FLAGSTAR BANCORP INC
Form 10-Q
May 08, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from _________ to _________

Commission File Number: 001-16577

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

Michigan (State or other jurisdiction of Incorporation or organization)	38-3150651 (I.R.S. Employer Identification No.)
5151 Corporate Drive, Troy, Michigan (Address of principal executive offices)	48098-2639 (Zip code)

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

Not applicable
(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨.
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý.
As of May 6, 2015, 56,436,026 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Flagstar Bancorp, Inc.
Consolidated Statements of Financial Condition
(In millions, except share data)

	March 31, 2015	December 31, 2014
	(Unaudited)	
Assets		
Cash and cash equivalents		
Cash	$43	$47
Interest-earning deposits	198	89
Total cash and cash equivalents	241	136
Investment securities	2,295	1,672
Loans held-for-sale ($2,044 and $1,196 measured at fair value, respectively)	2,097	1,244
Loans with government guarantees	704	1,128
Loans held-for-investment, net		
Loans held-for-investment ($189 and $211 measured at fair value, respectively)	4,631	4,448
Less: allowance for loan losses	(253)	(297)
Total loans held-for-investment, net	4,378	4,151
Mortgage servicing rights	279	258
Federal Home Loan Bank stock	155	155
Premises and equipment, net	241	238
Net deferred tax asset	416	442
Other assets	765	416
Total assets	$11,571	$9,840
Liabilities and Stockholders' Equity		
Deposits		
Noninterest bearing	$1,468	$1,209
Interest bearing	6,081	5,860
Total deposits	7,549	7,069
Federal Home Loan Bank advances (includes both short-term and long-term)	1,625	514
Long-term debt ($70 and $84 measured at fair value, respectively)	317	331
Representation and warranty reserve	53	53
Other liabilities ($82 and $82 measured at fair value, respectively)	607	500
Total liabilities	10,151	8,467
Stockholders' Equity		
Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding, respectively	267	267
Common stock $0.01 par value, 70,000,000 shares authorized; 56,436,026 and 56,332,307 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,483	1,482
Accumulated other comprehensive income	23	8
Accumulated deficit	(354)	(385)
Total stockholders' equity	1,420	1,373
Total liabilities and stockholders' equity	$11,571	$9,840

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

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

	Three Months Ended March 31,	
	2015	2014
	(Unaudited)	
Interest Income		
Loans	$65.5	$58.7
Investment securities available-for-sale	13.6	7.5
Interest-earning deposits and other	0.2	0.2
Total interest income	79.3	66.4
Interest Expense		
Deposits	9.3	6.0
Federal Home Loan Bank advances	3.1	0.5
Other	2.0	1.7
Total interest expense	14.4	8.2
Net interest income	64.9	58.2
(Benefit) provision for loan losses	(3.5)	112.3
Net interest income (loss) after provision for loan losses	68.4	(54.1)
Noninterest Income		
Net gain on loan sales	91.3	45.3
Loan fees and charges	17.0	12.3
Deposit fees and charges	6.1	4.8
Loan administration income	4.3	7.0
Net (loss) return on mortgage servicing asset	(2.4)	16.1
Net (loss) gain on sale of assets	(0.4)	2.2
Representation and warranty benefit	1.5	1.7
Other noninterest income (loss)	0.9	(14.4)
Total noninterest income	118.3	75.0
Noninterest Expense		
Compensation and benefits	60.8	65.6
Commissions	10.4	7.2
Occupancy and equipment	19.9	20.4
Asset resolution	7.8	11.5
Federal insurance premiums	5.5	5.0
Loan processing expense	11.7	7.7
Legal and professional expense	9.0	11.3
Other noninterest expense	11.9	10.6
Total noninterest expense	137.0	139.3
Income (loss) before income taxes	49.7	(118.4)
Provision (benefit) for income taxes	18.2	(40.0)
Net income (loss)	31.5	(78.4)
Preferred stock accretion	—	(0.5)
Net income (loss) applicable to common stock	$31.5	$(78.9)
Income (loss) per share		
Basic	$0.43	$(1.51)
Diluted	$0.43	$(1.51)
Weighted average shares outstanding		
Basic	56,385,454	56,194,184

Diluted	56,775,039	56,194,184

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

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

	Three Months Ended March 31,	
	2015	2014
	(Unaudited)	
Net income (loss)	$31.5	$(78.4)
Other comprehensive income (loss), before tax		
Investment securities available-for-sale		
Unrealized gains	23.7	5.9
Reclassification of net loss on the sale	—	(0.2)
Total investment securities available-for-sale, before tax	23.7	5.7
Other comprehensive income, deferred tax expense		
Provision for income taxes	8.8	2.0
Other comprehensive income, net of tax	14.9	3.7
Comprehensive income (loss)	$46.4	$(74.7)

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

Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders' Equity
(In millions)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2013 (Unaudited)	$266.2	$0.6	$1,479.2	$ (4.8)	$ (315.2)	$1,426.0
Net loss	—	—	—	—	(78.4)	(78.4)
Total other comprehensive income	—	—	—	3.7	—	3.7
Accretion of preferred stock	0.5	—	—	—	(0.5)	—
Stock-based compensation	—	—	0.2	—	—	0.2
Balance at March 31, 2014	$266.7	$0.6	$1,479.4	$ (1.1)	$ (394.1)	$1,351.5
Balance at December 31, 2014 (Unaudited)	$266.7	$0.6	$1,482.3	$ 8.4	$ (385.2)	$1,372.8
Net income	—	—	—	—	31.5	31.5
Total other comprehensive income	—	—	—	14.9	—	14.9
Stock-based compensation	—	—	0.3	—	—	0.3
Balance at March 31, 2015	$266.7	$0.6	$1,482.6	$ 23.3	$ (353.7)	$1,419.5

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

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

	Three Months Ended March 31,	
	2015	2014
	(Unaudited)	(Unaudited) As Restated
Operating Activities		
Net income (loss)	$31.5	$(78.4)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Provision for loan losses	(3.5)	112.3
Representation and warranty benefit	(1.5)	(1.7)
Depreciation and amortization	5.7	5.6
Deferred income taxes	18.0	(36.7)
Changes in fair value of MSRs, DOJ litigation settlement liability and long-term debt	28.8	11.9
Premium, change in fair value, and other non-cash changes	(263.3)	(136.2)
Net gain on loan and asset sales	(90.7)	(48.4)
Other changes:		
Proceeds from sales of loans held-for-sale ("HFS")	3,790.4	3,032.8
Origination and repurchase of loans, net of principal repayments	(6,927.9)	(4,686.4)
Decrease in accrued interest receivable	(2.5)	(3.2)
Decrease in other assets, excludes purchase of other investments	17.4	14.4
Net charge-offs in representation and warranty reserve	(0.5)	(5.6)
Decrease in other liabilities	(12.7)	(41.9)
Net cash used in operating activities	(3,410.8)	(1,861.5)
Investing Activities		
Proceeds from sale of available for sale securities including loans that have been securitized	2,706.2	1,909.0
Collection of principal on investment securities available-for-sale	53.4	30.9
Purchase of investment securities available-for-sale and other	(652.0)	(205.6)
Proceeds received from the sale of held-for-investment loans ("HFI")	277.0	35.1
Origination and purchase of loans HFI, net of principal repayments	(589.4)	(312.6)
Proceeds from the disposition of repossessed assets	5.4	10.0
Acquisitions of premises and equipment, net of proceeds	(8.5)	(7.8)
Proceeds from the sale of mortgage servicing rights	31.7	11.7
Net cash provided by investing activities	1,823.8	1,470.7
Financing Activities		
Net increase in deposit accounts	480.8	170.0
Proceeds from increases in Federal Home Loan Bank Advances	5,255.0	4,332.0
Repayment of Federal Home Loan Bank advances	(4,144.0)	(4,195.0)
Repayment of trust preferred securities and long-term debt	(15.5)	(5.4)
Net receipt of payments of loans serviced for others	113.7	24.9
Net receipt of escrow payments	2.4	3.0
Net cash provided by financing activities	1,692.4	329.5
Net increase (decrease) in cash and cash equivalents	105.4	(61.3)
Beginning cash and cash equivalents	136.0	280.5
Ending cash and cash equivalents	$241.4	$219.2
Supplemental disclosure of cash flow information		

