FLAGSTAR BANCORP INC
Form 10-K
February 28, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-16577
(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)

Registrant's telephone number, including area code: (248) 312-2000
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No ý
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 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 ý No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý
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 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 ý	Accelerated Filer o	Smaller Reporting Company o
Non-Accelerated Filer o	Emerging growth company o	

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 Act). Yes No ý
The estimated aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing sale price ($34.26 per share) as reported on the New York Stock Exchange on June 30,

2018, was approximately $1 billion. The registrant does not have any non-voting common equity shares.
As of February 26, 2019, 56,442,315 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement relating to the 2019 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report on Form 10-K.

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GLOSSARY OF ABBREVIATIONS AND ACRONYMS

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

Term	Definition	Term	Definition
AFS	Available for Sale	GNMA	Government National Mortgage Association
Agencies	Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively	HELOAN	Home Equity Loans
ALCO	Asset Liability Committee	HELOC	Home Equity Lines of Credit
ALLL	Allowance for Loan & Lease Losses	HFI	Held for Investment
AOCI	Accumulated Other Comprehensive Income (Loss)	HOLA	Home Owners Loan Act
ASR	Accelerated Share Repurchase	Home Equity	Second Mortgages, HELOANs, HELOCs
ASU	Accounting Standards Update	HPI	Housing Price Index
Basel III	Basel Committee on Banking Supervision Third Basel Accord	H.R.1.	House of Representatives 1 - Tax Cuts and Jobs Act
BSA	Bank Secrecy Act	HTM	Held to Maturity
C&I	Commercial and Industrial	LHFI	Loans Held-for-Investment
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity	LHFS	Loans Held-for-Sale
CDARS	Certificates of Deposit Account Registry Service	LIBOR	London Interbank Offered Rate
CD	Certificates of Deposit	LTV	Loan-to-Value Ratio
CET1	Common Equity Tier 1	Management	Flagstar Bancorp's Management
CLTV	Combined Loan to Value	MBIA	MBIA Insurance Corporation
Common Stock	Common Shares	MBS	Mortgage-Backed Securities
CRE	Commercial Real Estate	MD&A	Management's Discussion and Analysis
CFPB	Consumer Financial Protection Bureau	MP Thrift	MP Thrift Investments, L.P.
DCB	Desert Community Bank	MSR	Mortgage Servicing Rights
Deposit Beta	The change in the annualized cost of our deposits, divided by the change in the Federal Reserve discount rate	N/A	Not Applicable
DIF	Deposit Insurance Fund	NASDAQ	National Association of Securities Dealers Automated Quotations
DOJ	United States Department of Justice	NYSE	New York Stock Exchange
DTA	Deferred Tax Asset	OCC	Office of the Comptroller of the Currency
EVE	Economic Value of Equity	OCI	Other Comprehensive Income (Loss)
ExLTIP	Executive Long-Term Incentive Program	OTTI	Other-Than-Temporary-Impairment
		QTL	Qualified Thrift Lending

Fannie Mae	Federal National Mortgage Association		
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
FBC	Flagstar Bancorp	RMBS	Residential Mortgage-Backed Securities
FDIC	Federal Deposit Insurance Corporation	RSU	Restricted Stock Unit
Federal Reserve	Board of Governors of the Federal Reserve System	RWA	Risk Weighted Assets
FHA	Federal Housing Administration	SEC	Securities and Exchange Commission
FHFA	Federal Housing Finance Agency	SOFR	Secured Overnight Financing Rate
FHLB	Federal Home Loan Bank	SFR	Single Family Residence
FICO	Fair Isaac Corporation	TARP	Troubled Asset Relief Program
FRB	Federal Reserve Bank	TDR	Trouble Debt Restructuring
Freddie Mac	Federal Home Loan Mortgage Corporation	TILA	Truth in Lending Act
FTE	Full Time Equivalent	UPB	Unpaid Principal Balance
GAAP	Generally Accepted Accounting Principles	U.S. Treasury	United States Department of Treasury
Ginnie Mae	Government National Mortgage Association	VIE	Variable Interest Entity
GLBA	Gramm-Leach Bliley Act	XBRL	eXtensible Business Reporting Language

FORWARD-LOOKING STATEMENTS

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

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

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.

PART I

ITEM 1. BUSINESS

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-K.

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 savings bank founded in 1987. We provide commercial and consumer banking services and we are the 5th largest bank mortgage originator in the nation and the 6th largest sub-servicer of mortgage loans nationwide. At December 31, 2018, we had 3,938 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 December 31, 2018, 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 throughout Michigan, Indiana, California, Wisconsin, Ohio and contiguous states.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, and our own loan officers from 75 retail locations in 24 states and two call centers, which include our direct-to-consumer lending team. Flagstar is also a leading national servicer of mortgage loans and provides complementary ancillary offerings including MSR lending, servicing advance lending and recapture services.

Recent Acquisitions

In the first quarter of 2018, we closed on the purchase of the mortgage loan warehouse business from Santander Bank, which added $499 million in outstanding warehouse loans, and we completed the acquisition of eight Desert Community Bank branches in San Bernardino County, California, with $614 million in deposits and $59 million in loans.

