year exceeds net income for that year to date plus the retained net income for the preceding two years, or the Bank would not be at least adequately capitalized following the dividend. Additional restrictions on dividends apply if the Bank fails the QTL test. As of September 30, 2020, the Bank is in compliance with the QTL test. At September 30, 2020, the Bank is able to pay dividends to the holding company of approximately \$249 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 closings 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, 2020, we had \$2.5 billion available in unencumbered investment securities.

Our primary measure of liquidity is a ratio of ready liquidity to volatile funding, the volatile funds coverage ratio ("VFCR"). The VFCR is a liquidity coverage ratio that is customized to our business and ensures we have adequate coverage to meet our liquidity needs during times of liquidity stress. Volatile funds are the portion of the Bank's funding identified as being at a higher risk of runoff in times of stress. Ready liquidity consists of cash on reserve at the Federal Reserve and unused borrowing capacity provided by the loan and investments portfolios. The VFCR is calculated, reported, and forecasted daily as part of our liquidity management framework and was 59 percent as of September 30, 2020.

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 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 paid 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 average HFI loan-to-deposit ratio, was 75.9 percent for the three months ended September 30, 2020. 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 average HFI loan-to-deposit ratio was 74.8 percent for the three months ended September 30, 2020.

As governed and defined by our 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 believe 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 closings, making changes to warehouse funding facilities, or borrowing from the discount window.

Management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity.

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

	September 30, 2020	December 31, 2019	Change
	(Dollars in millions)		
Retail deposits	\$ 9,747	\$ 9,164	\$ 583
Government deposits	1,748	1,213	535
Wholesale deposits	1,034	633	401
Custodial deposits	7,416	4,136	3,280
Total deposits	<u>19,945</u>	<u>15,146</u>	<u>4,799</u>
FHLB advances and other short-term debt	3,426	4,815	(1,389)
Other long-term debt	493	496	(3)
Total borrowed funds	<u>3,919</u>	<u>5,311</u>	<u>(1,392)</u>
Total funding	<u>\$ 23,864</u>	<u>\$ 20,457</u>	<u>\$ 3,407</u>

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

	September 30, 2020	December 31, 2019	Change
	(Dollars in millions)		
Federal Home Loan Bank advances			
Outstanding advances	\$ 2,755	\$ 4,345	\$ (1,590)
Total used borrowing capacity	<u>\$ 2,755</u>	<u>\$ 4,345</u>	<u>\$ (1,590)</u>
<i>Borrowing capacity:</i>			
Collateralized borrowing capacity	\$ 3,057	\$ 2,345	\$ 712
Line of credit	30	30	—
Total unused borrowing capacity	<u>\$ 3,087</u>	<u>\$ 2,375</u>	<u>\$ 712</u>
FRB discount window			
Collateralized borrowing capacity	\$ 1,745	\$ 758	\$ 987
Unencumbered investment securities			
Agency - Commercial (1)	\$ 1,399	\$ 1,257	\$ 142
Agency - Residential (1)	956	1,180	(224)
Municipal obligations	25	26	(1)
Corporate debt obligations	70	77	(7)
Other	1	1	—
Total unencumbered investment securities	<u>\$ 2,451</u>	<u>\$ 2,541</u>	<u>\$ (90)</u>

(1) These are not currently pledged to the FHLB but are eligible to be pledged, at our discretion.

Deposits

The following table presents the composition of our deposits:

	September 30, 2020		December 31, 2019		Change
	Balance	% of Deposits	Balance	% of Deposits	
(Dollars in millions)					
Retail deposits					
Branch retail deposits					
Savings accounts	\$ 3,347	16.8 %	\$ 3,030	20.0 %	\$ 317
Certificates of deposit/CDARS (1)	1,525	7.6 %	2,353	15.5 %	(828)
Demand deposit accounts	1,573	7.9 %	1,318	8.7 %	255
Money market demand accounts	487	2.4 %	495	3.3 %	(8)
Total branch retail deposits	6,932	34.8 %	7,196	47.5 %	(264)
Commercial deposits (2)					
Demand deposit accounts	2,185	11.0 %	1,438	9.5 %	747
Savings accounts	432	2.2 %	342	2.3 %	90
Money market demand accounts	198	1.0 %	188	1.2 %	10
Total commercial retail deposits	2,815	14.1 %	1,968	13.0 %	847
Total retail deposits	\$ 9,747	48.9 %	\$ 9,164	60.5 %	\$ 583
Government deposits					
Savings accounts	\$ 830	4.2 %	\$ 495	3.3 %	\$ 335
Demand deposit accounts	518	2.6 %	360	2.4 %	158
Certificates of deposit/CDARS (1)	400	2.0 %	358	2.4 %	42
Total government deposits	1,748	8.8 %	1,213	8.0 %	535
Custodial deposits (3)	7,416	37.2 %	4,136	27.3 %	3,280
Wholesale deposits	1,034	5.2 %	633	4.2 %	401
Total deposits (4)	\$ 19,945	100.0 %	\$ 15,146	100.0 %	\$ 4,799

- (1) The aggregate amount of certificates of deposit with a minimum denomination of \$100,000 was approximately \$1.2 billion and \$1.7 billion at September 30, 2020 and December 31, 2019, 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 subserviced for others that have been placed on deposit with the Bank.
- (4) Total exposure related to uninsured deposits over \$250,000 was approximately \$5.6 billion and \$3.6 billion at September 30, 2020 and December 31, 2019, respectively.

Total deposits increased \$4.8 billion, or 32 percent, at September 30, 2020 compared to December 31, 2019, primarily driven by growth in our servicing business which resulted in a \$3.3 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, 2020, we were required to hold collateral for our government deposits in California that were in excess of \$250,000. The total of collateral held for California at September 30, 2020 was \$100 million. 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, 2020, collateral held on government deposits in these states was \$10 million. At September 30, 2020, government deposit accounts included \$0.4 billion of certificates of deposit with maturities typically less than one year and \$1.3 billion of checking and savings accounts.

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, 2020, we had \$123 million of total CDs enrolled in the CDARS program, a decrease of \$10 million from December 31, 2019.

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 closing 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, 2020, our Board of Directors authorized and approved a line of credit with the FHLB of up to \$10 billion, which is further limited based on our total assets and qualified collateral, as determined by the FHLB. At September 30, 2020, we had \$2.8 billion of advances outstanding and an additional \$3.1 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, 2020, we pledged collateral, which included commercial loans, municipal bonds, and agency bonds, to the FRB of Chicago amounting to \$2.6 billion with a lendable value of \$1.7 billion. At December 31, 2019, we pledged collateral to the FRB of Chicago amounting to \$788 million with a lendable value of \$758 million. We do not typically utilize this available funding source, and at September 30, 2020 and December 31, 2019, we had no borrowings outstanding against this line of credit.

Other Unsecured Borrowings

We have access to overnight federal funds purchased lines with other Federal Reserve member institutions. We utilize this source of funding for short-term liquidity needs, depending on the availability and cost of our other funding sources. At September 30, 2020 we had \$671 million of borrowings outstanding under this source of funding. Additional borrowing capacity under this and other sources of funding can vary depending on market conditions.

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, 2020, we are current on all interest payments. Additionally, we have \$246 million of senior debt outstanding at September 30, 2020 ("Senior Notes") which matures on July 15, 2021. For further information, see Note 9 - Borrowings.

Operational Risk

Operational risk is the risk to current or projected financial condition and resilience arising from inadequate or failed internal processes or systems, human errors or misconduct, or adverse external events which may include vendor failures, 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 ("VA"). 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 the nine months ended September 30, 2020, we had less than \$2.2 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 allowance for loan losses 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 \$2.5 billion at September 30, 2020, as compared to \$0.7 billion at December 31, 2019. GNMA has granted borrowers with an option to seek forbearances on their mortgage repayments. \$2.9 billion of GNMA loans are in forbearance as of September 30, 2020. When a GNMA loan is due, but unpaid, for three consecutive months (typically referred to as 90 days past due) the loan is required to be re-recognized on the balance sheet by the MSR owner. These loans are recorded in loans with government guarantees, and the liability to repurchase the loans is recorded in other liabilities on the consolidated statements of financial condition. This resulted in \$1.8 billion of repurchase options as of September 30, 2020, a \$1.7 billion increase from December 31, 2019. We have elected not to exercise these repurchase options as of September 30, 2020 because loans are not able to be modified and re-sold during the forbearance period. Our right to repurchase these loans continues as long as they remain unpaid for three consecutive months. At the prudent time, we intend to repurchase the loans which we believe will be accretive to net income by modifying and re-selling the loans or utilizing the partial claims process.

For further information, see Note 5 - Loans with Government Guarantees and the Credit Risk - Payment Deferrals section of the MD&A.

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 \$7 million and \$5 million at September 30, 2020 and December 31, 2019, respectively.

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 8.04 percent at September 30, 2020 providing a 853 basis point stress buffer above the minimum level needed to be considered "well-capitalized." Additionally, total risk-based capital to RWA was 11.29 percent at September 30, 2020 providing a 283 basis point 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

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. We implemented capital simplification on January 1, 2020. The New Rule increased the individual limit on MSRs and temporary difference DTAs to 25 percent of CET1 and eliminated the aggregate 15 percent CET1 deduction threshold for MSRs and temporary difference DTAs.

On March 27, 2020, U.S. banking regulators issued an interim final rule to delay for two years the initial adoption impact of CECL on regulatory capital in response to COVID-19 followed by a three-year transition period. During the two-year delay we will add back to CET1 capital 100 percent of the initial adoption impact of CECL plus 25 percent of the cumulative quarterly changes in the allowance for credit losses (i.e., quarterly transitional amounts). After two years, starting on January 1, 2022, the quarterly transitional amounts along with the initial adoption impact of CECL will be phased out of CET1 capital over the three-year period.

For the period presented, the following table sets forth our capital ratios as well as our excess capital over well-capitalized minimums.

Flagstar Bancorp	Actual		Well-Capitalized Under Prompt Corrective Action Provisions		Excess Capital Over Well-Capitalized Minimum (1)
	Amount	Ratio	Amount	Ratio	Capital Simplification
(Dollars in millions)					
September 30, 2020					
Tier 1 leverage capital (to adjusted avg. total assets)	2,256	8.04 %	1,403	5.0 %	\$ 853
Common equity Tier 1 capital (to RWA)	2,016	9.21 %	1,422	6.5 %	594
Tier 1 capital (to RWA)	2,256	10.31 %	1,751	8.0 %	505
Total capital (to RWA)	2,471	11.29 %	2,188	10.0 %	283

(1) Excess capital is the difference between the actual capital ratios under current 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 11.29 percent. It would take a \$283 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".

As of September 30, 2020, we had \$323 million in MSRs, \$89 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. For additional information on our capital requirements, see Note 14 - Regulatory Matters.

Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes certain non-GAAP financial measures. 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 tangible common equity and adjusted net interest margin. The Company believes that tangible book value per share, tangible common equity to assets ratio, return on average tangible common equity and adjusted net interest margin 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 they provide 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.

	September 30, 2020	June 30, 2020	March 31, 2020	December 31, 2019	September 30, 2019
	(Dollars in millions)				
Total stockholders' equity	\$ 2,195	\$ 1,971	\$ 1,842	\$ 1,788	\$ 1,734
Less: Goodwill and intangible assets	160	164	167	170	174
Tangible book value/Tangible common equity	\$ 2,035	\$ 1,807	\$ 1,675	\$ 1,618	\$ 1,560
Number of common shares outstanding	57,150,470	56,943,979	56,729,789	56,631,236	56,510,341
Tangible book value per share	\$ 35.60	\$ 31.74	\$ 29.52	\$ 28.57	\$ 27.62
Total assets	\$ 29,476	\$ 27,468	\$ 26,805	\$ 23,266	\$ 22,048
Tangible common equity to assets ratio	6.90 %	6.58 %	6.25 %	6.95 %	7.08 %
	Three Months Ended,		Nine Months Ended,		
	September 30, 2020	June 30, 2020	September 30, 2020	September 30, 2020	September 30, 2019
	(Dollars in millions, except share data)				
Net income	\$ 222	\$ 116	\$ 384	\$ 160	\$ 160
Plus: Intangible asset amortization, net of tax	3	3	7	10	10
Tangible net income	\$ 225	\$ 119	\$ 391	\$ 170	\$ 170
Total average equity	\$ 2,141	\$ 1,977	\$ 1,991	\$ 1,658	\$ 1,658
Less: Average goodwill and intangible assets	162	165	165	184	184
Total average tangible equity	\$ 1,979	\$ 1,812	\$ 1,826	\$ 1,474	\$ 1,474
Return on average common equity	41.54 %	23.47 %	25.71 %	12.90 %	12.90 %
Return on average tangible common equity	45.42 %	26.16 %	28.58 %	15.30 %	15.30 %
Net interest margin	2.78 %	2.86 %	2.81 %	3.07 %	3.07 %
Adjustment to LGG loans available for repurchase	0.16 %	0.02 %	0.07 %	— %	— %
Adjusted net interest margin	2.94 %	2.88 %	2.88 %	3.07 %	3.07 %

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 ACL 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, 2019 and our Form 10-Q for the quarter ended March 31, 2020, which are available on our website, flagstar.com, under the Investor Relations section, or on the website of the Securities and Exchange Commission, at 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, 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. The COVID-19 pandemic is adversely affecting us, our customers, counterparties, employees, and third-party service providers, and the ultimate extent of the impacts on our business, financial position, results of operations, liquidity, and prospects is uncertain. Other than as required under United States securities laws, Flagstar does 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. 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, 2019, which are incorporated by reference herein, and Item 1A. to Part II, of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2020.