Interest paid on deposits and other borrowings	$11.8	$6.4
Income tax payments	$3.0	$—
Non-cash reclassification of loans originated HFI to loans HFS	$277.0	$308.3
Non-cash reclassification of loans originated HFS to HFI	$5.0	$4.6
Non-cash reclassification of loans HFS to AFS securities	$2,709.3	$1,889.1
Mortgage servicing rights resulting from sale or securitization of loans	$67.9	$51.0
Non-cash reclassification of loans with government guarantee to other assets	$372.8	$—

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

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation and Accounting Standards

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

These consolidated financial statements do not include all of the information and footnotes required by GAAP for a full year presentation and certain disclosures have been condensed or omitted in accordance with rules and regulations of the Securities and Exchange Commission. These interim financial statements are unaudited and include, in the opinion of the Company, all adjustments necessary for a fair presentation of the results for the periods indicated, which, however, are not necessarily indicative of results which may be expected for the full year. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, which are available on the Company’s website, at flagstar.com, and on the SEC website, at sec.gov. We reviewed subsequent events and determined that no further disclosures or adjustments were required. Certain prior period amounts have been reclassified to conform to the current period presentation.

Recently Adopted Accounting Pronouncements

On January 1, 2015, the Company adopted to FASB Accounting Standards Update ("ASU") Update No. 2014-14, Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40). The amendments in this update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The Company reclassified $329 million of repossessed assets and associated claims from loans with government guarantees to other assets on the Consolidated Statements of Financial Condition at March 31, 2015.

Recently Issued Accounting Pronouncements

In January 2015, the FASB issued ASU No. 2015-01, Income Statement - Extraordinary and Unusual items (Subtopic 22-20). The adoption of this guidance is not expected to have a material effect on the Company’s Consolidated Financial Statements or the Notes thereto.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810) - Amendments to the Consolidation Analysis. Under the amended guidance all reporting entities are within the scope of Subtopic 810-10, Consolidation - Overall, including limited partnerships and similar legal entities, unless a scope exception applies. The presumption that a general partner controls a limited partnership has been eliminated. The ASU is effective for the annual period ending after December 15, 2015, and all reporting periods thereafter. The adoption of this guidance is not expected to have a material effect on the Company’s Consolidated Financial Statements or the Notes thereto.

In April 2015, the FASB issued ASU No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30). The amendments will require that debt issuance costs related to a recognized debt liability be presented in the balance

sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The ASU is effective prospectively or retrospectively for annual and interim periods beginning after December 15, 2015. The adoption of this guidance is not expected to have a material effect on the Company's Consolidated Financial Statements or the Notes thereto.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other Internal-Use Software. The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other licenses. If it does not include a software license, the customer should account for the arrangement as a service contract. The ASU is effective for the annual period ending after December 15, 2015, and all reporting periods thereafter. The adoption of this guidance is not expected to have a material effect on the Company's Consolidated Financial Statements or the Notes thereto.

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Note 2 – Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
March 31, 2015				
Available-for-sale securities				
Agency	$398	$8	$—	$406
Agency-collateralized mortgage obligations	1,863	28	(2)	1,889
Total available-for-sale securities	$2,261	$36	$(2)	$2,295
December 31, 2014				
Available-for-sale securities				
Agency	$925	$6	$(2)	$929
Agency-collateralized mortgage obligations	734	8	(1)	741
Municipal obligations	2	—	—	2
Total available-for-sale securities	$1,661	$14	$(3)	$1,672

Available-for-sale securities

Securities available-for-sale are carried at fair value, with unrealized gains and losses reported as a component of other comprehensive losses to the extent they are temporary in nature. Credit related declines in the securities are classified as other-than-temporary impairments ("OTTI") and are reported as a separate component of noninterest income within the Consolidated Statement of Operations. OTTI are considered to have occurred if (1) the Company intends to sell the security; (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover all contractually required principal and interest payments.

The Company purchased $652.0 million of investment securities, which included agency securities, comprised of mortgage-backed securities and collateralized mortgage obligations during the three months ended March 31, 2015. The Company purchased $206.9 million of mortgage-backed agency securities during the three months ended March 31, 2014.

The following table summarizes by duration the unrealized loss positions on investment securities available-for-sale.

	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
Type of Security	(Dollars in millions)					
March 31, 2015						
Agency	$—	$—	$—	$10	$1	$—
Agency-collateralized mortgage obligations	37	6	(1)	254	14	(1)
December 31, 2014						
Agency	$53	6	$—	$305	21	$(2)
Agency-collateralized mortgage obligations	98	10	(1)	38	4	—

Gains (losses) on sales of available-for-sale securities are reported in net gain on securities available-for-sale in the Consolidated Statements of Operations. During the three months ended March 31, 2015, there were no sales of investment securities except for those related to loans that had been securitized for sale in the normal course of business, compared to $18.7 million sales of U.S. government sponsored agencies, resulting in a gain of $0.2 million during the three months ended March 31, 2014. During the three months ended March 31, 2015, $2.0 million of municipal obligations matured.

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Note 3 – Loans Held-for-Sale

At March 31, 2015 and December 31, 2014, loans held-for-sale totaled $2.1 billion and $1.2 billion, respectively. For the period ended March 31, 2015 and 2014, the Company reported net gain on loan sales of $91.3 million and $45.3 million, respectively. The increase in loans held-for-sale and net gain on loan sales was the result of an increase in mortgage loan originations and an improvement in the gain on sale margin during the three months ended March 31, 2015.

At March 31, 2015 and December 31, 2014, $53 million and $48 million, respectively, of loans held-for-sale were recorded at lower of cost or fair value. The remainder of the loans in the portfolio is recorded at fair value as the Company elected the fair value option.

Note 4 – Loans with Government Guarantees

Substantially all of loans with government guarantees continue to be insured or guaranteed by the FHA. These repurchased loans earn interest at a rate based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent.

At March 31, 2015, loans with government guarantees actually repurchased totaled $704 million and were classified as loans with government guarantees. At December 31, 2014, loans with government guarantees actually repurchased totaled $1.1 billion and were classified as loans repurchased with government guarantees.

As a result of the Company's adoption of ASU Update No. 2014-14, Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40), the Company reclassified $329 million of repossessed assets and associated claims from loans with government guarantees to other assets at March 31, 2015. At December 31, 2014, $373 million of repossessed assets and associated claims would have been reclassified had the ASU been effective.