In the fourth quarter of 2018, we closed on the purchase of 52 branches in Indiana, Michigan, Wisconsin and Ohio, from Wells Fargo, with $1.8 billion in deposits and $107 million in loans. For further information, see Note 2 - Acquisitions.

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 23 - Segment Information.

Competition

We face substantial competition in attracting deposits and generating loans. Our most direct competition for deposits has historically come from other savings banks, commercial banks and credit unions in our banking footprint. Money market funds, full-service securities brokerage firms, and financial technology companies also compete with us for these funds. We compete for deposits by offering a broad range of high quality customized banking services at competitive rates. From a lending perspective, there are many institutions including commercial banks, national mortgage lenders, local savings banks, credit unions, and commercial lenders offering consumer and commercial loans. We compete by offering competitive interest rates, fees, and other loan terms through efficient and customized service.

Subsidiaries

We conduct business primarily through our wholly-owned bank subsidiary. In addition, the Bank has wholly-owned subsidiaries through which we conduct non-bank business or which are inactive. The Bank and its wholly owned subsidiaries comprised 99.7 percent of our total assets at December 31, 2018. For further information, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards, Note 8 - Variable Interest Entities and Note 24 - Holding Company Only Financial Statements.

Regulation and Supervision

The Bank is a federally chartered savings bank, subject to federal regulation and oversight by the OCC. We are also subject to regulation and examination by the FDIC, which insures the deposits of the Bank to the extent permitted by law and the requirements established by the Federal Reserve. The Bank is also subject to the supervision of the CFPB which regulates the offering and provision of consumer financial products or services under the federal consumer financial laws. The OCC, FDIC and the CFPB may take regulatory enforcement actions if we do not operate in accordance with applicable regulations, policies and directives. Proceedings may be instituted against us, or any "institution-affiliated party," such as a director, officer, employee, agent or controlling person, who engages in unsafe and unsound practices, including violations of applicable laws and regulations. The FDIC has additional authority to terminate insurance of accounts, if after notice and hearing, we are found to have engaged in unsafe and unsound practices, including violations of applicable laws and regulations. The federal system of regulation and supervision establishes a comprehensive framework of activities in which to operate and is intended primarily for the protection of depositors and the FDIC's Deposit Insurance Fund rather than our shareholders.

As a savings and loan holding company, we are required to comply with the rules and regulations of the Federal Reserve. We are required to file certain reports and we are subject to examination by the enforcement authority of the Federal Reserve. Under the federal securities laws, we are also subject to the rules and regulations of the Securities and Exchange Commission.

Any change to laws and regulations, whether by the FDIC, OCC, CFPB, SEC, the Federal Reserve, or Congress, could have a material adverse impact on our operations.

Holding Company Regulation

Acquisition, Activities and Change in Control. Flagstar Bancorp, Inc. is a unitary savings and loan holding company. We may only conduct, or acquire control of companies engaged in, activities permissible for a unitary savings and loan holding company pursuant to the relevant provisions of the Home Owners' Loan Act and relevant regulations. Further, we generally are required to obtain Federal Reserve approval before acquiring directly or indirectly, ownership or control of any voting shares of another bank or bank holding company (or savings associations or savings and loan holding company) if, after such acquisition, we would own or control more than 5 percent of the outstanding shares of any class of voting securities of the bank or bank holding company (or savings association or savings and loan holding company). Additionally, we are prohibited from acquiring control of a depository institution that is not federally insured or retaining control of a savings association subsidiary for more than one year after the date that such subsidiary becomes uninsured.

We may not be acquired by a company, unless the Federal Reserve approves such transaction. In addition, the GLBA generally restricts a company from acquiring us if that company is engaged directly or indirectly in activities that are not permissible for a savings and loan holding company or financial holding company.

Volcker Rule. Section 619 of the Dodd-Frank Act required the federal financial regulatory agencies to adopt rules that prohibit banking entities, including federal savings associations and their and affiliates, from engaging in proprietary trading and investing in and/or sponsoring certain "covered funds," In 2013, the agencies adopted rules to implement section 619. These rules, collectively with section 619, are commonly referred to as the "Volcker Rule." Compliance with the Volcker Rule generally has been required since July 21, 2015. Pursuant to the requirements of the Volcker Rule, we have established a standard compliance program based on the size and complexity of our operations.

Capital Requirements. The Bank and Flagstar are currently subject to the regulatory capital framework and guidelines reached by Basel III as adopted by the OCC and Federal Reserve. The OCC and Federal Reserve have risk-based capital adequacy guidelines 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.

The Bank and Flagstar have been subject to the capital requirements of the Basel III rules since January 1, 2015. On October 27, 2017, the agencies published a proposed rule which would simplify certain aspects of the capital rules, including the capital treatment for items covered by the rule. The agencies expect that the capital treatment and transition provisions for items covered by Basel III rules will change once the proposal is finalized and effective. On November 21, 2017, in preparation for forthcoming rules that would simplify regulatory capital requirements to reduce regulatory burden, federal banking regulators approved the extension of the existing transitional capital treatment for certain regulatory capital deductions and risk weights. For additional information, see Note 20 - Regulatory Capital.