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)

	September 30, 2020	December 31, 2019
	(Unaudited)	
Assets		
Cash	\$ 194	\$ 220
Interest-earning deposits	86	206
Total cash and cash equivalents	280	426
Investment securities available-for-sale	2,165	2,116
Investment securities held-to-maturity	440	598
Loans held-for-sale (\$5,349 and \$5,219 measured at fair value, respectively)	5,372	5,258
Loans held-for-investment (\$14 and \$12 measured at fair value, respectively)	16,476	12,129
Loans with government guarantees	2,500	736
Less: allowance for loan losses	(255)	(107)
Total loans held-for-investment and loans with government guarantees, net	18,721	12,758
Mortgage servicing rights	323	291
Federal Home Loan Bank stock	377	303
Premises and equipment, net	410	416
Goodwill and intangible assets	160	170
Other assets	1,228	930
Total assets	<u>\$ 29,476</u>	<u>\$ 23,266</u>
Liabilities and Stockholders' Equity		
Noninterest bearing deposits	\$ 9,429	\$ 5,467
Interest bearing deposits	10,516	9,679
Total deposits	19,945	15,146
Short-term Federal Home Loan Bank advances and other	2,226	4,165
Long-term Federal Home Loan Bank advances	1,200	650
Other long-term debt	493	496
Other liabilities (\$35 and \$35 measured at fair value, respectively)	3,417	1,021
Total liabilities	27,281	21,478
Stockholders' Equity		
Common stock \$0.01 par value, 80,000,000 and 80,000,000 shares authorized; 57,150,470 and 56,631,236 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,493	1,483
Accumulated other comprehensive income	46	1
Retained earnings	655	303
Total stockholders' equity	2,195	1,788
Total liabilities and stockholders' equity	<u>\$ 29,476</u>	<u>\$ 23,266</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,	
	2020	2019	2020	2019
	(Unaudited)			
Interest Income				
Loans	\$ 190	\$ 185	\$ 551	\$ 517
Investment securities	16	17	56	61
Interest-earning deposits and other	—	1	1	3
Total interest income	206	203	608	581
Interest Expense				
Deposits	16	38	69	102
Short-term Federal Home Loan Bank advances and other	2	10	16	44
Long-term Federal Home Loan Bank advances	3	2	9	4
Other long-term debt	5	7	18	21
Total interest expense	26	57	112	171
Net interest income	180	146	496	410
Provision for credit losses	32	1	148	18
Net interest income after provision for credit losses	148	145	348	392
Noninterest Income				
Net gain on loan sales	346	110	739	234
Loan fees and charges	45	29	112	70
Net return on mortgage servicing rights	12	(2)	10	9
Loan administration income	26	5	59	22
Deposit fees and charges	8	10	24	28
Other noninterest income	15	19	44	85
Total noninterest income	452	171	988	448
Noninterest Expense				
Compensation and benefits	123	98	341	275
Occupancy and equipment	47	40	132	118
Commissions	72	38	162	76
Loan processing expense	24	22	69	60
Legal and professional expense	9	6	20	18
Federal insurance premiums	6	5	19	14
Intangible asset amortization	3	3	10	11
Other noninterest expense	21	26	84	71
Total noninterest expense	305	238	837	643
Income before income taxes	295	78	499	197
Provision for income taxes	73	15	115	37
Net income	\$ 222	\$ 63	\$ 384	\$ 160
Net income per share				
Basic	\$ 3.90	\$ 1.12	\$ 6.76	\$ 2.83
Diluted	\$ 3.88	\$ 1.11	\$ 6.71	\$ 2.80
Weighted average shares outstanding				
Basic	57,032,746	56,484,499	56,827,171	56,607,944
Diluted	57,379,809	57,110,796	57,231,689	57,252,540

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,	
	2020	2019	2020	2019
			(Unaudited)	
Net income	\$ 222	\$ 63	\$ 384	\$ 160
Other comprehensive income, net of tax				
Investment securities	—	13	55	52
Derivatives and hedging activities	—	—	(10)	—
Other comprehensive income, net of tax	—	13	45	52
Comprehensive income	<u>\$ 222</u>	<u>\$ 76</u>	<u>\$ 429</u>	<u>\$ 212</u>

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)

	Common Stock		Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Number of Shares	Amount				
Balance at December 31, 2018	57,749,464	\$ 1	\$ 1,522	\$ (47)	\$ 94	\$ 1,570
(Unaudited)						
Net income	—	—	—	—	160	160
Total other comprehensive income	—	—	—	52	—	52
Shares issued from the Employee Stock Purchase Plan	84,036	—	—	—	—	—
Bancorp Dividends Declared and paid @ 0.04/share	280	—	—	—	(7)	(7)
Stock-based compensation	194,266	—	9	—	—	9
Repurchase of shares (1)	(1,517,705)	—	(50)	—	—	(50)
Balance at September 30, 2019	56,510,341	\$ 1	\$ 1,481	\$ 5	\$ 247	\$ 1,734
Balance at December 31, 2019	56,631,236	\$ 1	\$ 1,483	\$ 1	\$ 303	\$ 1,788
(Unaudited)						
Net income	—	—	—	—	384	384
Total other comprehensive income	—	—	—	45	—	45
Shares issued from the Employee Stock Purchase Plan	149,789	—	—	—	—	—
Bancorp Dividends Declared and paid @ 0.05/share	583	—	—	—	(9)	(9)
Stock-based compensation	368,862	—	10	—	—	10
CECL ASU Adjustment to RE	—	—	—	—	(23)	(23)
Repurchase of shares (1)	—	—	—	—	—	—
Balance at September 30, 2020	57,150,470	\$ 1	\$ 1,493	\$ 46	\$ 655	\$ 2,195

(1) 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)

	Nine Months Ended September 30,	
	2020	2019
	(Unaudited)	
Operating Activities		
Net cash used in operating activities	\$ (5,991)	\$ (15,700)
Investing Activities		
Proceeds from sale of AFS securities including loans that have been securitized	\$ 6,175	\$ 15,631
Collection of principal on investment securities AFS	395	129
Purchase of investment securities AFS and other	(359)	(39)
Collection of principal on investment securities HTM	158	68
Proceeds received from the sale of LHFI	433	167
Net closings, purchases, and principal repayments of LHFI	(4,794)	(3,575)
Acquisition of premises and equipment, net of proceeds	(44)	(48)
Net purchase of FHLB stock	(74)	—
Proceeds from the sale of MSRs	42	56
Other, net	(11)	(8)
Net cash provided by investing activities	\$ 1,921	\$ 12,381
Financing Activities		
Net change in deposit accounts	\$ 4,799	\$ 3,365
Net change in short-term FHLB borrowings and other short-term debt	(1,939)	(913)
Proceeds from increases in FHLB long-term advances and other debt	550	550
Repayment of FHLB long-term advances	—	(50)
Repayment of long-term debt	(3)	—
Net receipt of payments of loans serviced for others	531	366
Common stock repurchase	—	(50)
Dividends declared and paid	(9)	(7)
Other	(8)	14
Net cash provided by financing activities	\$ 3,921	\$ 3,275
Net change in cash, cash equivalents and restricted cash (1)	(149)	(44)
Beginning cash, cash equivalents and restricted cash (1)	456	432
Ending cash, cash equivalents and restricted cash (1)	\$ 307	\$ 388
Supplemental disclosure of cash flow information		
Non-cash reclassification of LHFI to LHFS	\$ 445	\$ 101
Non-cash reclassification of LHFS to securitized HFS loans	\$ 6,183	\$ 15,198
MSRs resulting from sale or securitization of loans	\$ 209	\$ 203
Operating section supplemental disclosures		
Proceeds from sales of LHFS	\$ 30,332	\$ 7,714
Closings, premium paid and purchase of LHFS, net of principal repayments	\$ (35,603)	\$ (23,249)

(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 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, 2019, 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 AFS and HTM investment securities:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
September 30, 2020				
Available-for-sale securities				
Agency - Commercial	\$ 1,126	\$ 45	\$ —	\$ 1,171
Agency - Residential	806	31	—	837
Corporate debt obligations	76	1	—	77
Municipal obligations	29	1	—	30
Other MBS	49	—	—	49
Certificate of deposits	1	—	—	1
Total available-for-sale securities (1)	<u>\$ 2,087</u>	<u>\$ 78</u>	<u>\$ —</u>	<u>\$ 2,165</u>
Held-to-maturity securities				
Agency - Commercial	\$ 221	\$ 8	\$ —	\$ 229
Agency - Residential	219	10	—	229
Total held-to-maturity securities (1)	<u>\$ 440</u>	<u>\$ 18</u>	<u>\$ —</u>	<u>\$ 458</u>
December 31, 2019				
Available-for-sale securities				
Agency - Commercial	\$ 948	\$ 2	\$ (3)	\$ 947
Agency - Residential	1,015	4	(4)	1,015
Corporate debt obligations	76	1	—	77
Municipal obligations	31	—	—	31
Other MBS	44	1	—	45
Certificate of Deposits	1	—	—	1
Total available-for-sale securities (1)	<u>\$ 2,115</u>	<u>\$ 8</u>	<u>\$ (7)</u>	<u>\$ 2,116</u>
Held-to-maturity securities				
Agency - Commercial	\$ 306	\$ —	\$ (1)	\$ 305
Agency - Residential	292	3	(1)	294
Total held-to-maturity securities (1)	<u>\$ 598</u>	<u>\$ 3</u>	<u>\$ (2)</u>	<u>\$ 599</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, 2020 or December 31, 2019.

We evaluate AFS debt securities where the value has declined below amortized cost for impairment. If we intend to sell or believe it is more likely than not that we will be required to sell the debt security, it is written down to fair value through earnings. For AFS debt securities we intend to hold, we evaluate the debt securities for expected credit losses, except for debt securities that are guaranteed by the U.S. Treasury, U.S. government agencies or sovereign entities of high credit quality for

which we apply a zero credit loss assumption and which represented 94 percent of our AFS portfolio as of September 30, 2020. For the remaining AFS securities, credit losses are recognized as an increase to the allowance for credit losses through the credit loss provision. If any of the decline in fair value is related to market factors, that amount is recognized in OCI. We had no unrealized credit losses as of September 30, 2020 and December 31, 2019.

We separately evaluate our HTM debt securities for any credit losses. As of September 30, 2020 and December 31, 2019, our entire HTM portfolio qualified for the zero loss assumption as all securities are guaranteed by the U.S. Treasury, U.S. government agencies.

Investment securities transactions are recorded on the trade date for purchases and sales. Interest earned on investment securities, including the amortization of premiums and the accretion of discounts, are determined using the effective interest method over the period of maturity and recorded in interest income in the Consolidated Statements of Operations. Accrued interest receivable on investment securities totaled \$6 million at both September 30, 2020 and December 31, 2019, and was reported in other assets on the Consolidated Statements of Financial Condition.

Available-for-sale securities

Securities available-for-sale are carried at fair value. Unrealized gains and losses on AFS securities are reported as a component of other comprehensive income.

We purchased \$359 million of AFS securities, which were comprised of U.S. government sponsored agency MBS, certificate of deposits, and corporate debt obligations during the nine months ended September 30, 2020. We did not purchase any AFS securities during the three months ended September 30, 2020. 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. In addition, we retained \$18 million of passive interests in our own private MBS during the nine months ended September 30, 2020. We did not retain any interest in our own private MBS during the three months ended September 30, 2020 or both the three and nine months ended September 30, 2019.