Note 5 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows.

	March 31, 2015	December 31, 2014
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	$2,013	$2,194
Second mortgage	146	149
HELOC	316	256
Other	30	31
Total consumer loans	2,505	2,630
Commercial loans		
Commercial real estate	635	620
Commercial and industrial	408	429
Warehouse lending	1,083	769
Total commercial loans	2,126	1,818
Total loans held-for-investment	4,631	4,448
Less allowance for loan losses	(253)	(297)
Loans held-for-investment, net	$4,378	$4,151

At December 31, 2014, the Company had $350 million of troubled debt restructured residential first mortgage loans with a specifically identified reserve of $76 million. During the three months ended March 31, 2015, the Company remeasured this specifically identified reserve relating to the troubled debt restructured loans, resulting in a $36.0 million reduction in reserve based on a change in expected future cash flows. During the first quarter 2015, the Company changed its intent to hold these loans for investment and instead decided to hold these loans for sale. The loans for which the intent changed had an approximate unpaid principal balance of $331 million, including approximately $291 million of troubled debt restructured

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residential first mortgage loans, and $30 million in specifically identified reserves at the time this intent was changed. These loans were transferred to loans held-for-sale and subsequently sold, resulting in a loss on sale of $0.4 million.

During the three months ended March 31, 2014, the Company sold nonperforming, troubled debt restructured residential first mortgage and residential first mortgage jumbo loans with unpaid principal balances totaling $313 million. A portion of the allowance for loan losses associated with these loans was reduced, resulting in a $2.3 million reduction in reserve. The loans were transferred to held-for-sale, resulting in a gain on sale of $1.4 million.

The Company has pledged certain loans held-for-investment, loans held-for-sale and loans with government guarantees to collateralize lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the Federal Home Loan Bank of Indianapolis. At March 31, 2015 and December 31, 2014, the Company pledged $4.6 billion and $4.1 billion, respectively.

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

	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
Three Months Ended March 31, 2015								
Beginning balance allowance for loan losses	$234.3	$12.4	$18.7	$0.8	$ 17.4	$ 10.7	$2.7	$297.0
Charge-offs	(40.8)	(0.8)	(0.9)	(0.7)	—	—	—	(43.2)
Recoveries	0.3	0.1	0.1	0.5	1.7	—	—	2.7
Provision (benefit)	(6.4)	0.3	3.3	(0.2)	(2.9)	1.3	1.1	(3.5)
Ending balance allowance for loan losses	$187.4	$12.0	$21.2	$0.4	$ 16.2	$ 12.0	$3.8	$253.0
Three Months Ended March 31, 2014								
Beginning balance allowance for loan losses	$161.2	$12.1	$7.9	$2.4	$ 18.5	$ 3.5	$1.4	$207.0
Charge-offs	(10.8)	(1.1)	(2.7)	(0.5)	—	—	—	(15.1)
Recoveries	1.2	0.1	—	0.3	1.1	0.1	—	2.8
Provision (benefit)	104.8	2.3	6.3	(0.8)	(1.5)	1.1	0.1	112.3
Ending balance allowance for loan losses	$256.4	$13.4	$11.5	$1.4	$ 18.1	$ 4.7	$1.5	$307.0

For the three months ended March 31, 2015, the Company sold nonperforming residential first mortgage loans as discussed above. The $36.0 million reduction in the reserve associated with these sales was partially offset by an increase in volume and reserve rates in the portfolio.

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

	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
March 31, 2015								
Loans held-for-investment								
Individually evaluated	$116	$31	$1	$—	$ —	$ —	$—	$148
Collectively evaluated (1)	1,871	65	202	30	635	408	1,083	4,294
Total loans	$1,987	$96	$203	$30	$ 635	$ 408	$1,083	$4,442
Allowance for loan losses								
Individually evaluated	$15.9	$5.5	$0.9	$0.1	$ —	$ —	$—	$22.4
Collectively evaluated (1)	171.5	6.5	20.3	0.3	16.2	12.0	3.8	230.6
Total allowance for loan losses	$187.4	$12.0	$21.2	$0.4	$ 16.2	$ 12.0	$3.8	$253.0
December 31, 2014								
Loans held-for-investment								
Individually evaluated	$385	$31	$1	$—	$ —	$ —	$—	$417
Collectively evaluated (1)	1,782	65	124	31	620	429	769	3,820
Total loans	$2,167	$96	$125	$31	$ 620	$ 429	$769	$4,237
Allowance for loan losses								
Individually evaluated	$81.8	$5.6	$1.0	$0.1	$ —	$ —	$—	$88.5
Collectively evaluated (1)	152.5	6.8	17.7	0.7	17.4	10.7	2.7	208.5
Total allowance for loan losses	$234.3	$12.4	$18.7	$0.8	$ 17.4	$ 10.7	$2.7	$297.0

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

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

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

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Investment Loans
	(Dollars in millions)					
March 31, 2015						
Consumer loans						
Residential first mortgage	$17	$6	$78	$101	$1,912	$2,013
Second mortgage	1	—	2	3	143	146
HELOC	4	2	4	10	306	316
Other	—	—	—	—	30	30
Total consumer loans	22	8	84	114	2,391	2,505
Commercial loans						
Commercial real estate	—	—	—	—	635	635
Commercial and industrial	—	—	—	—	408	408
Warehouse lending	—	—	—	—	1,083	1,083
Total commercial loans	—	—	—	—	2,126	2,126
Total loans (1)	$22	$8	$84	$114	$4,517	$4,631
December 31, 2014						
Consumer loans						
Residential first mortgage	$29	$9	$115	$153	$2,041	$2,194
Second mortgage	1	—	2	3	146	149
HELOC	4	1	3	8	248	256
Other	—	—	—	—	31	31
Total consumer loans	34	10	120	164	2,466	2,630
Commercial loans						
Commercial real estate	—	—	—	—	620	620
Commercial and industrial	—	—	—	—	429	429
Warehouse lending	—	—	—	—	769	769
Total commercial loans	—	—	—	—	1,818	1,818
Total loans (1)	$34	$10	$120	$164	$4,284	$4,448

(1) Includes $5 million of loans 90 days or greater past due accounted for under the fair value option at both March 31, 2015 and December 31, 2014, respectively.

Loans held-for-investment and loans held-for-sale on which interest accruals have been discontinued totaled approximately $103 million and $135 million at March 31, 2015 and December 31, 2014, respectively, and $118 million at March 31, 2014. Interest income is recognized on impaired loans using a cost recovery method unless amounts contractually due are not in doubt. Interest that would have been accrued on impaired loans totaled approximately $1.4 million and $1.8 million during the three months ended March 31, 2015 and 2014, respectively. At March 31, 2015 and December 31, 2014, the Company had no loans 90 days past due and still accruing.

Troubled Debt Restructuring

The Company may modify certain loans in both consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. The Company has programs designed to assist borrowers by extending payment dates or reducing the borrower's contractual payments. All loan modifications are made on a case-by-case basis. The Company's standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. TDRs result in those instances in which a

borrower demonstrates financial difficulty and for which a concession has been granted, which includes reductions of interest rate, extensions of amortization period, principal and/or interest forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. These loans are classified as TDRs and are included in nonaccrual loans if the loan was

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nonperforming prior to the restructuring. These loans will continue on nonaccrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months, after which they will begin to accrue interest.