Source of Strength. The Dodd-Frank Act codified the Federal Reserve’s "source of strength" doctrine and extended it to savings and loan holding companies. Under the Dodd-Frank Act, the prudential regulatory agencies are required to promulgate joint rules requiring savings and loan holding companies, such as us, to serve as a source of financial strength for any depository institution subsidiary by maintaining the ability to provide financial assistance to such insured depository institution in the event that it suffers financial distress.

Collins Amendment. The Collins Amendment to the Dodd Frank Act 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 by the Federal Reserve. The minimum Tier 1 leverage and risk-based capital requirements are determined by the minimum ratios established by the federal banking agencies that apply to insured depository institutions under the prompt corrective action regulations. The amendment states that 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 are included as Tier 1 capital while they are outstanding, unless we complete an acquisition of a depository institution holding company and we report total assets greater than $15 billion at the end of the quarter in which the acquisition occurs. At our present size, with total assets of $18.5 billion at December 31, 2018, an acquisition of a depository holding company would likely cause our trust preferred securities totaling $247 million at December 31, 2018 to no longer be included in Tier 1 capital and would therefore be included in Tier 2 capital.

Banking Regulation

We must comply with a wide variety of banking, consumer protection and securities laws, regulations and supervisory expectations and are regulated by multiple regulators, including the Federal Reserve, the Office of the Comptroller of the Currency of the U.S. Department of the Treasury, the Consumer Financial Protection Bureau, and the Federal Deposit Insurance Corporation.

FDIC Insurance and Assessment. The FDIC insures the deposits of the Bank and such insurance is backed by the full faith and credit of the U.S. government through the DIF. The FDIC maintains the DIF by assessing each financial institution an insurance premium. The FDIC defined deposit insurance assessment base for an insured depository institution is equal to the average consolidated total assets during the assessment period, minus average tangible equity.

All FDIC-insured financial institutions must pay an annual assessment based on asset size to provide funds for the payment of interest on bonds issued by the Financing Corporation ("FICO bonds"), a federal corporation chartered under the authority of the Federal Housing Finance Board. The last of the remaining FICO bonds will mature in September 2019. The Federal Housing Finance Agency (FHFA) projects that the last FICO assessment will be collected in the first half of 2019.

In 2016, the FDIC adopted a rule in accordance with the provisions of Dodd-Frank that requires large institutions to bear the burden, through an imposed surcharge, of raising the DIF reserve ratio. As of September 30, 2018, the DIF has exceeded the required ratio and therefore the surcharge imposed on large banks ended as of that date. We expect the elimination of the surcharge to decrease FDIC insurance premiums approximately $3 million for the full year 2019.

Affiliate Transaction Restrictions. The Bank is subject to the affiliate and insider transaction rules applicable to member banks of the Federal Reserve as well as additional limitations imposed by the OCC. These provisions prohibit or limit the Bank from extending credit to, or entering into certain transactions with principal stockholders, directors and executive officers of the banking institution and certain of its affiliates. The Dodd-Frank Act imposed further restrictions on transactions with certain affiliates and extension of credit to executive officers, directors and principal stockholders.

Limitation on Capital Distributions. The OCC and FRB regulate all capital distributions made by the Bank, directly or indirectly, to the holding company, including dividend payments. The Bank must receive approval from the OCC and FRB to pay dividends to the Bancorp if, after paying those dividends, the Bank would fail to meet the required minimum levels under risk-based capital guidelines and the minimum leverage and tangible capital ratio requirements. Payment of dividends by the Bank also may be restricted at any time at the discretion of the OCC if it deems the payment to constitute an unsafe and unsound banking practice.

Loans to One Borrower. Under the Home Owners Loan Act (HOLA), loans to one borrower may not be in excess of 15 percent of Tier 1 and Tier 2 capital plus any portion of the allowance for loan losses not included in Tier 2 capital. This limit was $256 million as of December 31, 2018. For further information, see MD&A - Risk Management.

Bank Secrecy Act and Anti-Money Laundering. The Bank is subject to the BSA and other anti-money laundering laws and regulations, including the USA PATRIOT Act. The BSA requires all financial institutions to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. The BSA includes various record keeping and reporting requirements such as cash transaction and suspicious activity reporting as well as due diligence requirements. The Bank is also required to comply with U.S. Treasury's Office of Foreign Assets Control imposed economic sanctions that affect transactions with designated foreign countries, nationals, individuals, entities and others.