There were no sales of AFS securities during both the three and nine months ended September 30, 2020. There were no sales of AFS securities during the three months ended September 30, 2019, and \$432 million in sales of AFS securities during the nine months ended September 30, 2019. These sales resulted in a 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.

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, 2020 and September 30, 2019.

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

	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, 2020						
Available-for-sale securities						
Agency - Commercial	\$ 3	1	\$ —	\$ 4	1	\$ —
Municipal obligations	\$ —	—	\$ —	\$ 6	1	\$ —
Corporate debt obligations	\$ —	—	\$ —	\$ 13	4	\$ —
Other mortgage-backed securities	\$ —	—	\$ —	\$ —	1	\$ —
Held-to-maturity securities						
Agency - Residential	\$ —	—	\$ —	\$ 5	2	\$ —
December 31, 2019						
Available-for-sale securities						
Agency - Commercial	\$ 148	17	\$ (3)	\$ 303	19	\$ —
Agency - Residential	\$ 266	26	\$ (3)	\$ 148	14	\$ (1)
Municipal obligations	\$ 8	3	\$ —	\$ —	—	\$ —
Held-to-maturity securities						
Agency - Commercial	\$ 148	13	\$ (1)	\$ 85	6	\$ —
Agency - Residential	\$ 35	7	\$ (1)	\$ 38	10	\$ —

Unrealized losses on available-for-sale securities have not been recognized into income because almost all of the portfolio held by us are issued by U.S. government entities and agencies. These securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies, and have a long history of no credit losses. The remaining unrealized losses on available-for-sale securities are municipal securities and corporate debt obligations, all of which are considered investment grade or are de minimis. The fair value is expected to recover as the bonds approach maturity.

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, 2020						
Due in one year or less	\$ 5	\$ 5	2.24 %	\$ —	\$ —	— %
Due after one year through five years	8	8	2.71 %	8	8	2.52 %
Due after five years through 10 years	108	111	4.23 %	8	8	2.35 %
Due after 10 years	1,966	2,041	2.38 %	424	442	2.34 %
Total	<u>\$ 2,087</u>	<u>\$ 2,165</u>		<u>\$ 440</u>	<u>\$ 458</u>	

We pledge investment securities, primarily agency collateralized and municipal taxable mortgage obligations, to collateralize lines of credit and/or borrowings. At September 30, 2020 and December 31, 2019, we had pledged investment securities of \$176 million and \$874 million, 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 \$5.4 billion and \$5.3 billion at September 30, 2020 and December 31, 2019, respectively. For the three and nine months ended September 30, 2020 we had net gain on loan sales associated with LHFS of \$344 million and \$737 million as compared to \$110 million and \$232 million for the three and nine months ended September 30, 2019.

At September 30, 2020 and December 31, 2019, \$15 million and \$39 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

We classify loans that we have the intent and ability to hold for the foreseeable future or until maturity as LHFI. We report LHFI at their amortized cost, which includes the outstanding principal balance adjusted for any unamortized premiums, discounts, deferred fees and costs. The accrued interest receivable on loans held-for-investment totaled \$41.0 million at September 30, 2020 and \$36.9 million at December 31, 2019 and was reported in other assets on the Consolidated Statements of Financial Condition.

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

	September 30, 2020	December 31, 2019
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	\$ 2,472	\$ 3,154
Home equity	924	1,024
Other	973	729
Total consumer loans	4,369	4,907
Commercial loans		
Commercial real estate	2,996	2,828
Commercial and industrial	1,520	1,634
Warehouse lending	7,591	2,760
Total commercial loans	12,107	7,222
Total loans held-for-investment	\$ 16,476	\$ 12,129

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

	Nine Months Ended September 30,	
	2020	2019
	(Dollars in millions)	
Loans Sold (1)		
Performing loans	\$ 436	\$ 166
Total loans sold	\$ 436	\$ 166
Net gain associated with loan sales (2)	\$ 3	\$ 2
Loans Purchased		
Home equity	\$ —	\$ 199
Other consumer (3)	63	51
Total loans purchased	\$ 63	\$ 250
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 point of sale 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, 2020 we had pledged loans of \$10.7 billion, compared to \$9.1 billion at December 31, 2019.

Allowance for Loan Losses

We determine the estimate of the allowance for loan losses on at least a quarterly basis. The allowance for loan losses represents management's estimate of lifetime losses in our LHFI portfolio, excluding loans carried under the fair value option. We establish an allowance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. The allowance uses a loan-level, model-based approach, to estimate the expected lifetime credit losses. For non-performing loans, we've elected to use the collateral dependent practical expedient. The reserve for collateral dependent loans is established as the difference between fair value of the collateral less cost to sell and the amortized cost of the loan. Management applies judgment and assigns qualitative factors to each loan

portfolio segment or the portfolio as a whole based upon the consideration of the following factors: levels of and trends in delinquencies and performance of loans, levels of and trends in write-offs and recoveries collected, changes in the nature and volume of the portfolio, changes in reasonable and supportable economic forecasts, changes in lending policies and procedures, changes in economic and business conditions, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in prepayment expectations or other factors affecting assessments of loan contractual term, changes in concentrations of credit, industry conditions and other internal or external factor changes.

A specific allowance is established on impaired loans when it is probable all amounts due will not be collected pursuant to the original contractual terms of the loan and the recorded investment in the loan exceeds its fair value. The required allowance is measured using either the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent.

A general allowance is established for lifetime losses inherent on non-impaired loans by segmenting the portfolio based upon common risk characteristics. Our consumer loan portfolio is segmented into Residential First Mortgage, Home Equity and Other Consumer. Loan characteristics impacting these segments include lien position, credit quality, and loan structure. At a high-level our commercial loans are segmented into Commercial Real Estate, Commercial and Industrial, and Warehouse Lending. Loan characteristics impacting these segments include credit quality and loan structure.

We measure the allowance using the applicable dual risk rating model which measures probability of default, loss given default and exposure at default. As of September 30, 2020, we estimated losses over a two-year reasonable and supportable forecast period using macroeconomic scenarios before reverting economic variables over a one-year period to their long-term historical averages on a straight-line basis. As of September 30, 2020, we utilized the Moody's September scenarios in our forecast: a growth forecast, weighted at 30 percent; a baseline forecast, weighted at 40 percent; and an adverse forecast, weighted at 30 percent. The resulting composite forecast for the third quarter of 2020 was roughly equivalent to the scenario used in the second quarter 2020. Unemployment ends the year at 10 percent and recovers only slightly in 2021. GDP recovers only slightly by the end of the year from current levels and does not return to near pre-COVID level until 2024. HPI decreases 2 percent from mid-2020 through 2021.

The following table presents changes in the allowance for loan losses, by class of loan:

	Residential First Mortgage (1)	Home Equity	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
(Dollars in millions)							
Three Months Ended September 30, 2020							
Beginning balance	\$ 60	\$ 28	\$ 34	\$ 83	\$ 23	\$ 1	229
Provision	(6)	1	4	6	19	4	28
Charge-offs	(2)	(1)	(1)	—	—	—	(4)
Recoveries	—	1	1	—	—	—	2
Ending allowance balance	\$ 52	\$ 29	\$ 38	\$ 89	\$ 42	\$ 5	255
Three Months Ended September 30, 2019							
Beginning balance	\$ 26	\$ 16	\$ 5	\$ 35	\$ 23	\$ 5	110
Provision (benefit)	2	—	3	(2)	(2)	—	1
Charge-offs	(1)	(1)	(2)	—	—	—	(4)
Recoveries	1	1	—	—	1	—	3
Ending allowance balance	\$ 28	\$ 16	\$ 6	\$ 33	\$ 22	\$ 5	110
Nine Months Ended September 30, 2020							
Beginning balance, prior to adoption of ASC 326	\$ 22	\$ 14	\$ 6	\$ 38	\$ 22	\$ 5	107
Impact of adopting ASC 326	25	12	10	(14)	(6)	(4)	23
Provision	10	3	24	65	26	4	132
Charge-offs	(5)	(3)	(4)	—	—	—	(12)
Recoveries	—	3	2	—	—	—	5
Ending allowance balance	\$ 52	\$ 29	\$ 38	\$ 89	\$ 42	\$ 5	255
Nine Months Ended September 30, 2019							
Beginning balance	\$ 38	\$ 15	\$ 3	\$ 48	\$ 18	\$ 6	128
Provision (benefit)	(8)	—	8	(15)	34	(1)	18
Charge-offs	(3)	(1)	(5)	—	(31)	—	(40)
Recoveries	1	2	—	—	1	—	4
Ending allowance balance	\$ 28	\$ 16	\$ 6	\$ 33	\$ 22	\$ 5	110

(1) Includes loans with government guarantees.

The allowance for loan losses was \$255 million at September 30, 2020 and \$110 million at September 30, 2019. The increase in the allowance is reflective of the adoption of CECL, changes in the economic forecasts used in the ACL models as a result of the ongoing COVID-19 pandemic and credit downgrades largely attributed to challenging economic conditions being faced by certain of our borrowers due to the pandemic.

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.

Beginning in March 2020, as a response to COVID-19, customers facing COVID-19 related difficulties were offered forbearance in an effort to help our borrowers get to the other side of the health crisis when we believe they will be able to fulfill all of their contractual commitments.

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. We do not measure an allowance for credit losses for accrued interest receivables as accrued interest is written off in a timely manner. We are not aging receivables for customers who have been granted a payment deferral in response to COVID-19 which remain in the aging category they were in at the time of payment deferral. We continue to accrue interest on these loans, consistent with our forbearance programs.

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due (1)	Total Past Due	Current	Total LHFH (3) (4)
(Dollars in millions)						
September 30, 2020						
Consumer loans						
Residential first mortgage	\$ 5	\$ 3	\$ 30	\$ 38	\$ 2,434	\$ 2,472
Home equity	1	—	4	5	919	924
Other	3	1	2	6	967	973
Total consumer loans	9	4	36	49	4,320	4,369
Commercial loans						
Commercial real estate	—	—	—	—	2,996	2,996
Commercial and industrial	—	—	10	10	1,510	1,520
Warehouse lending	—	—	—	—	7,591	7,591
Total commercial loans	—	—	10	10	12,097	12,107
Total loans (2)	\$ 9	\$ 4	\$ 46	\$ 59	\$ 16,417	\$ 16,476
December 31, 2019						
Consumer loans						
Residential first mortgage	\$ 5	\$ 4	\$ 21	\$ 30	\$ 3,124	\$ 3,154
Home Equity	1	—	4	5	1,019	1,024
Other	3	1	1	5	724	729
Total consumer loans	9	5	26	40	4,867	4,907
Commercial loans						
Commercial real estate	—	—	—	—	2,828	2,828
Commercial and industrial	—	—	—	—	1,634	1,634
Warehouse lending	—	—	—	—	2,760	2,760
Total commercial loans	—	—	—	—	7,222	7,222
Total loans (2)	\$ 9	\$ 5	\$ 26	\$ 40	\$ 12,089	\$ 12,129

- (1) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans.
- (2) Includes \$8 million and \$4 million of past due loans accounted for under the fair value option as of September 30, 2020 and December 31, 2019, respectively.
- (3) Collateral dependent loans totaled \$74 million at September 30, 2020 and \$54 million at December 31, 2019, respectively. The majority of these loans are secured by real estate.
- (4) The interest income recognized on impaired loans was \$2 million and less than \$1 million at September 30, 2020 and December 31, 2019, respectively.

Interest income is recognized on nonaccrual loans using a cash basis method. The interest that would have been accrued on impaired loans was \$2 million and less than \$1 million at September 30, 2020 and December 31, 2019, respectively. At September 30, 2020 and December 31, 2019, we had no loans 90 days past due and still accruing interest.

Reserve for Unfunded Commitments

We estimated expected credit losses over the contractual period in which we are exposed to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by us. The reserve for unfunded commitments is adjusted as a provision for credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life.

The reserve for unfunded commitments is reflected in other liabilities on the Consolidated Statements of Financial Condition and was \$25 million as of September 30, 2020, compared to \$3 million as of December 31, 2019. The increase in the reserve is reflective of the adoption of CECL which required us to record an allowance for our estimate of lifetime losses and an increase due to changes in the economic forecasts used in the ACL models as a result of the ongoing COVID-19 pandemic.