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

	TDRs		
	Performing	Nonperforming	Total
March 31, 2015	(Dollars in millions)		
Consumer loans (1)			
Residential first mortgage	$57	$25	$82
Second mortgage	35	1	36
HELOC	19	2	21
Total TDRs (2)	$111	$28	$139
December 31, 2014			
Consumer loans (1)			
Residential first mortgage	$307	$43	$350
Second mortgage	35	2	37
HELOC	20	1	21
Total TDRs (2)	$362	$46	$408

(1) The allowance for loan losses on consumer TDR loans totaled $23 million and $81 million at March 31, 2015 and December 31, 2014, respectively.

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

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. Such losses are factored into the Company's allowance for loan losses estimate. Management evaluates loans for impairment both collectively and individually depending on the risk characteristics underlying the loan and the availability of data. The Company measures impairment using the discounted cash flow method for performing TDRs and measures impairment based on collateral values for re-defaulted TDRs.

The following table provides a summary of newly modified TDRs and TDR loans in the past 12 months that have subsequently defaulted during the three months ended March 31, 2015 and 2014. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when greater than 90 days past due.

	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
Three Months Ended March 31, 2015		(Dollars in millions)		
Residential first mortgages	114	$30.5	$ 28.7	$0.6
Second mortgages	33	1.3	1.2	(0.1)
HELOC (2)	36	0.2	0.7	—
Total TDR loans	183	$32.0	$ 30.6	$0.5

	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase in Allowance at Modification

Three Months Ended March 31, 2014		(Dollars in millions)		
Residential first mortgages	25	$7.0	$ 6.7	$0.6
Second mortgages	94	3.0	2.9	—
HELOC (2)	9	0.4	0.3	—
Total TDR loans	128	$10.4	$ 9.9	$0.6

(1) Post-modification balances include past due amounts that are capitalized at modification date.
(2) HELOC post-modification unpaid principal balance reflects write downs.

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The following table presents impaired loans and the associated allowance:

	March 31, 2015			December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in millions)					
With no related allowance recorded						
Consumer loans						
Residential first mortgage loans	$40	$46	$—	$63	$78	$—
Second mortgage	1	6	—	1	6	—
HELOC	—	1	—	—	1	—
	$41	$53	$—	$64	$85	$—
With an allowance recorded						
Consumer loans						
Residential first mortgage	$75	$81	$16	$321	$325	$82
Second mortgage	29	29	6	29	29	6
HELOC	1	1	1	1	1	1
	$105	$111	$23	$351	$355	$89
Total						
Consumer loans						
Residential first mortgage	$115	$127	$16	$384	$403	$82
Second mortgage	30	35	6	30	35	6
HELOC	1	2	1	1	2	1
Total impaired loans	$146	$164	$23	$415	$440	$89

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

	Three Months Ended March 31,			
	2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in millions)			
Consumer loans				
Residential first mortgage	$306.7	$2.1	$413.2	$2.6
Second mortgage	30.8	0.4	25.2	0.2
HELOC	0.8	—	0.2	—
Commercial loans				
Commercial real estate	0.4	—	2.0	—
Total impaired loans	$338.7	$2.5	$440.6	$2.8

The Company follows the guidance provided in the FFIEC’s "Uniform Retail Credit Classification and Account Management Policy" issued June 20, 2000 for Retail Credits. This policy focuses on the delinquency status, loan type, collateral protection, and other events influencing repayment, such as bankruptcy, death, and fraud, in determining the appropriate risk classification for a retail credit. The Company considers performing retail loans that are 60 days delinquent as well as all performing retail TDRs as Watch. All nonaccrual retail loans as well as retail loans 90 days or more delinquent are classified as Substandard. In cases of bankruptcy, death, or fraud, the Company will follow the FFIEC policy and classify the loans as appropriate.

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Credit Quality

The Company utilizes an internal risk rating system which is applied to all consumer and commercial loans. Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship. Descriptions of the Company's internal risk ratings as they relate to credit quality follow the ratings used by the U.S. bank regulatory agencies as listed below.

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

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

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

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

Doubtful. Assets identified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. The possibility of a loss on a doubtful asset is high. However, due to important and reasonably specific pending factors, which may work to strengthen (or weaken) the asset, its classification as an estimated loss is deferred until its more exact status can be determined.

Loss. An asset classified loss is considered uncollectible and of such little value that the continuance as 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 this basically worthless asset even though partial recovery may occur in the future.

Commercial Credit Loans	March 31, 2015			
	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial
	(Dollars in millions)			
Grade				
Pass	$596	$ 350	$937	$1,883
Watch	29	19	117	165
Special mention	7	14	29	50
Substandard	3	25	—	28
Total loans	$635	$ 408	$1,083	$2,126

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Consumer Credit Loans	March 31, 2015				
	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Total
	(Dollars in millions)				
Grade					
Pass	$1,874	$108	$292	$30	$2,304
Watch	61	36	20	—	117
Substandard	78	2	4	—	84
Total loans	$2,013	$146	$316	$30	$2,505

Commercial Credit Loans	December 31, 2014			
	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial
	(Dollars in millions)			
Grade				
Pass	$578	$ 399	$650	$1,627
Watch	29	10	119	158
Special mention	2	—	—	2
Substandard	11	20	—	31
Total loans	$620	$ 429	$769	$1,818

Consumer Credit Loans	December 31, 2014				
	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Total Consumer
	(Dollars in millions)				
Grade					
Pass	$1,765	$111	$232	$31	$2,139
Watch	314	36	21	—	371
Substandard	115	2	3	—	120
Total loans	$2,194	$149	$256	$31	$2,630

Note 6 – Variable Interest Entities ("VIEs")

Due to the Assured Settlement Agreement in 2013, the Company became the primary beneficiary and reconsolidated the FSTAR 2005-1 and the FSTAR 2006-2 HELOC securitization trust's assets and liabilities. The Company had elected the fair value option for these assets and liabilities. At March 31, 2015, the Company has a total fair value of HELOC loans of $112 million and long-term debt of $70 million related to these variable interest entities. At December 31, 2014, the fair value of HELOC loans totaled $132 million and long-term debt totaled $84 million related to these variable interest entities. The decrease during the three months ended March 31, 2015 on the HELOC securitization trust's loans, was primarily due to a $5.5 million reduction in the fair value resulting from loans reaching the maturity dates.

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

	2005-1	2006-2	Total
March 31, 2015	(Dollars in millions)		
HELOC Securitizations			
Assets			
Loans held-for-investment	$47	$65	$112
Liabilities			

Long-term debt	$31	$39	$70

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

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

The Company has an unconsolidated VIE with which the Company has a continuing involvement, but is not the primary beneficiary. The financial assets were de-recognized by the Company upon transfer to the FSTAR 2007-1 mortgage securitization trust, which then issued and sold mortgage-backed securities to third-party investors. The Company relinquished control over the loans at the time the financial assets were transferred to the FSTAR 2007-1 mortgage securitization trust and the Company recognized a gain on the sale of the transferred assets. In accordance with the MBIA Settlement Agreement, MBIA will be required to satisfy all of its obligation under the FSTAR 2007-1 insurance policy and related FSTAR 2007-1 obligations without further recourse to the Company. At March 31, 2015, the FSTAR 2007-1 mortgage securitization trust included 3,470 loans, with an aggregate principal balance of $135 million.