The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") was enacted, which repealed or modified several provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). Certain key aspects of the Economic Growth Act that have the potential to affect the Company's business and results of operations include:

- Raising the total asset threshold from $10 billion to $250 billion at which bank holding companies are required to conduct annual company-run stress tests mandated by the Dodd-Frank Act.
- Revising the definition of high volatility commercial real estate loans to ease the regulatory burden associated with the identification of loans that meet qualifying criteria.
- Providing that certain reciprocal deposits shall not be considered brokered deposits, subject to certain limitations.
- Entitling federal savings associations, such as the Bank, with less than $20 billion in total assets as of December 31, 2017, an option to elect to operate as covered savings associations (similar to a national bank) without changing their charter.

Consumer Protection Laws and Regulations

The Bank is subject to a number of federal consumer protection laws and regulations. These include, among others, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Servicemembers Civil Relief Act, the Expedited Funds Availability Act, the Community Reinvestment Act, the Real Estate Settlement Procedures Act, electronic funds transfer laws, redlining laws, predatory lending laws, laws prohibiting unfair, deceptive or abusive acts or practices in connection with the offer, or sale of consumer financial products or services, and the GLBA regarding customer privacy and data security.

The Bank is subject to supervision by the CFPB, which has responsibility for enforcing federal consumer financial laws. The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers, including prohibitions against unfair, deceptive abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service including regulations related to the origination and servicing of residential mortgages. The Bank is subject to the CFPB's supervisory, examination and enforcement authority with respect to consumer protection laws and regulations. As a result, we could incur increased costs, potential litigation or be materially limited or restricted in our business, product offerings or services in the future.

Due to regulatory focus on compliance with consumer protection laws and regulations, portions of our lending operations which most directly deal with consumers, including mortgage and consumer lending, may pose particular challenges. Further, the CFPB continues to propose new rules and to amend existing rules. While we are not aware of any material compliance issues related to our mortgage and consumer lending practices, the focus of regulators and the changes to regulations may increase our compliance risks. Despite the supervision and oversight we exercise in these areas, failure to comply with these regulations could result in the Bank being liable for damages to individual borrowers or other imposed penalties.

Additionally, the Equal Credit Opportunity Act and the Fair Housing Act prohibit financial institutions from engaging in discriminatory lending practices. The Department of Justice, CFPB, and other agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in class action litigation. A successful challenge to the Bank's performance under the fair lending laws and regulations could adversely impact the Bank's rating under the Community Reinvestment Act and result in a wide variety of sanctions or penalties or limit certain revenue channels.

Regulatory Matters

Supervisory Agreement. The Supervisory Agreement originally dated January 27, 2010, was lifted by the Federal Reserve on August 14, 2018. For further information and a complete description of all of the terms of the Supervisory Agreement, please refer to the copy of the Supervisory Agreement filed with the SEC as an exhibit to our 2016 Form 10-K for the year ended December 31, 2016.

Consent Order with CFPB. On September 29, 2014, the Bank entered into a Consent Order with the CFPB. The Consent Order relates to alleged violations of federal consumer financial laws arising from the Bank's residential first mortgage loan loss mitigation practices and default servicing operations dating back to 2011. Under the terms of the Consent Order, the Bank paid $28 million for borrower remediation and $10 million in civil money penalties. The settlement did not include an admission of wrongdoing on the part of the Bank or its employees, directors, officers, or agents. For further information and a complete description of all of the terms of the Consent Order, please refer to the copy of the Consent Order filed with the SEC as an exhibit to our Current Report on Form 8-K filed on September 29, 2014.

Incentive Compensation

The U.S. bank regulatory agencies issued comprehensive guidance on incentive compensation policies intended to ensure that the incentive compensation policies of U.S. banks do not undermine safety and soundness by encouraging excessive risk-taking. The U.S. bank regulatory agencies review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of U.S. banks that are not "large, complex banking organizations." These reviews are tailored to each bank based on the scope and complexity of the bank's activities and the prevalence of incentive compensation arrangements.

Additional Information

Our executive offices are located at 5151 Corporate Drive, Troy, Michigan 48098, and our telephone number is (248) 312-2000. Our stock is traded on the NYSE under the symbol "FBC."

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act available free of charge on our website at www.flagstar.com, under "Investor Relations," as soon as reasonably practicable after we electronically file such material with the SEC. These reports are also available without charge on the SEC website at www.sec.gov.

ITEM 1A. RISK FACTORS

Our financial condition and results of operations may be adversely affected by various factors, many of which are beyond our control. In addition to the factors identified elsewhere in this Report, we believe the most significant risk factors affecting our business are set forth below.

Market, Interest Rate, Credit and Liquidity Risk

Economic and general conditions in the markets in which we operate may adversely affect our business.

Our business and results of operations are affected by economic and market conditions, political uncertainty and social conditions, factors impacting the level and volatility of short-term and long-term interest rates, inflation, home prices, unemployment and under-employment levels, bankruptcies, household income, consumer spending, fluctuations in both debt and equity capital markets and currencies, liquidity of the financial markets, the availability and cost of capital and credit, investor sentiment and confidence in the financial markets, and the sustainability of economic growth. Deterioration of any of these conditions could adversely affect our business segments, the level of credit risk we have assumed, our capital levels, liquidity, and our results of operations.