The following categories of off-balance sheet credit exposures have been identified: unfunded loans with available balances, new commitments to lend that are not yet funded, and standby and commercial letters of credit. For further information, see Note 15 - Legal Proceedings, Contingencies and Commitments.

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. 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, 2019 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.

Beginning in March 2020, as a response to COVID-19, we offered our consumer and commercial customers principal and interest payment deferrals and extensions. We considered these programs in the context of whether or not the short-term modifications of these loans would constitute a TDR. We considered the CARES Act, interagency guidance and related guidance from the FASB, which provided that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not required to be accounted for as TDRs. As a result, we have determined that these loans are not TDRs.

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

	TDRs		
	Performing	Nonperforming	Total
	(Dollars in millions)		
September 30, 2020			
Consumer loans			
Residential first mortgage	\$ 20	\$ 7	\$ 27
Home equity	14	2	16
Commercial Real Estate	5	—	5
Total TDRs (1)(2)	<u>\$ 39</u>	<u>\$ 9</u>	<u>\$ 48</u>
December 31, 2019			
Consumer loans			
Residential first mortgage	\$ 20	\$ 8	\$ 28
Home Equity	18	2	20
Total TDRs (1)(2)	<u>\$ 38</u>	<u>\$ 10</u>	<u>\$ 48</u>

(1) Allowance for loan losses on TDR loans totaled \$5 million and \$8 million at September 30, 2020 and December 31, 2019, respectively.

(2) Includes \$2 million of TDR loans accounted for under the fair value option at September 30, 2020 and December 31, 2019.

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)
(Dollars in millions)			
Three Months Ended September 30, 2020			
Residential first mortgages	1	\$ —	\$ —
Home equity (2)(3)	1	—	—
Consumer	1	—	—
Total TDR loans	3	\$ —	\$ —
Three Months Ended September 30, 2019			
Residential first mortgages	4	\$ 1	\$ 1
Total TDR loans	4	\$ 1	\$ 1
Nine Months Ended September 30, 2020			
Residential first mortgages	6	\$ 1	\$ 1
Home equity (2)(3)	3	—	—
Consumer	2	—	—
Commercial Real Estate	1	5	5
Total TDR loans	12	\$ 6	\$ 6
Nine Months Ended September 30, 2019			
Residential first mortgages	6	\$ 1	\$ 1
Home equity (2)(3)	4	1	1
Total TDR loans	10	\$ 2	\$ 2

(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 loans modified in the previous 12 months that subsequently defaulted during the three and nine months ended September 30, 2020 or September 30, 2019. 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.

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 based 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.

Payment activity, credit rating and loan-to-value ratios have the most significant impact on the ACL for consumer loans. The following table presents the amortized cost in residential and consumer loans based on payment activity:

As of September 30, 2020	Term Loans					Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term Loans Amortized Cost Basis	Total	December 31, 2019	
	Amortized Cost Basis by Closing Year									
	2020	2019	2018	2017	2016	Prior				
Consumer Loans	(Dollars in millions)									
Residential First Mortgage										
Pass	\$ 256	\$ 630	\$ 272	\$ 348	\$ 308	\$ 483	\$ 105	\$ 8	\$ 2,410	\$ 3,107
Watch	—	1	—	2	—	16	—	—	19	23
Substandard	—	4	6	2	—	17	—	1	30	15
Home Equity										
Pass	6	37	16	7	2	12	799	29	908	1,002
Watch	—	—	—	—	—	12	—	—	12	16
Substandard	—	—	—	—	—	1	1	—	2	3
Other Consumer										
Pass	226	345	165	4	2	7	218	5	972	727
Watch	—	—	—	—	—	—	—	—	—	1
Substandard	—	—	1	—	—	—	—	—	1	1
Total Consumer Loans (1)	\$ 488	\$ 1,017	\$ 460	\$ 363	\$ 312	\$ 548	\$ 1,123	\$ 43	\$ 4,354	\$ 4,895

(1) Excludes loans carried under the fair value option

The following table presents the amortized cost in residential and consumer loans based on credit scores:

As of September 30, 2020	FICO Band						Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term Loans Amortized Cost Basis	Total
	Amortized Cost Basis by Closing Year								
	2020	2019	2018	2017	2016	Prior			
Consumer Loans	(Dollars in millions)								
Residential First Mortgage									
>750	\$ 151	\$ 323	\$ 141	\$ 241	\$ 228	\$ 272	\$ 61	\$ 2	\$ 1,419
700-750	79	212	106	95	73	148	30	5	748
<700	26	100	31	16	7	96	14	2	292
Home Equity									
>750	2	11	6	3	—	7	358	4	391
700-750	2	14	5	3	1	9	319	14	367
<700	2	12	5	1	1	9	123	11	164
Other Consumer									
>750	160	220	87	1	—	5	200	5	678
700-750	61	114	65	3	2	2	18	—	265
<700	5	11	14	—	—	—	—	—	30
Total Consumer Loans (1)	\$ 488	\$ 1,017	\$ 460	\$ 363	\$ 312	\$ 548	\$ 1,123	\$ 43	\$ 4,354

(1) Excludes loans carried under the fair value option

Loan-to-value ratios primarily impact the allowance on mortgages within the consumer loan portfolio. The following table presents the amortized cost in residential first mortgages and home equity based on loan-to-value ratios:

As of September 30, 2020	LTV Band						Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term Loans Amortized Cost Basis	Total
	Amortized Cost Basis by Closing Year								
	2020	2019	2018	2017	2016	Prior			
Consumer Loans	(Dollars in millions)								
Residential first mortgage									
>90	\$ 53	\$ 286	\$ 142	\$ 39	\$ 3	\$ 21	\$ —	\$ —	\$ 544
71-90	122	213	77	123	82	267	—	—	884
55-70	64	78	29	99	121	140	—	—	531
<55	17	58	30	91	102	88	105	9	500
Home Equity									
>90	—	—	—	2	1	11	1	—	15
71-90	4	29	12	4	1	10	612	21	693
<=70	2	8	4	1	—	4	187	8	214
Total (1)	\$ 262	\$ 672	\$ 294	\$ 359	\$ 310	\$ 541	\$ 905	\$ 38	\$ 3,381

(1) Excludes loans carried under the fair value option

Commercial Loans

Risk rating and average loan duration have the most significant impact on the ACL for commercial loans. Additional factors which impact the ACL are debt-service-coverage ratio, loan-to-value ratio, interest-coverage ratio and leverage ratio.

Internal audit conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. All loans are examined on an at least annual basis. 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.

Based on the most recent analysis performed, the amortized cost basis, by risk category for each class of loans within the commercial portfolio is as follows:

As of September 30, 2020	Term Loans					Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term Loans Amortized Cost Basis	Total	December 31, 2019	
	Amortized Cost Basis by Closing Year									
	2020	2019	2018	2017	2016	Prior				
(Dollars in million)										
Commercial Loans										
Commercial real estate										
Pass	\$ 249	\$ 978	\$ 466	\$ 452	\$ 325	\$ 239	\$ (1)	\$ —	\$ 2,708	\$ 2,794
Watch	20	14	81	44	28	31	—	—	218	24
Special mention	4	9	16	—	10	—	—	—	39	5
Substandard	—	3	3	25	—	—	—	—	31	5
Commercial and industrial										
Pass	212	494	185	188	107	116	20	—	1,322	1,533
Watch	2	46	26	25	—	1	—	—	100	72
Special mention	2	13	13	17	—	5	—	—	50	24
Substandard	21	1	16	10	—	—	—	—	48	5
Warehouse										
Pass	—	—	—	—	—	—	7,381	—	7,381	2,556
Watch	—	—	—	—	—	—	195	—	195	189
Special mention	—	—	—	—	—	—	15	—	15	15
Substandard	—	—	—	—	—	—	—	—	—	—
Total commercial loans	\$ 510	\$ 1,558	\$ 806	\$ 761	\$ 470	\$ 392	\$ 7,610	\$ —	\$ 12,107	\$ 7,222

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. When a GNMA loan is due, but unpaid, for three consecutive months (typically referred to as 90 days past due) the loan is required to be re-recognized on the balance sheet by the MSR owner. These loans are recorded in loans with government guarantees, and the liability to repurchase the loans is recorded in other liabilities on the consolidated statements of financial condition. This resulted in \$1.8 billion of repurchase options as of September 30, 2020, a \$1.7 billion increase from December 31, 2019. 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 allowance for loan losses on residential first mortgages.

Repossessed assets and the associated claims related to government guaranteed loans are recorded in other assets and totaled \$22 million and \$45 million, at September 30, 2020 and December 31, 2019, respectively.

Note 6 - Variable Interest Entities

We have no consolidated VIEs as of September 30, 2020 and December 31, 2019.

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 2 - Investment Securities and 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,	
	2020	2019	2020	2019
	(Dollars in millions)			
Balance at beginning of period	\$ 261	\$ 316	\$ 291	\$ 290
Additions from loans sold with servicing retained	85	39	209	203
Reductions from sales	—	(12)	(46)	(57)
Decrease in MSR fair value due to pay-offs, pay-downs, run-off, model changes, and other (1)	(25)	(30)	(74)	(60)
Changes in estimates of fair value due to interest rate risk (1) (2)	2	(28)	(57)	(91)
Fair value of MSR at end of period	<u>\$ 323</u>	<u>\$ 285</u>	<u>\$ 323</u>	<u>\$ 285</u>

- (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, 2020			December 31, 2019		
	Actual	Fair value		Actual	Fair value	
		10% adverse change	20% adverse change		10% adverse change	20% adverse change
	(Dollars in millions)					
Option adjusted spread	7.61 % \$	316 \$	310	5.34 % \$	284 \$	280
Constant prepayment rate	11.36 % \$	300 \$	279	10.59 % \$	271 \$	257
Weighted average cost to service per loan	\$ 81.68	\$ 320	\$ 316	\$ 84.41	\$ 285	\$ 282

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:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(Dollars in millions)			
Net return (loss) on mortgage servicing rights				
Servicing fees, ancillary income and late fees (1)	\$ 30	\$ 25	\$ 75	\$ 70
Decrease in MSR fair value due to pay-offs, pay-downs, run-off, model changes, and other	(25)	(30)	(74)	(60)
Changes in fair value due to interest rate risk	2	(28)	(57)	(91)
Gain on MSR derivatives (2)	4	31	68	92
Net transaction costs	1	—	(2)	(2)
Total return (loss) included in net return on mortgage servicing rights	\$ 12	\$ (2)	\$ 10	\$ 9

(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:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(Dollars in millions)			
Loan administration income on mortgage loans subserviced				
Servicing fees, ancillary income and late fees (1)	\$ 33	\$ 27	\$ 94	\$ 77
Charges on subserviced custodial balances (2)	(3)	(20)	(26)	(50)
Other servicing charges	(4)	(2)	(9)	(5)
Total income on mortgage loans subserviced, included in loan administration	\$ 26	\$ 5	\$ 59	\$ 22

(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 our 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 investment securities available for sale and residential first mortgage loans held for investment using the last-of-layer method. Cash flows and the profit impact associated with designated hedges are reported in the same category as the underlying hedged item.

We have also designated certain interest rate swaps as cash flow hedges on LIBOR based variable interest payments on certain custodial deposits. Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income on the Consolidated Statement of Financial Condition and reclassified into interest expense in the same period in which the hedge transaction is recognized in earnings. At September 30, 2020, we had \$10 million (net-of-tax) of unrealized losses on derivatives classified as cash flow hedges recorded in accumulated other comprehensive income. We had

no designated cash flow hedges at December 31, 2019. The estimated amount to be reclassified from other comprehensive income into earnings during the next 12 months represents \$4 million of losses (net-of-tax).

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, 2020.

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

	September 30, 2020 (1)		
	Notional Amount	Fair Value (2)	Expiration Dates
(Dollars in millions)			
Derivatives in cash flow hedge relationships:			
Assets			
Interest rate swaps on custodial deposits	\$ 800	\$ 1	2026-2027
Derivatives in fair value hedge relationships:			
Assets			
Interest rate swaps on AFS securities	\$ 450	\$ —	2022-2025
Interest rate swaps on HFI residential first mortgages	100	—	2024
Total derivative assets	<u>\$ 550</u>	<u>\$ —</u>	
Derivatives not designated as hedging instruments:			
Assets			
Futures	\$ 1,132	\$ —	2020-2023
Mortgage-backed securities forwards	3,471	9	2020
Rate lock commitments	12,015	257	2020-2021
Interest rate swaps	724	65	2020-2030
Total derivative assets	<u>\$ 17,342</u>	<u>\$ 331</u>	
Liabilities			
Mortgage-backed securities forwards	\$ 8,008	\$ 37	2020
Rate lock commitments	169	—	2020-2021
Interest rate swaps and swaptions	2,030	9	2020-2050
Total derivative liabilities	<u>\$ 10,207</u>	<u>\$ 46</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.