Note 7 – Mortgage Servicing Rights

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

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

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions)	
Balance at beginning of period	$257.8	$284.7
Additions from loans sold with servicing retained	67.9	51.0
Reductions from sales	(21.6)	(5.9)
Changes in fair value due to (1)		
Decrease in MSR due to pay-offs, pay-downs and run-off	(14.6)	(4.9)
Changes in valuation inputs or assumptions (2)	(10.9)	(4.7)
Fair value of MSRs at end of period	$278.6	$320.2

(1) Changes in fair value are included within net return on mortgage servicing asset on the Consolidated Statements of Operations.
(2) Represents estimated MSR value change resulting primarily from market-driven changes in interest rates.

The fair value of residential MSRs is estimated using a valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. The Company obtains independent third-party valuations of its residential MSRs on a quarterly basis to assess the reasonableness of the fair value calculated by the valuation model. In certain circumstances, based on the probability of the completion of a sale of MSRs pursuant to a bona-fide purchase offer, the Company considers the bid price of that offer and identifiable transaction costs in comparison to the calculated fair value and may adjust the estimate of fair value to reflect the terms of the pending transaction.

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

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions)	
Income on mortgage servicing asset		
Servicing fees, ancillary income and late fees	$16.6	$17.2
Fair value adjustments	(25.5)	(9.6)
Gain on hedging activity (1)	8.3	4.9
Net transaction costs	(1.8)	3.6
Total (loss) income on mortgage servicing asset, included in net return on mortgage servicing asset	$(2.4)	$16.1

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

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

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

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions)	
Income on mortgage loans subserviced		
Servicing fees, ancillary income and late fees (1)	$7.6	$7.4
Other servicing charges (1)	(3.3)	(0.4)
Total income on mortgage loans subserviced, included in loan administration	$4.3	$7.0

(1) Includes the servicing fees, ancillary income and late fees on mortgage loans subserviced, which is included in loan administration income on the Consolidated Statements of Operations.

The following table presents the unpaid principal balance of residential loans serviced for others and the number of accounts associated with those loans.

	March 31, 2015		December 31, 2014	
	Amount	Number of accounts	Amount	Number of accounts
	(Dollars in millions)			
Residential mortgage servicing				
Serviced for others	$27,046	126,393	$25,427	117,881
Subserviced for others (1)	44,708	231,223	46,724	238,498
Total residential loans serviced for others (1)	$71,754	357,616	$72,151	356,379

(1) Does not include temporary short-term subservicing performed as a result of some sales of servicing.

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

	March 31, 2015				December 31, 2014			
			Decline in fair value due to				Decline in fair value due to	
	Actual		10% adverse change	20% adverse change	Actual		10% adverse change	20% adverse change
			(Dollars in millions)					
Option adjusted spread	8.76	%	$272	$266	8.88	%	$250	$243
Constant prepayment rate	14.86	%	269	262	14.98	%	253	245
Weighted average cost to service per loan	74.55	%	275	272	74.49	%	258	255

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

Note 8 – Derivative Financial Instruments

Derivative assets and liabilities are recorded at fair value on the Consolidated Statements of Financial Condition, after taking into account the effects of legally enforceable bilateral collateral and master netting agreements. For market traded instruments, gross positive fair values are netted with gross negative fair values by counterparty pursuant to a valid master netting agreement. In addition, collateral received from or paid to a given counterparty are considered in this netting. These agreements allow the Company to settle all derivative contracts held with a single counterparty on a net basis in a single currency, and to offset net derivative positions with related collateral, where applicable.

Counterparty credit risk. The Bank is exposed to credit loss in the event of nonperformance by the counterparties to its various derivative financial instruments. Should a counterparty fail to perform under the terms of a derivative contract, the Company’s counterparty credit risk is equal to the amount reported as a derivative asset in the Consolidated Statements of Condition. The Company manages this risk by selecting only well-established, financially strong counterparties, spreading the credit risk among such counterparties, and by placing contractual limits on the amount of unsecured credit risk from any single counterparty. Counterparties to the Company's derivatives include major financial institutions with investment grade credit ratings from the major rating agencies.

Collateral agreements require the counterparty to post, on a daily basis, collateral (typically cash or investment securities) equal to the Company’s net derivative receivable. For highly-rated counterparties, the agreements may include minimum dollar posting thresholds, but allow for the Company to call for immediate, full collateral coverage under circumstances which constitute default under the agreements, which may include the triggering of credit-rating thresholds by counterparties. The Company’s collateral agreements contain provisions that require collateralization of the Company’s net liability derivative positions. Required collateral coverage is based on certain net liability thresholds. Under circumstances which constitute default under the agreements, the counterparties to the derivatives could request immediate full collateral coverage for derivatives in net liability positions. The Company's collateral agreements in which the collateral is restricted include provisions requiring unilateral funding of coverage for derivatives in net liability positions, as well as minimum collateral positions.

The Company originates loans and extends credit, both of which expose the Company to interest rate risk. The Company actively manages the overall loan portfolio and the associated interest rate risk in a manner consistent with asset quality objectives. This objective is accomplished primarily through the use of an investment-grade diversified dealer-traded basket of swaps. These transactions may generate fee income, and diversify and reduce overall portfolio interest rate risk volatility. Although the Company utilizes swaps for risk management purposes, they are not treated as or do not qualify as hedging instruments.

The Company hedges the risk of overall changes in fair value of loans held-for-sale and rate lock commitments generally by selling forward contracts on securities of the agencies. The forward contracts used to economically hedge the loan commitments are accounted for as non-designated hedges and naturally offset rate lock commitment mark-to-market gains and

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losses recognized as a component of gain on loan sale. Additionally, the Company hedges the risk of overall changes in fair value of MSRs through the use of various derivatives including purchases of forward contracts on securities of Fannie Mae and Freddie Mac, the purchase/sale of U.S. Treasury futures contracts and the purchase/sale of euro dollar future contracts. These derivatives are accounted for as non-designated hedges against changes in the fair value of MSRs and recognized as a component of net return on mortgage servicing asset.

The Company uses a combination of derivatives (U.S. Treasury futures, euro dollar futures, swap futures, and "to be announced" forwards with settlement dates beyond the next regular settlement date for such securities), and certain trading securities to hedge the MSRs. For accounting purposes, these hedges represent economic hedges of the MSR asset with both the hedges and the MSR asset carried at fair value on the balance sheet. Certain derivative strategies that the Company uses to manage its investment in MSRs may not fully offset changes in the fair value of such asset due to changes in interest rates and market liquidity.

The Company writes and purchases interest rate swaps to accommodate the needs of customers requesting such services. Customer-initiated trading derivatives are used primarily to provide derivative products to customers enabling them to manage interest rate risk exposure. The Company mitigates most of the inherent market risk of customer-initiated interest rate swap contracts by entering into offsetting derivative contracts with other counterparties. The offsetting derivative contracts have nearly identical notional values, terms and indices. The difference in the asset and liability is an adjustment for non-performance risk in the measurement of fair value of derivative instruments, which is insignificant. The Company's interest rate swap agreements are structured such that variable payments are primarily based on LIBOR (one-month, three-month or six-month). Fee income on customer-initiated trading derivatives is earned from entering into various transactions at the request of the customer, primarily interest rate swap contracts. Changes in fair value are recognized in "other noninterest income" on the Consolidated Statements of Operations.