Domestic and international fiscal and monetary policies also affect our business. Central bank actions, particularly those of the Federal Reserve, can affect the value of financial instruments and other assets, such as investment securities and MSRs, and their policies can affect our borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in fiscal and monetary policies are beyond our control and difficult to predict but could have an adverse impact on our capital requirements and the cost of running our business.

Changes in interest rates could adversely affect our financial condition and results of operations including our net interest margin, mortgage related assets, and our investment portfolio.

Our results of operations and financial condition could be significantly affected by changes in interest rates. Our financial results depend substantially on net interest income, which is the difference between the interest income that we earn on interest-earning assets and the interest expense we pay on interest-bearing liabilities. Net interest income represented 53 percent of our total revenue for the full year ended December 31, 2018.

Changes in interest rates may affect the expected average life of our mortgage LHFI and mortgage backed securities and, to a lesser extent, our commercial loans. Decreases in interest rates can trigger an increase in unscheduled prepayments of our loans and mortgage backed securities as borrowers refinance to reduce their own borrowing costs. Conversely, increases in interest rates may decrease loan refinance activity.

The fair value of our fixed-rate financial instruments, including certain LHFI, LHFS, and investment securities is affected by changes in interest rates. If interest rates increase, the fair value of our fixed-rate financial instruments will generally decline and, therefore, have a negative effect on our financial results. We use derivatives to provide a level of protection against interest rate risks, but no hedging strategy will offset this risk completely.

Additionally, the fair value of our MSRs is highly sensitive to changes in interest rates and changes in market implied interest rate volatility. Decreases in interest rates can trigger an increase in actual repayments and market expectation for higher levels of repayments in the future which have a negative impact on MSR fair value. Conversely, higher rates typically drive lower repayments which result in an increase in the MSR fair value. We utilize derivatives to manage the impact of changes in the fair value of the MSRs. Our risk management strategies, which rely on assumptions or projections, may not adequately mitigate the impact of changes in interest rates, interest rate volatility, credit spreads or prepayment speeds, and as a result, the change in the fair value of MSRs may negatively impact earnings.

Changes in the method of determining the London Inter-Bank Offered Rate (LIBOR), or the replacement of LIBOR with an alternative reference rate, may adversely affect interest income or expense.

On July 27, 2017, the United Kingdom Financial Conduct Authority, which oversees LIBOR, formally announced that it could not assure the continued existence of LIBOR in its current form beyond the end of 2021, and that an orderly transition process to one or more alternative benchmarks should begin. In June 2017, the Alternative Reference Rates Committee, a steering committee comprised of large U.S. financial institutions organized by the Federal Reserve, announced that it had selected a modified version of the unpublished Broad Treasuries Financing Rate as the preferred alternative reference rate for U.S. dollar obligations. This rate, now referred to as the Secured Overnight Financing Rate (SOFR), is based on actual transactions in certain portions of overnight repurchase agreement markets for certain U.S. Treasury obligations, and was first published during the first half of 2018.

It is unclear whether, or in what form, LIBOR will continue to exist after 2021. If LIBOR ceases to exist or if the methods of calculating LIBOR change from current methods for any reason, interest rates on our floating rate loans, deposits, obligations, derivatives, and other financial instruments tied to LIBOR rates, as well as the revenue and expenses associated with those financial instruments, may be adversely affected. Additionally, whether or not SOFR attains market traction as a replacement to LIBOR remains in question and it remains uncertain at this time what the impact of a possible transition to SOFR may have on our business, financial result and operations.

Rising interest rates and adverse changes in mortgage market conditions could reduce mortgage revenue.

In 2018, approximately 47 percent of our revenue was derived from our Mortgage Origination segment which includes activities related to the origination and sales of residential mortgages. The residential real estate mortgage lending business is sensitive to changes in interest rates. Declining interest rates generally increase the volume of mortgage originations while higher interest rates generally cause that volume to decrease. Historically, mortgage origination volume and sales for the Bank and for other financial institutions have risen and fallen in response to these and other factors. An increase in interest rates and/or a decrease in our mortgage production volume could have a material adverse effect on our operating results. During 2018, average 10 year U.S. Treasury rates, on which we base our pricing of our 30 year mortgages, was 2.91 percent, 58 basis points higher than average rates experienced during 2017. The sustained higher rates experienced throughout 2018 negatively impacted the mortgage market including loan origination volume and refinancing activity.

In addition to being affected by interest rates, the secondary mortgage markets are also subject to investor demand for residential mortgage loans and investor yield requirements for these loans. These conditions may fluctuate or worsen in the future. Adverse market conditions, including increased volatility and reduced market demand, could result in greater risk in retaining mortgage loans pending their sale to investors. A prolonged period of secondary market illiquidity may result in a reduction of our loan mortgage production volume and could have a material adverse effect on our financial condition and results of operations.