December 31, 2019 (1)

	Notional Amount	Fair Value (2)	Expiration Dates
(Dollars in millions)			
Derivatives in fair value hedge relationships:			
Assets			
Interest rate swaps on FHLB advances	\$ 200	\$ —	2020
Interest rate swaps on AFS securities	100	—	2022
Total derivative assets	<u>\$ 300</u>	<u>\$ —</u>	
Derivatives not designated as hedging instruments:			
Assets			
Futures	\$ 550	\$ —	2020-2023
Mortgage-backed securities forwards	1,918	2	2020
Rate lock commitments	3,870	34	2020
Interest rate swaps	799	26	2020-2029
Total derivative assets	<u>\$ 7,137</u>	<u>\$ 62</u>	
Liabilities			
Mortgage-backed securities forwards	\$ 5,749	\$ 9	2020
Rate lock commitments	229	1	2020
Interest rate swaps and swaptions	1,662	8	2020-2050
Total derivative liabilities	<u>\$ 7,640</u>	<u>\$ 18</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)					
September 30, 2020					
Derivatives designated as hedging instruments:					
Assets					
Interest rate swaps on AFS securities	\$ —	\$ —	\$ —	\$ —	4
Interest rate swaps on custodial deposits	1	—	1	—	7
Interest rate swaps on HFI residential first mortgages	—	—	—	—	1
Total derivative assets	\$ 1	\$ —	\$ 1	\$ —	12
Liabilities					
Interest rate swaps on AFS securities	\$ —	\$ —	\$ —	\$ —	—
Total derivative liabilities	\$ —	\$ —	\$ —	\$ —	—
Derivatives not designated as hedging instruments:					
Assets					
Mortgage-backed securities forwards	\$ 9	\$ —	\$ 9	\$ —	—
Interest rate swaps	65	—	65	—	—
Futures	—	—	—	—	—
Total derivative assets	\$ 74	\$ —	\$ 74	\$ —	—
Liabilities					
Mortgage-backed securities forwards	\$ 37	\$ —	\$ 37	\$ —	39
Interest rate swaps and swaptions (1)	9	—	9	—	31
Total derivative liabilities	\$ 46	\$ —	\$ 46	\$ —	70
December 31, 2019					
Derivatives not designated as hedging instruments:					
Assets					
Mortgage-backed securities forwards	\$ 2	\$ —	\$ 2	\$ —	—
Interest rate swaps	26	—	26	—	—
Total derivative assets	\$ 28	\$ —	\$ 28	\$ —	—
Liabilities					
Mortgage-backed securities forwards	\$ 9	\$ —	\$ 9	\$ —	24
Interest rate swaps and swaptions (1)	8	—	8	—	39
Total derivative liabilities	\$ 17	\$ —	\$ 17	\$ —	63

- (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.

Losses of \$1 million on fair value hedging relationships of AFS securities were recorded in interest income for three and nine months ended September 30, 2020

Losses of \$1 million and \$2 million on cash flow hedging relationships of custodial deposits were reclassified from AOCI into loan administration income during the three and nine months ended September 30, 2020.

Gains and losses on fair value hedging relationships of HFI residential first mortgages for the three and nine months ended September 30, 2020 were de-minimis.

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 \$1,878 million at September 30, 2020 and \$287 million at December 31, 2019 of which \$8 million and \$1 million, respectively, were due to the fair value hedge relationship. The closed portfolio of AFS securities designated in this last layer method hedge was \$1,808 million par (amortized cost of \$1,805 million) at September 30, 2020 and \$291 million par (amortized cost of \$289 million) at

December 31, 2019 of which we have designated \$450 million and \$100 million at September 30, 2020 and December 31, 2019, respectively.

The fair value basis adjustment on our hedged fair HFI residential first mortgages is included in loans held-for-investment on our Consolidated Statements of Financial Condition. The carrying amount of our hedged loans was \$255 million at September 30, 2020 of which \$1 million was due to the fair value hedge relationship. There were no hedged HFI residential first mortgages at December 31, 2019. We have designated \$100 million of this closed portfolio of loans in a hedging relationship as of September 30, 2020.

At September 30, 2020, we pledged a total of \$82 million related to derivative financial instruments, consisting of \$56 million of cash collateral on derivative liabilities and \$26 million of maintenance margin on centrally cleared derivatives and had a de-minimis obligation to return cash on derivative assets. We pledged a total of \$63 million related to derivative financial instruments, consisting of \$34 million of cash collateral on derivatives and \$29 million of maintenance margin on centrally cleared derivatives and had a de-minimis obligation to return cash on derivative assets at December 31, 2019. 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 net gain 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,	
		2020	2019	2020	2019
(Dollars in millions)					
Derivatives not designated as hedging instruments:					
Futures	Net loss on mortgage servicing rights	\$ —	\$ —	\$ 1	\$ (2)
Interest rate swaps and swaptions	Net gain (loss) on mortgage servicing rights	(2)	28	39	71
Mortgage-backed securities forwards	Net gain (loss) on mortgage servicing rights	5	3	28	23
Rate lock commitments and MSR forwards	Net gain (loss) on loan sales	70	27	190	57
Forward commitments	Other noninterest income	—	—	—	2
Interest rate swaps (1)	Other noninterest income	—	2	1	3
Total derivative (loss) gain		\$ 73	\$ 60	\$ 259	\$ 154

(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, 2020		December 31, 2019	
	Amount	Rate	Amount	Rate
(Dollars in millions)				
Short-term fixed rate term advances	\$ 1,555	0.20 %	\$ 3,695	1.61 %
Other short-term borrowings (1)	671	0.11 %	470	1.64 %
Total short-term Federal Home Loan Bank advances and other borrowings	2,226		4,165	
Long-term fixed rate advances (2)	1,200	1.03 %	650	1.45 %
Total long-term Federal Home Loan Bank advances	1,200		650	
Total Federal Home Loan Bank advances and other borrowings	\$ 3,426		\$ 4,815	

(1) Includes borrowings under overnight federal funds purchased lines with other Federal Reserve member institutions.

(2) There was no current portion of fixed rate advances at both September 30, 2020 and December 31, 2019.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars in millions)			
Maximum outstanding at any month end	\$ 4,388	\$ 2,979	\$ 6,841	\$ 3,391
Average outstanding balance	\$ 3,528	\$ 2,446	\$ 4,234	\$ 2,769
Average remaining borrowing capacity	\$ 5,494	\$ 4,957	\$ 5,249	\$ 3,932
Weighted average interest rate	0.48 %	2.10 %	0.76 %	2.33 %

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

	September 30, 2020
	(Dollars in millions)
2020	\$ 2,226
2021	—
2022	200
2023	500
Thereafter	500
Total	<u>\$ 3,426</u>

Parent Company Senior Notes and Trust Preferred Securities

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

	September 30, 2020		December 31, 2019	
	Amount	Interest Rate	Amount	Interest Rate
	(Dollars in millions)			
Senior Notes				
Senior notes, matures 2021	\$ 246	6.125 %	\$ 249	6.125 %
Trust Preferred Securities				
Floating Three Month LIBOR Plus:				
3.25%, matures 2032	26	3.48 %	26	5.20 %
3.25%, matures 2033	26	3.53 %	26	5.24 %
3.25%, matures 2033	26	3.47 %	26	5.21 %
2.00%, matures 2035	26	2.28 %	26	3.99 %
2.00%, matures 2035	26	2.28 %	26	3.99 %
1.75%, matures 2035	51	2.00 %	51	3.64 %
1.50%, matures 2035	25	1.78 %	25	3.49 %
1.45%, matures 2037	25	1.70 %	25	3.34 %
2.50%, matures 2037	16	2.75 %	16	4.39 %
Total Trust Preferred Securities	<u>247</u>		<u>247</u>	
Total other long-term debt	<u>\$ 493</u>		<u>\$ 496</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, in addition to 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, 2020, we had no deferred interest.

Note 10 - Accumulated Other Comprehensive Income

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
(Dollars in millions)				
Investment Securities				
Beginning balance	\$ 56	\$ (8)	\$ 1	\$(47)
Unrealized gain	—	18	72	61
Less: Tax provision	—	5	17	15
Net unrealized gain	—	13	55	46
Reclassifications out of AOCI (1)	—	—	—	7
Less: Tax provision	—	—	—	1
Net unrealized gain reclassified out of AOCI	—	—	—	6
Other comprehensive income, net of tax	—	13	55	52
Ending balance	\$ 56	\$ 5	\$ 56	\$ 5
Cash Flow Hedges				
Beginning balance	\$ (10)	\$ —	\$ —	\$ —
Unrealized loss	—	—	(13)	—
Less: Tax benefit	—	—	(3)	—
Net unrealized loss	—	—	(10)	—
Reclassifications out of AOCI (1)	—	—	—	—
Other comprehensive loss, net of tax	—	—	(10)	—
Ending balance	\$ (10)	\$ —	\$ (10)	\$ —

(1) Reclassifications are reported in noninterest income 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,	
	2020	2019	2020	2019
(Dollars in millions, except share data)				
Net income applicable to common stockholders	\$ 222	\$ 63	\$ 384	\$ 160
Weighted Average Shares				
Weighted average common shares outstanding	57,032,746	56,484,499	56,827,171	56,607,944
Effect of dilutive securities				
Stock-based awards	347,063	626,297	404,518	644,596
Weighted average diluted common shares	\$ 57,379,809	\$ 57,110,796	\$ 57,231,689	\$ 57,252,540
Earnings per common share				
Basic earnings per common share	\$ 3.90	\$ 1.12	\$ 6.76	\$ 2.83
Effect of dilutive securities				
Stock-based awards	(0.02)	(0.01)	(0.05)	(0.03)
Diluted earnings per common share	\$ 3.88	\$ 1.11	\$ 6.71	\$ 2.80

Note 12 - Stock-Based Compensation

We had stock-based compensation expense of \$6 million and \$14 million for the three and nine months ended September 30, 2020, and \$4 million and \$9 million for the three and nine months ended September 30, 2019.

Restricted Stock and Restricted Stock Units

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

	Three Months Ended September 30, 2020		Nine Months Ended September 30, 2020	
	Shares	Weighted — Average Grant-Date Fair Value per Share	Shares	Weighted — Average Grant-Date Fair Value per Share
Restricted Stock and Restricted Stock Units				
Non-vested balance at beginning of period	1,412,884	\$ 29.72	1,399,127	\$ 28.72
Granted	7,429	30.96	378,953	27.96
Vested	(207,046)	26.48	(448,452)	25.50
Canceled and forfeited	(133,394)	22.70	(249,755)	22.59
Non-vested balance at end of period	1,079,873	\$ 31.21	1,079,873	\$ 31.21

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 382,140 remain as of September 30, 2020. There were 43,946 and 149,789 shares issued under the ESPP during the three and nine months ended September 30, 2020 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,	
	2020	2019	2020	2019
	(Dollars in millions)			
Income before income taxes	\$ 295	\$ 78	\$ 499	\$ 197
Provision for income taxes	73	15	115	37
Effective tax provision rate	24.7 %	18.4 %	23.0 %	18.6 %

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.

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, 2020 and December 31, 2019.