Fair values of derivative instruments represent the net unrealized gains or losses on such contracts and are recorded in the consolidated balance sheets. Changes in fair value are recognized in the consolidated statements of income. The net gains recognized in income on derivative instruments, net of the impact of offsetting positions, were as follows.

		Three Months Ended March 31,	
	Location of Gain/(Loss)	2015	2014
		(Dollars in millions)	
U.S. Treasury and euro dollars futures	Net return on mortgage servicing asset	$5.9	$3.1
Swap futures	Net return on mortgage servicing asset	(0.1)	—
Mortgage backed securities forwards	Net return on mortgage servicing asset	2.5	1.8
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	10.5	(5.6)
Interest rate swaps	Other noninterest income	0.1	0.7
Total derivative gain (loss)		$18.9	$—

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The Company had the following derivative financial instruments.

	Notional Amount	Fair Value	Expiration Dates
	(Dollars in millions)		
March 31, 2015			
Assets (1)			
U.S. Treasury and euro dollar futures	$2,028	$5	2016-2020
Mortgage backed securities forwards	150	1	2016
Rate lock commitments	3,722	55	2016
Forward agency and loan sales	276	—	2016
Interest rate swaps	356	7	2016-2021
Total derivative assets	$6,532	$68	
Liabilities (2)			
U.S. Treasury and euro dollar futures	$468	$2	2016-2020
Mortgage backed securities forwards	15	—	2016
Swap futures	77	1	2030-2035
Rate lock commitments	80	—	2016
Forward agency and loan sales	4,050	26	2016
Interest rate swaps	356	8	2016-2021
Total derivative liabilities	$5,046	$37	
December 31, 2014			
Assets (1)			
U.S. Treasury and euro dollar futures	$2,530	$7	2015-2020
Mortgage backed securities forwards	161	2	2015
Rate lock commitments	2,604	31	2015
Forward agency and loan sales	194	—	2015
Interest rate swaps	355	6	2015-2021
Total derivative assets	$5,844	$46	
Liabilities (2)			
Mortgage servicing rights			
U.S. Treasury and euro dollar futures	$688	$1	2015-2020
Rate lock commitments	22	—	2015
Forward agency and loan sales	2,789	13	2015
Interest rate swaps	367	6	2015-2021
Total derivative liabilities	$3,866	$20	

(1) Asset derivatives are included in "other assets" on the Consolidated Statements of Financial Condition.
(2) Liability derivatives are included in "other liabilities" on the Consolidated Statements of Financial Condition.

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

	March 31, 2015					
				Gross Amounts Not Offset in the Statement of Financial Position		
Economic Undesignated Hedges	Gross Amount	Gross Amounts Offset in the Statement of Financial Position	Net Amount Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral	Net Amount
	(Dollars in millions)					
Assets						
U.S. Treasury swap and euro dollar futures	$12	$2	$10	$—	$7	$3
Mortgage backed securities forwards	28	—	28	—	27	1
Interest rate swaps	8	—	8	—	1	7
Total derivative assets	$48	$2	$46	$—	$35	$11
Liabilities						
Interest rate swaps	$8	$—	$8	$—	$—	$8

	December 31, 2014					
				Gross Amounts Not Offset in the Statement of Financial Position		
Economic Undesignated Hedges	Gross Amount	Gross Amounts Offset in the Statement of Financial Position	Net Amount Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral	Net Amount
	(Dollars in millions)					
Assets						
U.S. Treasury swap and euro dollar futures	$17	$1	$16	$—	$10	$6
Mortgage backed securities forwards	26	—	26	—	24	2
Interest rate swaps	8	—	8	—	2	6
Total derivative assets	$51	$1	$50	$—	$36	$14
Liabilities						
Interest rate swaps	$6	$—	$6	$—	$—	$6

The Company pledged a total of $35 million and $36 million of investment securities and cash collateral to counterparties at March 31, 2015 and December 31, 2014, respectively, for derivative activities. The cash pledged was restricted and is included in other assets on the Consolidated Statements of Financial Condition.

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Note 9 – Federal Home Loan Bank Advances

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

	March 31, 2015		December 31, 2014	
	Amount	Rate	Amount	Rate
	(Dollars in millions)			
Short-term fixed rate term advances	$700	0.17 %	$214	0.26 %
Long-term fixed rate term advances	925	1.58 %	300	1.36 %
Total	$1,625	0.97 %	$514	0.90 %

During the three months ended March 31, 2015, the Company entered into longer-term fixed rate advances to provide more stable funding for planned loan growth. At March 31, 2015, the Company had the authority and approval from the Federal Home Loan Bank to utilize a line of credit of up to $7.0 billion and the Company may access that line to the extent that collateral is provided. At March 31, 2015, the Company had $1.6 billion of advances outstanding and an additional $1.5 billion of collateralized borrowing capacity available at the Federal Home Loan Bank. The advances are collateralized by non-delinquent single-family residential first mortgage loans, loans with government guarantees, certain other loans and investment securities.

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions)	
Maximum outstanding at any month end	$1,625	$1,125
Average outstanding balance	1,161	886
Average remaining borrowing capacity	1,894	1,802
Weighted-average interest rate	1.08 %	0.24 %

The following outlines the Company’s Federal Home Loan Bank advance final maturity dates as of March 31, 2015.

	March 31, 2015
	(Dollars in millions)
2015	$700
2016	175
2017	—
2018	125
Thereafter	625
Total	$1,625

Note 10 – Long-Term Debt

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

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

	March 31, 2015			December 31, 2014		
	(Dollars in millions)					
Trust Preferred Securities						
Floating Three Month LIBOR						
Plus 3.25%, matures 2032	$26	3.52	%	$26	3.50	%
Plus 3.25%, matures 2033	26	3.50	%	26	3.48	%
Plus 3.25%, matures 2033	26	3.52	%	26	3.51	%
Plus 2.00%, matures 2035	26	2.25	%	26	2.23	%
Plus 2.00%, matures 2035	26	2.25	%	26	2.23	%
Plus 1.75%, matures 2035	50	2.02	%	50	1.99	%
Plus 1.50%, matures 2035	26	1.75	%	26	1.73	%
Plus 1.45%, matures 2037	26	1.72	%	26	1.69	%
Plus 2.50%, matures 2037	15	2.77	%	15	2.74	%
Subtotal	$247			$247		
Notes associated with consolidated VIEs						
Floating One Month LIBOR						
Plus 0.46% (1), matures 2018 (3)	31			42		
Plus 0.16% (2), matures 2019 (4)	39			42		
Total long-term debt	$317			$331		

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

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

(3) The par value for the debt was $31 million and $43 million, respectively, at March 31, 2015 and December 31, 2014.

(4) The par value for the debt was $41 million and $45 million, respectively, at March 31, 2015 and December 31, 2014.

At March 31, 2015 and December 31, 2014 the three-month LIBOR interest rate was 0.27 percent and 0.26 percent, respectively. At March 31, 2015 the one-month LIBOR interest rate was 0.18 percent, compared to 0.17 percent at December 31, 2014.