Our mortgage origination business is also subject to the cyclical and seasonal trends of the real estate market. Cyclicality in our industry could lead to periods of strong growth in the mortgage and real estate markets followed by periods of sharp declines and losses in such markets. Seasonal trends have historically reflected the general patterns of residential and commercial real estate sales, which typically peak in the spring and summer seasons. One of the primary influences on our mortgage business is the aggregate demand for mortgage loans, which is affected by prevailing interest rates, housing supply and demand, residential construction trends, and overall economic conditions. If we are unable to respond to the cyclicality of our industry by appropriately adjusting our operations or relying on the strength of our other product offerings during cyclical downturns, our business, financial condition and results of operations could be adversely affected.

To effectively manage our MSR concentration risk we may have to sell our MSRs when market conditions are not optimal or hold MSRs at a level which is punitive to our Common Equity Tier 1 capital (CET1) under Basel III.

We are subject to capital standards requirements, including requirements of the Dodd-Frank Act and those developed by the Bank's regulators based on the Basel Committee on Banking Supervision, commonly referred to as Basel III. Basel III established a qualifying criteria for regulatory capital, including limitations on the amount of DTAs and MSRs that may be held without triggering higher capital requirements. Basel III currently limits the amount of MSRs and DTAs each to 10 percent of CET1, individually, and 15 percent of CET1, in the aggregate.

As of December 31, 2018, we had $290 million in MSRs and a MSR to Common Equity Tier 1 Capital ratio of 23.0 percent. We produced, on average, approximately $89 million of new MSRs per quarter in 2018 and we expect to continue to generate MSRs going forward. Considering the volume of MSRs that we generate, we must continually sell MSRs to manage the concentration of this asset. In 2018, we sold $371 million in MSRs and as of December 31, 2018, we had pending MSR sales with a fair value of $44 million which closed during the first quarter of 2019. While our established plan to manage our MSR concentration incorporates our production volumes and required sales, no assurance can be given that we will be able to do so. Additionally, to manage our MSR concentration, we may have to sell our MSRs at a price less than their fair value due to market constraints present at the time of sale which could have an adverse effect on our financial condition and results of operations.

On October 27, 2017, the agencies issued a notice of proposed rulemaking (NPR) which would simplify certain aspects of the Basel III capital rules. The agencies expect that the capital treatment and transition provisions for items covered by this final rule will change once the simplification proposal is finalized and effective. Specifically, the proposal would increase the limit on MSRs to 25 percent of CET1 and eliminate the aggregate 15 percent CET1 deduction threshold for MSRs and temporary difference DTAs. The increase in the limit on MSRs would allow us to hold up to $347 million in MSRs without being punitive to our capital ratios. The regulators have not yet issued their final rule.

In preparation for the NPR, the Basel III implementation phase-in has been halted for the treatment of MSRs and certain DTAs. The agencies issued a final rule that will maintain the capital rules' 2017 transition provisions for several regulatory capital deductions and certain other requirements that are subject to multi-year phase-in schedules in the regulatory capital rules. Specifically, the final rule will maintain the capital rules' 2017 transition provisions at 80 percent for the regulatory capital treatment of the following items: (i) MSRs, (ii) DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, (iii) investments in the capital of unconsolidated financial institutions, and (iv) minority interests. As of December 31, 2018, we had $290 million on MSRs, $48 million in DTAs arising from temporary differences and no material investments in unconsolidated financial institutions or minority interest. This final rule will maintain the 2017 transition provisions for certain items for non-advanced approach banks, such as the Bank.

Our ALLL could be too low to sufficiently cover future credit losses. As of December 31, 2018, our ALLL was $128 million, covering 1.4 percent of total loans held-for-investment. Our estimate of the inherent losses is imperfect and based on management judgment.

Our ALLL, which reflects our estimate of such losses inherent in the loan portfolio at December 31, 2018, may not be adequate to cover actual credit losses. If this allowance is insufficient, future provisions for credit losses could adversely affect our financial condition and results of operations. We attempt to limit the risk that borrowers will fail to repay loans by carefully underwriting our loans, but losses nevertheless occur in the ordinary course of business. Our ALLL is based on historical experience as well as our evaluation of the risks inherent in the loan portfolio at December 31, 2018. The determination of an appropriate level of loan loss allowance is a subjective process that requires significant management judgment, including estimates of loss and the loss emergence period, estimates and judgments about the collectability of our loan portfolio including but not limited to the creditworthiness of our borrowers and the value of real estate or other collateral backing the repayment of loans. New information regarding existing loans, identification of additional problem loans, failure of borrowers and guarantors to perform in accordance with the terms of their loans, and other factors, both within and outside of our control, may require an increase in the ALLL. Moreover, our regulators, as part of their supervisory function, periodically review our ALLL and may recommend or require us to increase the amount of our ALLL, based on their judgment, which may be different from that of our management. Any increase in our loan losses would have an adverse effect on our earnings and financial condition.

Concentration of loans held-for-investment in certain geographic locations and markets may increase the magnitude of potential losses should defaults occur.