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)						
September 30, 2020						
Tier 1 capital (to adjusted avg. total assets)	\$ 2,256	8.0 %	\$ 1,123	4.0 %	\$ 1,403	5.0 %
Common equity Tier 1 capital (to RWA)	\$ 2,016	9.2 %	\$ 985	4.5 %	\$ 1,422	6.5 %
Tier 1 capital (to RWA)	\$ 2,256	10.3 %	\$ 1,313	6.0 %	\$ 1,751	8.0 %
Total capital (to RWA)	\$ 2,471	11.3 %	\$ 1,751	8.0 %	\$ 2,188	10.0 %
December 31, 2019						
Tier 1 capital (to adjusted avg. total assets)	\$ 1,720	7.6 %	\$ 909	4.0 %	\$ 1,136	5.0 %
Common equity Tier 1 capital (to RWA)	\$ 1,480	9.3 %	\$ 715	4.5 %	\$ 1,033	6.5 %
Tier 1 capital (to RWA)	\$ 1,720	10.8 %	\$ 953	6.0 %	\$ 1,271	8.0 %
Total capital (to RWA)	\$ 1,830	11.5 %	\$ 1,271	8.0 %	\$ 1,589	10.0 %

Flagstar Bank	Actual		For Capital Adequacy Purposes		Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in millions)						
September 30, 2020						
Tier 1 capital (to adjusted avg. total assets)	\$ 2,212	7.9 %	\$ 1,122	4.0 %	\$ 1,403	5.0 %
Common equity Tier 1 capital (to RWA)	\$ 2,212	10.1 %	\$ 985	4.5 %	\$ 1,422	6.5 %
Tier 1 capital (to RWA)	\$ 2,212	10.1 %	\$ 1,313	6.0 %	\$ 1,751	8.0 %
Total capital (to RWA)	\$ 2,427	11.1 %	\$ 1,751	8.0 %	\$ 2,188	10.0 %
December 31, 2019						
Tier 1 capital (to adjusted avg. total assets)	\$ 1,752	7.7 %	\$ 909	4.0 %	\$ 1,136	5.0 %
Common equity Tier 1 capital (to RWA)	\$ 1,752	11.0 %	\$ 714	4.5 %	\$ 1,032	6.5 %
Tier 1 capital (to RWA)	\$ 1,752	11.0 %	\$ 952	6.0 %	\$ 1,270	8.0 %
Total capital (to RWA)	\$ 1,862	11.7 %	\$ 1,270	8.0 %	\$ 1,587	10.0 %

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 closing, 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, 2020, 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.

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 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 satisfy the Settlement Agreement 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 discount rate, and the likelihood and types of potential business combinations, 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

At September 30, 2020 and December 31, 2019, excluding the fair value liability relating to the DOJ Liability, our total accrual for contingent liabilities and settled litigation was \$7 million and \$3 million, respectively.

Commitments

In the normal course of business, we have various commitments outstanding which are not included on our consolidated statements of financial position. The following table is a summary of the contractual amount of significant commitments:

	September 30, 2020	December 31, 2019
	(Dollars in millions)	
Commitments to extend credit		
Mortgage loan commitments including interest-rate locks	\$ 12,257	\$ 4,099
Warehouse loan commitments	2,218	1,944
Commercial and industrial commitments	1,207	1,107
Other commercial commitments	1,653	2,015
HELOC commitments	562	558
Other consumer commitments	301	175
Standby and commercial letters of credit	97	82

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. Because 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 commitments including interest-rate locks. We enter into mortgage loan commitments, including interest-rate locks with our customers. These interest-rate lock 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 businesses 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. Because 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. See Note 4 - Loans Held-for-Investment for additional information.

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, 2020 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, 2020			
	Level 1	Level 2	Level 3	Total Fair Value
	(Dollars in millions)			
Investment securities available-for-sale				
Agency - Commercial	\$ —	\$ 1,171	\$ —	\$ 1,171
Agency - Residential	—	837	—	837
Municipal obligations	—	30	—	30
Corporate debt obligations	—	77	—	77
Other MBS	—	49	—	49
Certificate of deposits	—	1	—	1
Loans held-for-sale				
Residential first mortgage loans	—	5,349	—	5,349
Loans held-for-investment				
Residential first mortgage loans	—	12	—	12
Home equity	—	—	2	2
Mortgage servicing rights	—	—	323	323
Derivative assets				
Rate lock commitments (fallout-adjusted)	—	—	257	257
Futures	—	—	—	—
Mortgage-backed securities forwards	—	9	—	9
Interest rate swaps and swaptions	—	66	—	66
Total assets at fair value	\$ —	\$ 7,601	\$ 582	\$ 8,183
Derivative liabilities				
Mortgage backed securities forwards	\$ —	\$ (37)	\$ —	\$ (37)
Interest rate swaps	—	(9)	—	(9)
DOJ Liability	—	—	(35)	(35)
Total liabilities at fair value	\$ —	\$ (46)	\$ (35)	\$ (81)

	December 31, 2019			
	Level 1	Level 2	Level 3	Total Fair Value
	(Dollars in millions)			
Investment securities available-for-sale				
Agency - Commercial	\$	—	\$ 947	\$ 947
Agency - Residential		1,015	—	1,015
Municipal obligations		31	—	31
Corporate debt obligations		77	—	77
Other MBS		45	—	45
Certificate of Deposit		1	—	1
Loans held-for-sale				
Residential first mortgage loans		5,219	—	5,219
Loans held-for-investment				
Residential first mortgage loans		10	—	10
Home equity		—	2	2
Mortgage servicing rights		—	291	291
Derivative assets				
Rate lock commitments (fallout-adjusted)		—	34	34
Mortgage-backed securities forwards		2	—	2
Interest rate swaps and swaptions		26	—	26
Total assets at fair value	\$	—	\$ 7,373	\$ 7,700
Derivative liabilities				
Rate lock commitments (fallout-adjusted)	\$	—	\$ —	(1) \$
Mortgage-backed securities forwards		(9)	—	(9)
Interest rate swaps		(8)	—	(8)
DOJ Liability		—	(35)	(35)
Contingent consideration		—	(10)	(10)
Total liabilities at fair value	\$	—	\$ (17)	\$ (63)

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 / Closings	Sales	Settlement	Transfers Out	Balance at End of Period
(Dollars in millions)							
Three Months Ended September 30, 2020							
Assets							
Loans held-for-investment							
Home equity	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ —	2
Mortgage servicing rights (2)	261	(23)	85	—	—	—	323
Rate lock commitments (net) (2)(3)	205	90	333	—	—	(371)	257
Totals	\$ 468	\$ 67	\$ 418	\$ —	\$ —	\$ (371)	\$ 582
Liabilities							
DOJ Liability	\$ (35)	\$ —	\$ —	\$ —	\$ —	\$ —	(35)
Contingent consideration	(27)	—	—	—	27	—	—
Totals	\$ (62)	\$ —	\$ —	\$ —	\$ 27	\$ —	\$ (35)
Three Months Ended September 30, 2019							
Assets							
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	\$ 368	\$ (38)	\$ 152	\$ (12)	\$ —	\$ (133)	\$ 337
Liabilities							
DOJ Liability	\$ (35)	\$ —	\$ —	\$ —	\$ —	\$ —	(35)
Contingent consideration	(7)	(4)	—	—	3	—	(8)
Totals	\$ (42)	\$ (4)	\$ —	\$ —	\$ 3	\$ —	\$ (43)

- (1) There were no unrealized gains (losses) recorded in OCI during the three months ended September 30, 2020 and 2019.
- (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/ Closings	Sales	Settlement	Transfers Out	Balance at End of Period
(Dollars in millions)							
Nine Months Ended September 30, 2020							
Assets							
Loans held-for-investment							
Home equity	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ —	2
Mortgage servicing rights (2)	291	(131)	209	(46)	—	—	323
Rate lock commitments (net) (2)(3)	34	274	805	—	—	(856)	257
Totals	\$ 327	\$ 143	\$ 1,014	\$ (46)	\$ —	\$ (856)	\$ 582
Liabilities							
DOJ Liability	\$ (35)	\$ —	\$ —	\$ —	\$ —	\$ —	(35)
Contingent consideration	(10)	(17)	—	—	27	—	—
Totals	\$ (45)	\$ (17)	\$ —	\$ —	\$ 27	\$ —	\$ (35)
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	\$ 312	\$ (76)	\$ 448	\$ (57)	\$ —	\$ (290)	\$ 337
Liabilities							
DOJ Liability	\$ (60)	\$ 25	\$ —	\$ —	\$ —	\$ —	(35)
Contingent consideration	(6)	(5)	—	—	3	—	(8)
Totals	\$ (66)	\$ 20	\$ —	\$ —	\$ 3	\$ —	\$ (43)

- (1) There were no unrealized gains (losses) recorded in OCI during the nine months ended September 30, 2020 and 2019.
- (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)				
September 30, 2020				
Assets				
Loans held-for-investment				
Home equity	\$ 2	Discounted cash flows	Discount rate Constant prepayment rate Constant default rate	7.2% - 10.8% (9.0%) 23.1% - 34.7% (28.9%) 1.7% - 2.6% (2.2%)
Mortgage servicing rights	\$ 323	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service per loan	3.7% - 21.2% (7.6%) 0% - 14.3% (11.4%) \$67 - \$95 (\$82)
Rate lock commitments (net)	\$ 257	Consensus pricing	Closing pull-through rate	80.6% - 87.2% (81.9%)
Liabilities				
DOJ Liability	\$ (35)	Discounted cash flows	See description below	See description below
(Dollars in millions)				
December 31, 2019				
Assets				
Loans held-for-investment				
Home equity	\$ 2	Discounted cash flows	Discount rate Constant prepayment rate Constant default rate	7.2% - 10.8% (9.0%) 13.0% - 19.5% (16.2%) 2.7% - 4.0% (3.3%)
Mortgage servicing rights	\$ 291	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service per loan	2.4% - 20.4% (5.3%) 0% - 12.3% (10.6%) \$67 - \$95 (\$84)
Rate lock commitments (net)	\$ 34	Consensus pricing	Origination pull-through rate	80.0% - 87.2% (81.5%)
Liabilities				
DOJ Liability	\$ (35)	Discounted cash flows	See description below	See description below
Contingent consideration	\$ (10)	Discounted cash flows	See description below	See description below

(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. For September 30, 2020 and December 31, 2019, the weighted average life (in years) for the entire MSR portfolio was 3.9 and 4.1, 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 \$25 million during the year ended December 31, 2019. 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.

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.

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	Losses
(Dollars in millions)				
September 30, 2020				
Loans held-for-sale (2)	\$ 14	\$ 14	\$ —	(1)
Impaired loans held-for-investment (2)				
Residential first mortgage loans	21	—	21	(3)
Repossessed assets (3)	6	—	6	(3)
Totals	\$ 41	\$ 14	\$ 27	(7)
December 31, 2019				
Loans held-for-sale (2)	\$ 6	\$ 6	\$ —	(1)
Impaired loans held-for-investment (2)				
Residential first mortgage loans	14	—	14	(5)
Repossessed assets (3)	10	—	10	(3)
Totals	\$ 30	\$ 6	\$ 24	(9)

- (1) The fair values are determined at various dates dependent upon when certain conditions were met requiring fair value measurement.
- (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)				
September 30, 2020				
Impaired loans held-for-investment				
Residential first mortgage loans	\$ 21	Fair value of collateral	Loss severity discount	0% - 100% (12.4%) (1)
Repossessed assets	\$ 6	Fair value of collateral	Loss severity discount	0% - 96.3% (31.8%) (1)
December 31, 2019				
Impaired loans held-for-investment				
Residential first mortgage loans	\$ 14	Fair value of collateral	Loss severity discount	25% - 30% (25.9%) (1)
Repossessed assets	\$ 10	Fair value of collateral	Loss severity discount	0% - 100% (17.1%) (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, 2020

	Estimated Fair Value				
	Carrying Value	Total	Level 1	Level 2	Level 3
(Dollars in millions)					
Assets					
Cash and cash equivalents	\$ 280	\$ 280	\$ 280	\$ —	\$ —
Investment securities available-for-sale	2,165	2,165	—	2,165	—
Investment securities held-to-maturity	440	458	—	458	—
Loans held-for-sale	5,372	5,372	—	5,372	—
Loans held-for-investment	16,476	16,266	—	12	16,254
Loans with government guarantees	2,500	2,480	—	2,480	—
Mortgage servicing rights	323	323	—	—	323
Federal Home Loan Bank stock	377	377	—	377	—
Bank owned life insurance	355	355	—	355	—
Reposessed assets	6	6	—	—	6
Other assets, foreclosure claims	22	22	—	22	—
Derivative financial instruments, assets	332	332	—	75	257
Liabilities					
Retail deposits					
Demand deposits and savings accounts	\$ (8,223)	\$ (7,634)	\$ —	\$ (7,634)	\$ —
Certificates of deposit	(1,525)	(1,539)	—	(1,539)	—
Wholesale deposits	(1,034)	(1,053)	—	(1,053)	—
Government deposits	(1,748)	(1,703)	—	(1,703)	—
Company controlled deposits	(7,416)	(7,377)	—	(7,377)	—
Federal Home Loan Bank advances and other	(3,426)	(3,455)	—	(3,455)	—
Long-term debt	(493)	(449)	—	(449)	—
DOJ Liability	(35)	(35)	—	—	(35)
Contingent consideration	—	—	—	—	—
Derivative financial instruments, liabilities	(46)	(46)	—	(46)	—