Trust Preferred Securities

The trust preferred securities outstanding are callable by the Company and are junior subordinated notes. Under the terms of the related indentures interest is payable quarterly; however, the Company may defer interest payments for up to 20 quarters without default or penalty. In January 2012, the Company exercised its contractual rights to defer its interest payments with respect to trust preferred securities. The payments are periodically evaluated and will be reinstated when appropriate, subject to the provisions of the Company's Supervisory Agreement and Consent Order. At March 31, 2015, the Company has deferred for 13 quarters and has $22 million accrued for these deferred interest payments.

Notes Associated with Consolidated VIEs

As previously discussed in Note 6 of the Notes to the Consolidated Financial Statements, herein, the Company determined it was the primary beneficiary of VIEs associated with HELOC securitizations and such VIEs are therefore

consolidated in the Consolidated Financial Statements. As of June 30, 2013, the Company reconsolidated the assets and liabilities associated with the HELOC securitization trusts, the proceeds of which are used by the trust to repay outstanding debt.

The Company has elected the fair value option for these liabilities and changes in fair value are recorded to "other noninterest income" on the Consolidated Statements of Operations. Fair value is estimated using quantitative models which incorporate observable and, in some instances, unobservable inputs including security prices, interest rate yield curves, option volatility, currency, commodity or equity rates, and correlations between these inputs. The Company also considers the impact

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of its own observable credit spreads in the secondary bond markets in determining the discount rate used to value these liabilities. See Note 17 of the Notes to the Consolidated Financial Statements, herein, for additional recurring fair value disclosures.

The final legal maturities of the long-term debt associated with the VIEs are June 2018 and June 2019, respectively; however these debt agreements have contractual provisions that allow for a clean-up call of the debt when less than 10 percent of the balance remains outstanding. As of March 31, 2015, FSTAR 2005-1 (LIBOR plus 0.46 percent) is currently below the 10 percent threshold and FSTAR 2006-2 (LIBOR plus 0.16 percent) is expected to be below the threshold near the end of 2015. The debt pays interest based on a spread over the 30-day LIBOR interest rate.

Note 11 - Representation and Warranty Reserve

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

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions)	
Balance, beginning of period	$53.0	$54.0
Provision		
Charged to gain on sale for current loan sales	1.9	1.2
Charged to representation and warranty reserve - change in estimate	(1.5)	(1.7)
Total	0.4	(0.5)
Charge-offs, net	(0.4)	(5.5)
Balance, end of period	$53.0	$48.0

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

Note 12 – Stockholders’ Equity

Preferred Stock and Other Warrants

On January 30, 2009, the Company sold to the U.S. Treasury 266,657 shares of Series C fixed rate cumulative non-convertible perpetual preferred stock ("Series C Preferred Stock") and a warrant to purchase up to approximately 0.7 million shares of Common Stock at an exercise price of $62.00 per share (the "Warrant") for $266.7 million. The issuance and the sale of the Series C Preferred Stock and Warrant were exempt from the registration requirements of the Securities Act of 1933, as amended. The Series C Preferred Stock qualifies as Tier 1 capital and currently pays cumulative dividends quarterly at a rate of 9 percent per annum. The Warrant is exercisable through 2019.

In 2013 the U.S. Treasury sold the Series C Preferred Stock and Warrants which are now held by unrelated third-party investors and are no longer held by the U.S. government under the TARP Capital Purchase Program. The warrants are valued utilizing the equity method. At March 31, 2015 and December 31, 2014, the Company’s warrant value was $5 million and $6 million, respectively.

Preferred stock with a par value of $0.01 and a liquidation value of $1,000 and additional paid in capital attributable to preferred stock at March 31, 2015 is summarized as follows.

	Rate		Earliest Redemption Date	Shares Outstanding	Preferred Shares	Additional Paid in Capital
	(Dollars in millions)					
Series C Preferred Stock	9.0	%	January 31, 2012	266,657	$3	$266.7

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At March 31, 2015, the Company has deferred $63.5 million of dividend payments on the Series C Preferred Stock.

Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss) for available-for-sale securities.

	Available-for-Sale Securities (Dollars in millions)
Accumulated other comprehensive income (loss)	
Balance at December 31, 2014, net of tax	$8.4
Net unrealized gain (loss), net of tax	14.9
Balance at March 31, 2015, net of tax (1)	$23.3
Balance at December 31, 2013, net of tax	$(4.8)
Net unrealized gain (loss), net of tax	3.9
Net realized (loss) gains reclassified into earnings, net of tax	(0.2)
Balance at March 31, 2014, net of tax	$(1.1)

(1) For the period ended March 31, 2015, there were no reclassifications out of accumulated other comprehensive income (loss) into earnings.

Note 13 – Earnings (Loss) Per Share

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

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

	Three Months Ended March 31,	
	2015	2014
	(Dollars in millions, except share data)	
Net income (loss)	$31.5	$(78.4)
Less: preferred stock dividend/accretion	—	(0.5)
Net income (loss) from continuing operations	31.5	(78.9)
Deferred cumulative preferred stock dividends	(7.3)	(5.7)
Net income (loss) applicable to common stock	$24.2	$(84.6)
Weighted average shares		
Weighted average common shares outstanding	56,385,454	56,194,184
Effect of dilutive securities		
Warrants	232,474	—
Stock-based awards	157,111	—
Weighted average diluted common shares	56,775,039	56,194,184
Earnings (loss) per common share		
Net income (loss) applicable to common stock	$0.43	$(1.51)
Effect of dilutive securities		
Warrants	—	—

Stock-based awards	—	—
Diluted earnings (loss) per share	$0.43	$(1.51)

The March 31, 2014 diluted loss per share calculation excludes all common stock equivalents, including 1,334,045 shares pertaining to warrants and 295,179 shares pertaining to stock based awards. The inclusion of these securities would be anti-dilutive.

Under the terms of the Series C Preferred Stock the Company may defer dividend payments. The Company elected to defer dividend payments beginning with the February 2012 dividend. Although not included in quarterly net income, the deferral impacts net income (loss) applicable to common stock for the purpose of calculating earnings per share, as shown above. The cumulative amount in arrears as of March 31, 2015 is $63.5 million.

Note 14 – Income Taxes

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

During the three months ended March 31, 2015, the provision for income taxes was $18.2 million, or an effective tax provision rate of 36.6 percent, compared to a benefit for income taxes of $40.0 million, or an effective tax benefit rate of 33.8 percent for the three months ended March 31, 2014. The effective rate for the three months ended March 31, 2015 and March 31, 2014 differs from the combined federal and state statutory tax rate due to non-taxable income and expense items, primarily the non-taxable impact of changes related to our warrants.

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

The Company believes that it is unlikely that the unrecognized tax benefits will change by a material amount during the next 12 months. As permitted under applicable accounting guidance for income taxes, the Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense.

Note 15 — Regulatory Matters

Regulatory Capital

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

To be categorized as "well capitalized," the Company and the Bank must maintain minimum Tangible capital, Tier 1 capital, Common Equity Tier 1, and Total capital ratios as set forth in the table below. The Company and the Bank are considered "well capitalized" at both March 31, 2015 and December 31, 2014. There have been no conditions or

events that management believes have changed the Company's or the Bank’s category.