Our residential mortgage loan portfolio is geographically concentrated in certain states, including California and Michigan, which comprise approximately 52 percent of the portfolio. In addition, our commercial loan portfolio has a concentration of Michigan lending relationships. Approximately 44 percent of our CRE loans are collateralized by properties in Michigan and 29 percent of our C&I borrowers are located in Michigan. These concentrations have made, and will continue to make, our loan portfolio particularly susceptible to downturns in the local economies and the real estate and mortgage markets in these areas. Adverse conditions that are beyond our control may affect these areas, including unemployment, inflation, recession, natural disasters, declining property values, municipal bankruptcies and other factors which could increase both the probability and severity of defaults in our loan portfolio, reduce our ability to generate new loans and negatively affect our financial results.

In 2018, we continued to grow our commercial portfolio to $5.0 billion at December 31, 2018. As a part of that, CRE and C&I loans grew to $3.6 billion and comprised 39 percent of our total LHFI portfolio. Additionally, our home builder finance program reached $718 million in outstanding loans at December 31, 2018. The home builder lending portfolio contains secured and unsecured loans and our lending platform originates loans throughout the U.S. with regional offices in Houston and Denver. The growth of our home builder lending business may be impacted by overall economic conditions in the areas builders operate as well as new home construction rates and trends.

Commercial loans, excluding our warehouse loans, generally expose us to a greater risk of nonpayment and loss than residential real estate loans due to the more complex nature of underwriting. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. At December 31, 2018, our largest CRE and C&I borrowers had loans of $71 million and $70 million, respectively. Further, we have commitments up to $100 million in our CRE and C&I portfolios. As such, a default by one of our larger borrowers could result in a significant loss relative to our ALLL. Additionally, secured loans, including residential and commercial real estate, may experience changes in the underlying collateral value due to adverse market conditions which could result in increased charge-offs in the event of a loan default.

At December 31, 2018, our adjustable-rate warehouse lines of credit granted to other mortgage lenders was $3.8 billion, of which $1.5 billion was outstanding. There may be risks associated with the mortgage lenders that borrow from the Bank, including credit risk, inadequate underwriting, and potential external fraud. At December 31, 2018, our largest borrower had an outstanding advance of $80 million. A default by one of our larger warehouse borrowers could result in a large loss. Additionally, adverse changes to industry competition, mortgage demand and the interest rate environment may have a negative impact on warehouse lending.

Liquidity risk may affect our ability to meet obligations and impact our ability to grow our business.

We require substantial liquidity to repay our customers' deposits, fulfill loan demand, meet borrowing obligations as they come due, and fund our operations under both normal operating environments and unforeseen circumstances causing liquidity stress. Our liquidity could be impaired by our inability to access the capital markets or unforeseen outflows of deposits. Our access to liquidity, including deposits, as well as the cost of that liquidity, is dependent on various factors, a number of which could make funding more difficult, more expensive or unavailable on any terms. These factors include: losses or declining financial results, material changes to operating margins, financial leverage on an absolute basis or relative to peers, changes within the organization, specific events that impact our financial condition or reputation, disruptions in the capital markets, specific events that adversely impact the financial services industry, counterparty availability, the corporate and regulatory structure, balance sheet and capital structure, geographic and business diversification, interest rate fluctuations, market share and competitive position, general economic conditions and the legal, regulatory, accounting and tax environments governing funding transactions. Many of these factors are beyond our control. A material deterioration in any one or a combination of these factors could result in a downgrade of our credit or servicer standing with counterparties or a decline in our reputation within the marketplace, and could result in higher cash outflows requiring additional access to liquidity, having a limited ability to borrow funds, maintain or increase deposits (including custodial deposits from our agency servicing portfolio) or to raise capital on commercially reasonable terms or at all.   If we are unable to maintain and grow certain of these financing arrangements, are restricted from accessing certain funding sources by our regulators, are unable to arrange for new financing on acceptable terms, or if we default on any of the covenants imposed upon us by our borrowing facilities, then we may have to limit our growth, reduce the number of loans we are able to originate or take actions that could have other negative effects on our operations.

We are a holding company and are, therefore, dependent on the Bank for funding of obligations.

As a holding company with no significant assets other than the capital stock of the Bank and cash on hand, our ability to service our debt, including interest payments on our senior notes and trust preferred securities, pay dividends, repurchase shares of our common stock, pay for certain services we purchase from the Bank and cover operating expenses, depend upon available cash on hand and the receipt of dividends from the Bank. The holding company had cash and cash equivalents of $201 million at December 31, 2018, or approximately 3.2 years of future cash outflows, dividend payments, share repurchases and debt service coverage when excluding the redemption of $250 million of senior notes which mature on July 15, 2021. On January 29, 2019, our Board of Directors approved an accelerated share repurchase ("ASR") agreement with Wells Fargo, N.A. to repurchase up to $50 million of the Company's common stock. Operating expenses, which include costs paid to the Bank, totaled $34 million for the year ended December 31, 2018. The declaration and payment of dividends by the Bank on all classes of its capital stock is subject to the discretion of the Bank's Board of Directors and to applicable regulatory and legal limitations. If the Bank, does not, or cannot, make sufficient dividend payments to us, we may not be able to service our debt, which could have a material adverse effect on our financial condition and results of operations or could cause us to take other actions which could be materially detrimental.