	December 31, 2019				
	Carrying Value	Estimated Fair Value			
		Total	Level 1	Level 2	Level 3
(Dollars in millions)					
Assets					
Cash and cash equivalents	\$ 426	\$ 426	\$ 426	\$ —	\$ —
Investment securities available-for-sale	2,116	2,116	—	2,116	—
Investment securities held-to-maturity	598	599	—	599	—
Loans held-for-sale	5,258	5,258	—	5,258	—
Loans held-for-investment	12,129	12,031	—	10	12,021
Loans with government guarantees	736	707	—	707	—
Mortgage servicing rights	291	291	—	—	291
Federal Home Loan Bank stock	303	303	—	303	—
Bank owned life insurance	349	349	—	349	—
Reposessed assets	10	10	—	—	10
Other assets, foreclosure claims	45	45	—	45	—
Derivative financial instruments, assets	62	88	—	54	34
Liabilities					
Retail deposits					
Demand deposits and savings accounts	\$ (6,811)	\$ (6,050)	\$ —	\$ (6,050)	\$ —
Certificates of deposit	(2,353)	(2,368)	—	(2,368)	—
Wholesale deposits	(633)	(640)	—	(640)	—
Government deposits	(1,213)	(1,156)	—	(1,156)	—
Custodial deposits	(4,136)	(4,066)	—	(4,066)	—
Federal Home Loan Bank advances	(4,815)	(4,816)	—	(4,816)	—
Long-term debt	(496)	(462)	—	(462)	—
DOJ Liability	(35)	(35)	—	—	(35)
Contingent consideration	(10)	(10)	—	—	(10)
Derivative financial instruments, liabilities	(18)	(44)	—	(43)	(1)

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,	
	2020	2019	2020	2019
(Dollars in millions)				
Assets				
Loans held-for-sale				
Net gain on loan sales	\$ 340	\$ 97	\$ 899	\$ 272
Loans held-for-investment				
Other noninterest income	\$ —	\$ 1	\$ —	\$ 1
Liabilities				
DOJ Liability				
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, 2020			December 31, 2019		
	UPB	Fair Value	Fair Value Over / (Under) UPB	UPB	Fair Value	Fair Value Over / (Under) UPB
(Dollars in millions)						
Assets						
Nonaccrual loans						
Loans held-for-sale	\$ 6	\$ 5	(1)	\$ 3	\$ 3	—
Loans held-for-investment	9	8	(1)	5	4	(1)
Total nonaccrual loans	\$ 15	\$ 13	(2)	\$ 8	\$ 7	(1)
Other performing loans						
Loans held-for-sale	\$ 5,125	\$ 5,344	219	\$ 5,057	\$ 5,216	159
Loans held-for-investment	6	5	(1)	8	8	—
Total other performing loans	\$ 5,131	\$ 5,349	218	\$ 5,065	\$ 5,224	159
Total loans						
Loans held-for-sale	\$ 5,131	\$ 5,349	218	\$ 5,060	\$ 5,219	159
Loans held-for-investment	15	13	(2)	13	12	(1)
Total loans	\$ 5,146	\$ 5,362	216	\$ 5,073	\$ 5,231	158
Liabilities						
DOJ Liability (1)	\$ (118)	\$ (35)	83	\$ (118)	\$ (35)	83

(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, 2020, certain departments have been re-aligned between the Community Banking and Mortgage Originations. Specifically, a majority of the residential mortgage HFI portfolio is now part of the Mortgage Originations 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 and Warehouse Lending. 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. The interest income on LHFI is recognized in the Community Banking segment, excluding residential first mortgages and newly originated home equity products within the Mortgage Originations segment.

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 Originations segment recognizes interest income on loans that are held for sale and the gains from sales associated with these loans, along with the interest income on residential mortgages and newly originated home equity products within LHFI.

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 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 credit losses) and noninterest income. Noninterest expenses and a majority of provision (benefit) for income taxes, are allocated to each operating segment. Provision for credit losses is allocated to segments based on net charge offs and changes in outstanding balances. In contrast, the level of the consolidated provision for credit losses is determined based on an allowance model using the methodologies described in Item 2 – MD&A. The net effect of the credit provision is recorded in the Other 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, 2020				
	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
	(Dollars in millions)				
Summary of Operations					
Net interest income	\$ 158	\$ 49	\$ 5	\$ (32)	\$ 180
Provision (benefit) for credit losses	(2)	(3)	—	37	32
Net interest income after provision (benefit) for credit losses	160	52	5	(69)	148
Net gain on loan sales	2	344	—	—	346
Loan fees and charges	—	29	16	—	45
Net return on mortgage servicing rights	—	12	—	—	12
Loan administrative (expense) income	(1)	(10)	40	(3)	26
Other noninterest income	15	3	—	5	23
Total noninterest income	16	378	56	2	452
Compensation and benefits	28	42	12	41	123
Commissions	1	71	—	—	72
Loan processing expense	1	15	8	—	24
Other noninterest expense	63	32	21	(30)	86
Total noninterest expense	93	160	41	11	305
Income (loss) before indirect overhead allocations and income taxes	83	270	20	(78)	295
Indirect overhead allocation income (expense)	(11)	(18)	(4)	33	—
Provision (benefit) for income taxes	15	53	3	2	73
Net income (loss)	\$ 57	\$ 199	\$ 13	\$ (47)	\$ 222
Intersegment (expense) revenue	\$ (22)	\$ (12)	\$ 10	\$ 24	\$ —
Average balances					
Loans held-for-sale	\$ —	\$ 5,602	\$ —	\$ —	\$ 5,602
Loans with government guarantees	—	2,122	—	—	2,122
Loans held-for-investment (2)	12,311	2,498	—	30	14,839
Total assets	12,603	11,195	78	4,401	28,277
Deposits	11,265	—	7,329	967	19,561

- (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, 2019

	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
(Dollars in millions)					
Summary of Operations					
Net interest income	\$ 105	\$ 37	\$ 5	\$ (1)	\$ 146
Provision (benefit) for credit losses	—	(2)	—	3	1
Net interest income after provision for credit losses	105	39	5	(4)	145
Net gain (loss) on loan sales	(4)	114	—	—	110
Loan fees and charges	—	20	8	1	29
Net return on mortgage servicing rights	—	(2)	—	—	(2)
Loan administrative (expense) income	(1)	(7)	32	(19)	5
Other noninterest income	18	2	—	9	29
Total noninterest income	13	127	40	(9)	171
Compensation and benefits	27	29	7	35	98
Commissions	—	37	—	1	38
Loan processing expense	1	10	10	1	22
Other noninterest expense	42	25	14	(1)	80
Total noninterest expense	70	101	31	36	238
Income (loss) before indirect overhead allocations and income taxes	48	65	14	(49)	78
Indirect overhead allocation income (expense)	(10)	(10)	(4)	24	—
Provision (benefit) for income taxes	8	11	2	(6)	15
Net income (loss)	<u>\$ 30</u>	<u>\$ 44</u>	<u>\$ 8</u>	<u>\$ (19)</u>	<u>\$ 63</u>
Intersegment (expense) revenue	<u>\$ (6)</u>	<u>\$ 8</u>	<u>\$ 7</u>	<u>\$ (9)</u>	<u>\$ —</u>
Average balances					
Loans held-for-sale	\$ 20	\$ 3,766	\$ —	\$ —	\$ 3,786
Loans with government guarantees	—	574	—	—	574
Loans held-for-investment (2)	11,681	33	—	29	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.

Nine Months Ended September 30, 2020

	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
(Dollars in millions)					
Summary of Operations					
Net interest income	\$ 395	\$ 147	\$ 14	\$ (60)	\$ 496
Provision (benefit) for credit losses	3	(8)	—	153	148
Net interest income after provision (benefit) for credit losses	392	155	14	(213)	348
Net gain on loan sales	2	737	—	—	739
Loan fees and charges	1	68	43	—	112
Net loss on mortgage servicing rights	—	10	—	—	10
Loan administrative (expense) income	(2)	(25)	112	(26)	59
Other noninterest income	43	5	—	20	68
Total noninterest income	44	795	155	(6)	988
Compensation and benefits	79	111	33	118	341
Commissions	2	160	—	—	162
Loan processing expense	4	39	24	2	69
Other noninterest expense	231	114	57	(137)	265
Total noninterest expense	316	424	114	(17)	837
Income (loss) before indirect overhead allocations and income taxes	120	526	55	(202)	499
Indirect overhead allocation income (expense)	(31)	(45)	(15)	91	—
Provision (benefit) for income taxes	19	101	8	(13)	115
Net income (loss)	<u>\$ 70</u>	<u>\$ 380</u>	<u>\$ 32</u>	<u>\$ (98)</u>	<u>\$ 384</u>
Intersegment (expense) revenue	<u>\$ (97)</u>	<u>\$ (46)</u>	<u>\$ 27</u>	<u>\$ 116</u>	<u>\$ —</u>
Average balances					
Loans held-for-sale	\$ —	\$ 5,499	\$ —	\$ —	\$ 5,499
Loans with government guarantees	—	1,267	—	—	1,267
Loans held-for-investment (2)	10,702	2,693	—	29	13,424
Total assets	11,100	10,539	65	4,288	25,992
Deposits	10,817	—	6,114	767	17,698

- (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

	Community Banking	Mortgage Originations	Mortgage Servicing	Other (1)	Total
(Dollars in millions)					
Summary of Operations					
Net interest income	\$ 296	\$ 103	\$ 11	\$ —	\$ 410
Provision (benefit) for credit losses	17	(3)	—	4	18
Net interest income after provision for credit losses	279	106	11	(4)	392
Net gain (loss) on loan sales	(10)	243	—	1	234
Loan fees and charges	1	47	22	—	70
Net return on mortgage servicing rights	—	9	—	—	9
Loan administrative (expense) income	(3)	(16)	91	(50)	22
Other noninterest income	46	9	—	58	113
Total noninterest income	34	292	113	9	448
Compensation and benefits	77	79	19	100	275
Commissions	1	75	—	—	76
Loan processing expense	5	23	30	2	60
Other noninterest expense	125	63	43	1	232
Total noninterest expense	208	240	92	103	643
Income (loss) before indirect overhead allocations and income taxes	105	158	32	(98)	197
Indirect overhead allocation income (expense)	(30)	(30)	(13)	73	—
Provision (benefit) for income taxes	16	26	4	(9)	37
Net income (loss)	\$ 59	\$ 102	\$ 15	\$ (16)	\$ 160
Intersegment (expense) revenue	\$ (14)	\$ 19	\$ 19	\$ (24)	\$ —

Average balances

Loans held-for-sale	\$ 37	\$ 3,495	\$ —	\$ —	\$ 3,532
Loans with government guarantees	—	511	—	—	511
Loans held-for-investment (2)	10,465	22	—	29	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.

Note 18 - Recently Issued Accounting Pronouncements

Adoption of New Accounting Standards

We adopted the following ASU during the quarter ended September 30, 2020, which did not have a material impact to our financial statements:

Standard	Descriptions	Effective Date
ASU 2020-06	Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity	September 1, 2020

Note 19 - Subsequent Events

Subordinated Notes

On October 28, 2020, we issued \$150 million of Subordinated Debt (the "Notes") with a maturity date of November 1, 2030. The Notes bear interest at a fixed rate of 4.125% through October 31, 2025, and a variable rate tied to SOFR thereafter until maturity. We have the option to redeem all or a part of the Notes beginning on November 1, 2025 and on any subsequent interest payment date. The Notes will qualify as Tier 2 capital for regulatory purposes.

Share Repurchase

On October 28, 2020, we completed a share repurchase of 4,587,647 shares of common stock worth \$150 million from MP Thrift Investments L.P. at a purchase price per share of \$32.70.

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, 2020, 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, 2020.
- (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, 2020, 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

We are reviewing and updating our risk factors to contemplate the current pandemic resulting from COVID-19, including the following material changes from the risk factors reported in the Company's Annual Report on Form 10-K for the period ended December 31, 2019:

Adverse Economic Conditions

We are currently in the midst of a health crisis as a result of COVID-19. The COVID-19 pandemic is adversely affecting us, our customers, counterparties, employees, and third-party service providers, and the ultimate extent of the impacts on our business, financial position, results of operations, liquidity, and prospects is uncertain. In addition, the pandemic has resulted in temporary or permanent closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities. Some states and communities have re-opened and may be at risk of restrictions again in the future. As a result, the demand for our products and services may be significantly negatively impacted. Our ongoing response to COVID-19, including standing up new programs specified in the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), such as the PPP, and our long-term effectiveness while working remotely, could have a significant, lasting impact on our operations, financial condition and reputation. The extent to which COVID-19 impacts our business, results of operations, and financial condition, as well as our regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic.