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

Bancorp	Actual			For Capital Adequacy Purposes			Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
	(Dollars in millions)								
March 31, 2015									
Tangible capital (to tangible assets)	$1,257	12.02	%	N/A	N/A		N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,257	12.02	%	$418	4.00	%	$523	5.00	%
Common equity Tier 1 capital (to RWA)	909	15.38	%	266	4.50	%	384	6.50	%
Tier 1 capital (to risk weighted assets)	1,257	21.26	%	355	6.00	%	473	8.00	%
Total capital (to risk weighted assets)	1,336	22.61	%	473	8.00	%	591	10.00	%
December 31, 2014									
Tangible capital (to tangible assets)	$1,184	12.59	%	N/A	N/A		N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,184	12.59	%	$376	4.00	%	$470	5.00	%
Tier 1 capital (to risk weighted assets)	1,184	22.81	%	208	4.00	%	311	6.00	%
Total capital (to risk weighted assets)	1,252	24.12	%	415	8.00	%	519	10.00	%

N/A - Not applicable.

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

Bank	Actual			For Capital Adequacy Purposes			Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
	(Dollars in millions)								
March 31, 2015									
Tangible capital (to tangible assets)	$1,278	12.21	%	N/A	N/A		N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,278	12.21	%	$419	4.00	%	$524	5.00	%
Common equity tier 1 capital (to RWA)	1,278	21.58	%	267	4.50	%	385	6.50	%
Tier 1 capital (to risk weighted assets)	1,278	21.58	%	356	6.00	%	474	8.00	%
Total capital (to risk weighted assets)	1,357	22.91	%	474	8.00	%	593	10.00	%
December 31, 2014									
Tangible capital (to tangible assets)	$1,167	12.43	%	N/A	N/A		N/A	N/A	
Tier 1 capital (to adjusted tangible assets)	1,167	12.43	%	$376	4.00	%	$470	5.00	%
	1,167	22.54	%	207	4.00	%	311	6.00	%

Tier 1 capital (to risk weighted assets)									
Total capital (to risk weighted assets)	1,235	23.85	%	414	8.00	%	518	10.00	%

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

Note 16 – Legal Proceedings, Contingencies and Commitments

On at least a quarterly basis, the Company assesses the liabilities and loss contingencies in connection with pending or threatened legal and regulatory proceedings utilizing the latest information available. The Company establishes accruals for legal claims and regulatory matters when the Company believes it is probable that a loss may be incurred and that the amount of such loss can be reasonably estimated. Once established, litigation accruals are adjusted from time to time, as appropriate, in light of additional information. Management does not believe that the amount of any reasonably possible losses in excess of any amounts accrued with respect to ongoing proceedings or any other known claims, including the matters described below will be material to the Company’s financial statements. Management does not believe that the ultimate disposition of the proceedings will have a material adverse effect on the Company’s operations or financial condition taken as a whole.

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Legal Proceedings

The Company and certain subsidiaries are subject to various pending or threatened legal proceedings arising out of the normal course of business or operations. On the basis of information currently available, advice of counsel, available insurance coverage, and established reserves, it is the opinion of management that the eventual outcome of the current actions against us will not have a material adverse effect on our consolidated financial condition, results of operations, or cash flows. However, it is possible that the ultimate resolution of legal matters, if unfavorable, may be material to our consolidated financial condition, results of operations, or cash flows in a particular period.

From time to time, governmental agencies conduct investigations or examinations of various mortgage related practices of the Bank. In the course of such investigations or examinations, the Bank cooperates with such agencies and provides information as requested. In addition, the Bank is routinely named in civil actions throughout the country by borrowers and former borrowers relating to the origination, purchase, sale, and servicing of mortgage loans. The Bank does not believe that the ultimate outcome of these actions will have a material adverse effect on its financial condition, results of operations or cash flows.

The Company is currently a defendant in a shareholder derivative lawsuit filed in 2013 which focuses on the events leading up to the Company's 2012 DOJ litigation settlement as well as the settlement itself. The lawsuit alleges breaches of fiduciary duties and unjust enrichment by several current and former members of the Company's board of directors and executive officers and requests unspecified monetary damages.

DOJ litigation settlement

Per the February 2012 DOJ litigation settlement, the Company is required to make future additional payments of approximately $118 million contingent upon the occurrence of certain future events. The Company elected the fair value option to account for this liability and uses a weighted discounted cash flow model to measure fair value. The fair value of the DOJ litigation settlement liability was $82 million at both March 31, 2015 and December 31, 2014, using a discount rate of 7.9 percent and 8.7 percent at March 31, 2015 and December 31, 2014, respectively. The undiscounted amount of the DOJ litigation settlement liability remains at $118 million at March 31, 2015.

The DOJ litigation settlement does not have any effect on FHA insured loans in the Company's portfolio, including loans classified as loans with government guarantees as discussed in Note 4 to the Consolidated Financial Statements, herein.

Litigation Accruals

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

Commitments

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

	March 31, 2015	December 31, 2014
	(Dollars in millions)	
Commitments to extend credit		
Mortgage loans (interest-rate lock commitments)	$3,953	$2,172
HELOC trust commitments	101	88

Other consumer commitments	9	7
Warehouse loan commitments	663	827
Standby and commercial letters of credit	10	10
Other commercial commitments	491	445

Commitments to extend credit are agreements to lend. Since many of these commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements.

The Company enters into mortgage interest-rate lock commitments with its customers. These commitments are considered to be derivative instruments and changes in the fair value of these commitments are recorded in the Consolidated

Statements of Financial Condition as an other asset. Further discussion on derivative instruments is included in Note 8 - Derivative Financial Instruments.

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

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

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

Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the counterparties.

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

Note 17 – Fair Value Measurements

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

Valuation Hierarchy

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

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

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

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

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

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

Assets

Investment securities available-for-sale. These securities are comprised of U.S. government sponsored agencies and municipal obligations. The Company measures fair value using prices obtained from pricing services. A review is performed on the security prices received from the pricing services, which includes discussion and analysis of the inputs used by the pricing services to value our securities. Where possible, fair values are generated using market inputs including quoted prices (the closing price in an exchange market), bid prices (the price at which a buyer stands ready to purchase) and other market information. For fixed income securities that are not actively traded, the pricing services use alternative methods to determine fair value for the securities, including; quotes for similar fixed-income securities, matrix pricing, discounted cash flow using benchmark curves or other factors to determine fair value. U.S. government sponsored agency mortgage backed securities are classified within level 2 of the valuation hierarchy, U.S. government sponsored collateralized mortgage obligation securities are classified within level 2 of the valuation hierarchy and all other debt securities are classified within level 3 of the valuation hierarchy.

Loans held-for-sale. The Company generally estimates the fair value of loans held-for-sale based on quoted market prices for securities backed by similar types of loans. Where quoted market prices were available, such market prices were utilized as estimates for fair values. Otherwise, the fair value of loans was computed by discounting cash flows using observable inputs inclusive of interest rates, prepayment speeds and loss assumptions for similar collateral. These loans are classified as level 2.

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

Loans held-for-investment that are recorded at fair value on a recurring basis are loans that were previously recorded as loans held-for-sale but subsequently transferred to the held-for-investment category. As the Company selected the fair value option for the held-for-sale loans, they continue to be reported at fair value and measured consistent with the level 2 methodology for loans held-for-sale.