The Bank has instituted a work-from-home policy for all staff that are able to work remotely. Working remotely creates new challenges and the pace of change required to address government programs and forbearance increases the risk of internal control failure. In addition, consumers affected by the changed economic and market conditions as a result of a pandemic may continue to demonstrate changed behavior even after the crisis is over, including decreases in discretionary spending on a permanent or long-term basis. While almost all of our lobbies have re-opened, we have enhanced our cleaning protocols, installed plexiglass shields, and we require that our employees wear face protection. This change in business could also result in changes in consumer behavior for which we may not be prepared.

The response to the pandemic resulted in a strong contraction in our economy, increased market volatility and uncertainty in our capital markets, most notably impacting workers and small businesses. The economic health of these businesses may depend upon the fiscal assistance provided by the CARES Act or future acts taken by Congress. The CARES Act is the largest deployment of capital ever authorized by Congress with several provisions designed to ensure banks are able to provide assistance and relief to consumers and businesses. Although government intervention is intended to mitigate economic uncertainties, these programs may not be broad or specific enough to mitigate the economic risks of COVID-19, which may lead to adverse results.

Additionally, the CARES Act was passed quickly and regulators rapidly issued clarifying guidance and operationalized certain programs, such as the PPP. As a result, there is risk that there are subsequent interpretations of guidance or aggressive assertions of wrongdoing in regards to laws, regulations or applications of guidance which could cause an adverse impact to our financial results or our internal controls. We also face an increased risk of client disputes, litigation and governmental and regulatory scrutiny as a result of the effects of COVID-19 on economic and market conditions.

The adverse economic conditions will have an impact on our customers. Many of these customers have and may continue to experience unemployment and a loss of revenue, leading to a lack of cash flows. As a result of these lower cash flows, our customers are drawing on the lines of credit we have extended to them and withdrawing their deposits from the Bank. Both of these actions could have an adverse impact on our liquidity position. Additionally, the ability of our borrowers to make payments timely on outstanding loans, the value of collateral securing those loans, and demand for loans and other products and services that we offer have and may continue to be adversely impacted by COVID-19. Until the effects of the pandemic subside, we expect continued draws on lines of credit, reduced revenues in our businesses, and increased loan defaults and losses.

Even after the pandemic subsides, the U.S. economy may continue to experience a recession, and we anticipate our business would be materially and adversely affected by a prolonged recession in the U.S.

Interest Rates

In response to COVID-19, the Federal Reserve reduced the Federal Funds Rate to zero percent in March 2020. The outlook for the remainder of 2020 is uncertain, and there is a possibility that the Federal Reserve keeps interest rates low or even uses negative interest rates if economic conditions warrant. Although many of our commercial loans have floors, approximately half of our revenue is tied to interest rates, and an extended period of operations in a zero- or negative-rate environment could negatively impact profitability.

In addition, the Federal Reserve initiated new quantitative easing programs, buying securities at various points in time, resulting in disruptions to the mortgage-backed securities market. There is a risk that the Federal Reserve may take additional actions in the future or elect to stop their current actions which could disrupt the market and have an adverse impact on our mortgage gain on sale or other financial results. Further, the impact of these actions has caused the financial instruments we use to manage our interest rate and market risks to be less effective at times, which, in turn, could have a material, adverse impact on our operations and financial condition.

There has also been disruption in the market for mortgage backed securities resulting from overall low level of rates across the yield curve, the high level of volatility of interest rates, and the financial weakness of some traditional buyers of mortgage servicing rights. This has caused uncertainty with respect to our ability to sell mortgage servicing rights. At September 30, 2020, we had \$323 million of mortgage servicing rights which equated to 16.0 percent of common equity tier one capital. Should the level of mortgage servicing rights exceed 25 percent of common equity tier one capital, we are required to deduct the excess in determining our regulatory capital levels. If we have the inability to sell mortgage servicing rights on a timely basis, there could be negative impacts to our regulatory capital or an impact on our pricing for mortgage loans which could negatively impact our mortgage origination business and our financial condition.

Customer and Lending Relief Actions

As a result of recent federal legislation, we are required to provide mortgage forbearances to individuals with single-family, federally backed mortgages, such as those that we service which underlie our mortgage servicing rights, due to COVID-19 related difficulties. In addition, we waived fees for an extended time period as customers deal with the crisis, which we may continue to do in the future. This could result in a reduction in servicing fee income and a higher cost to service as customers do not pay their mortgages and we cover their payments for a temporary time period until the investors make us whole. Additionally, MSR transactions customarily contain early payment default provisions. If a customer requests forbearance on the residential mortgage loans underlying the MSRs we have sold, generally within 90 days following the sale, we may be contractually obligated to refund the purchase price of the MSR or pay a fee to the purchaser. Furthermore, we have provided forbearance to certain of our commercial customers. The result of these actions could result in financial, operational, credit and compliance risk as we navigate government requirements and our ability to modify our systems to account for these changes while maintaining an adequate internal control structure.

The following table details borrowers currently participating in a forbearance program:

	Forbearance Requested							
	Total Population		Borrowers making July, August and September Payments		Remaining Borrowers		Percent of UPB	Percent of Accounts
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts		
(Dollars in millions)								
Loan servicing								
Subserviced for others (2)	\$ 180,981	893,559	\$ 5,654	26,529	\$ 15,103	67,192	11.5 %	10.5 %
Serviced for others (3)	37,908	148,868	950	3,908	3,081	12,217	10.6 %	10.8 %
Serviced for own loan portfolio (4)	8,469	62,486	196	1,792	468	1,886	7.8 %	5.9 %
Total loans serviced	\$ 227,358	1,104,913	\$ 6,800	32,229	\$ 18,652	81,295	11.2 %	10.3 %

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

(2) Loans subserviced for a fee for non-Flagstar owned loans or MSR. Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs.

(3) Loans for which Flagstar owns the MSR.

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

Our application of forbearance, any loan payment deferrals that we grant, the servicing advances we are required to make and any escrow advances we are required to make while a loan is in forbearance could result in us carrying significant asset balances. This could result in a reduction in our liquidity and cause a reduction in our capital ratios. The combination of these impacts along with other impacts, could cause us to not have sufficient liquidity or capital.

We also have a concentration of customers in the mortgage finance business. We make warehouse and MSR loans to these customers, and often originate through them in the correspondent channel of our mortgage originations business. The implications of federally mandated forbearance is expected to have a detrimental impact on the liquidity position of these companies that may have already been experiencing financial stress. It is not clear what, if any, programs will be available to these customers to provide liquidity. As a consequence, some of these companies could fail. A failure of one of our customers could be a loss of mortgage closing volume and could also lead to credit losses, should the collateral underlying their loans prove insufficient to repay the amount of the loan outstanding.

Furthermore, we are not aging receivables for customers who have been granted a payment holiday, payment deferral or forbearance. Therefore, there is a risk that subsequently, customers may still be unable to make their payments, resulting in delinquencies at a higher rate than what is typical and a higher percentage of loans in nonaccrual status. Additionally, for consumer loans, current payments typically provide the primary evidence of a borrower's ability and intent to repay the loan. Therefore, during the forbearance, deferral or payment holiday period, we may not be able to discern which loans can be repaid and which require timely action to manage the potential for loss to a lower level. Consequently, when a borrower is unable to repay the loan, our losses could be higher than we have experienced in the past. In addition, newly originated or acquired mortgage loans could potentially request forbearance prior to us selling the loan, resulting in a higher carrying cost for us as we may not be able to sell them into the market at all or at prices we would accept.

Allowance for Credit Losses

Our ACL, which reflects our estimate of lifetime losses inherent in the loans held-for-investment portfolio and our reserve for unfunded commitment, may not be sufficient to cover actual credit losses. We have loan exposures to industries that have been impacted more severely by COVID-19 including:

	As of September 30, 2020	
	Loan Exposure	
	(Dollars in millions)	
Retail	\$	300
Hotel	\$	261
Leisure & Entertainment	\$	131
Senior Housing	\$	118
Automotive	\$	87
Healthcare	\$	40

Our ACL calculations include a forecast for a reasonable and supportable time period. We utilized the Moody's September scenarios in our forecast: a growth forecast, weighted at 30 percent; a baseline forecast, weighted at 40 percent; and an adverse forecast, weighted at 30 percent. The resulting composite forecast for the third quarter 2020 was roughly equivalent to the scenario we used in the second quarter of 2020. Unemployment ends the year at 10 percent and recovers only slightly in 2021. GDP recovers only slightly by the end of the year from current levels and does not return to near pre-COVID levels until 2024. HPI drops about 2 percent from mid-2020 through 2021. Changing economic conditions could cause a material difference in future forecasts used in our calculations. If actual results differ materially from the forecast used in our calculations, our credit loss provision may increase and our ACL may not be sufficient to cover losses sustained, particularly for the impacted industries. The current pandemic has resulted in the environment changing rapidly which increases the risk of inaccurate forecasts because they depend upon significant judgments and estimates, which can be even more challenging in an environment of uncertainty. The calculation for ACL is complex and the associated risk could impact our results of operations and may place stress on our internal controls over financial reporting.

Cybersecurity Risk

The COVID-19 pandemic has resulted in the Bank instituting a work-from-home policy for all staff that are able to work remotely. This exposes us to increased cybersecurity risk. Increased levels of remote access may create additional opportunities for cyber criminals to exploit vulnerabilities. We have observed an increase in attempted malicious activity from third parties directed at the Bank and employees may be more susceptible to phishing and social engineering attempts due to increased stress caused by the crisis and from balancing family and work responsibilities at home, such as attempts to obtain personally identifiable information. Cybercriminals may be opportunistic about fears about COVID-19 and the higher number of people accessing the network remotely, by including malware in emails that appear to include documents providing legitimate information for protecting oneself from COVID-19. The Bank may also be exposed to this risk if the operations of any of its vendors that provide critical services to the Bank are adversely impacted by cyberattacks. Furthermore, with the increased use of virtual private network ("VPN") servers, there is a risk of security misconfiguration in VPNs resulting in exposing sensitive information to the internet. A significant and sustained malware or other cybersecurity attack targeted at the Bank or any of its vendors that provide critical services to the Bank could have a material adverse impact on our ability to conduct our overall operations and on our financial condition.

Loss or Extended Absence of Key Personnel

We are and will continue to be dependent upon our management team and other key personnel. Losing the services of one or more key members of our management team or other key personnel could adversely affect our operations. In addition, COVID-19 increases the risk that certain senior executive officers or a member of the board of directors could become ill, causing them to be incapacitated or otherwise unable to perform their duties for an extended absence. Furthermore, because of the nature of the disease, multiple people working in close proximity could also become ill simultaneously which could result in the same department having extended absences. This could negatively impact the efficiency and effectiveness of processes and internal controls throughout the Bank.

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, 2020.

Issuer Purchases of Equity Securities

The Company made no purchases of its equity securities during the quarter ended September 30, 2020.

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*	<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>
3.2*	<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>
4.1*	<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>
4.2*	<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>
4.3*	<u>Form of 4.125% Fixed-to-Floating Rate Subordinated Note due 2030.</u>
31.1	<u>Section 302 Certification of Chief Executive Officer</u>
31.2	<u>Section 302 Certification of Chief Financial Officer</u>
32.1	<u>Section 906 Certification, as furnished by the Chief Executive Officer</u>
32.2	<u>Section 906 Certification, as furnished by the Chief Financial Officer</u>
101	Financial statements from Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2020, 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

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 9, 2020

/s/ Alessandro DiNello

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

/s/ James K. Cirolì

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

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Section 7: EX-31.1 (EX-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 9, 2020

/s/ Alessandro P. DiNello

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

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Section 8: EX-31.2 (EX-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 9, 2020

/s/ James K. Cirolì

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

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Section 9: EX-32.1 (EX-32.1)

EXHIBIT 32.1

SECTION 906 CERTIFICATION

In connection with the quarterly report of Flagstar Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, 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 9, 2020

/s/ Alessandro P. DiNello

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

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Section 10: EX-32.2 (EX-32.2)

EXHIBIT 32.2

SECTION 906 CERTIFICATION

In connection with the quarterly report of Flagstar Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, 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 9, 2020

/s/ James K. Cirolì

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

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