Regulatory Risk

We are highly dependent on the Agencies to buy mortgage loans that we originate. Changes in these entities or their current roles could adversely affect our business, financial condition and results of operations.

We generate mortgage revenues primarily from gains on the sale of single-family residential loans pursuant to programs currently offered by Fannie Mae, Freddie Mac, Ginnie Mae and other investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. During the year ended December 31, 2018, we sold approximately 50 percent of our mortgage loans to Fannie Mae and Freddie Mac. Any future changes in these programs, our eligibility to participate in such programs, the criteria for loans to be accepted or laws that significantly affect the activity of such entities could, in turn, result in a lower volume of corresponding loan originations or other administrative costs which may materially adversely affect our results of operations or could cause us to take other actions that would be materially detrimental.

Fannie Mae and Freddie Mac remain in conservatorship and a path forward for them to emerge from conservatorship is unclear. Their roles could be reduced, modified or eliminated as a result of regulatory actions and the nature of their guarantees could be limited or eliminated relative to historical measurements. The elimination or modification of the traditional roles of Fannie Mae or Freddie Mac could create additional competition in the market and significantly and adversely affect our business, financial condition and results of operations.

Changes in the servicing, origination, or underwriting guidelines or criteria required by the Agencies could adversely affect our business, financial condition and results of operations.

We are required to follow specific guidelines or criteria that impact the way that we originate, underwrite, or service. Agency loans, including guidelines with respect to credit standards for mortgage loans, our staffing levels and other servicing practices, the servicing and ancillary fees that we may charge, our modification standards and procedures and the amount of non-reimbursable advances.

We cannot negotiate these terms with the Agencies and they are subject to change at any time. A significant change in these guidelines which decreases the fees we charge or requires us to expend additional resources in providing mortgage services could decrease our revenues or increase our costs, which would adversely affect our business, financial condition and results of operations.

In addition, changes in the nature or extent of the guarantees provided by Fannie Mae and Freddie Mac or the insurance provided by the FHA could also have broad adverse market implications. The fees that we are required to pay to the Agencies for these guarantees have changed significantly over time and any future increases in these fees would adversely affect our business, financial condition and results of operations.

We depend upon having FDIC insurance to raise deposit funding at reasonable rates. Future changes in deposit insurance premiums and special FDIC assessments could adversely affect our earnings.

The Dodd-Frank Act required the FDIC to substantially revise its regulations for determining the amount of an institution's deposit insurance premiums. Consequently, the FDIC has defined the deposit insurance assessment base for an insured depository institution as average consolidated total assets during the assessment period, minus average Tier 1 Capital. Our assessment rate is determined by use of a scorecard that combines our CAMELS ratings with certain other financial information. Changes in the level and mix of these financial components in the scorecard may result in a higher assessment rate. The FDIC may determine that we present a higher risk to the DIF than other banks due to various factors. These factors include significant risks relating to interest rates, loan portfolio and geographic concentration, concentration of high credit risk loans, increased loan losses, regulatory compliance, existing and future litigation and other factors. As a result, we could be subject to higher deposit insurance premiums and special assessments in the future that could adversely affect our earnings. The Bank’s deposit insurance premiums and special assessments in the future also may be higher than competing banks may be required to pay. For the years ended December 31, 2018, 2017 and 2016, our FDIC insurance expense premiums totaled $22 million, $16 million and $11 million, respectively.

Operational Risk

Our recent acquisition of bank branches from Wells Fargo involves integration and other risks.

Bank branch acquisitions involve a number of challenges including, the ability to integrate new business into operations, internal controls and regulatory functions. There is no assurance we will be able to limit the outflow of deposits held by our new customers in the acquired branches or attract new deposits and generate new interest-earning assets in geographic areas we did not previously serve. There is no guarantee that the acquired branches will achieve results in the future similar to those achieved by our existing banking business; that we will compete effectively in the market areas served by acquired branches; or that we will manage any growth resulting from the transaction effectively. We face the additional risk that the anticipated benefits of the acquisition may not be realized fully or at all, or within the time period expected.

A failure of our information technology systems, or those of any of our key third party vendors or service providers, could cause operational losses and damage our reputation.

Our businesses are increasingly dependent on our ability to process, record and monitor a large number of complex transactions and data. If our internal information technology systems fail, we may be unable to conduct business for a period of time, which may impact our financial results if that interruption is sustained. In addition, our reputation with our customers or business partners may suffer, which could have a further, long-term impact on our financial results.

Because we conduct part of our business over the Internet and outsource a significant number of our critical functions to third parties, our operations depend on our third-party service providers to maintain and operate their own technology systems. To the extent these third parties’ systems fail, despite our monitoring and contingency plans, we may be unable to conduct business or provide certain services, and we may face financial and reputational losses as a result.

We face operational risks due to the high volume and the high dollar value of transactions we process.

We rely on the ability of our employees and systems to process a wide variety of transactions. Many of the transactions we process may be of high dollar value, such as those related to mortgage lending and warehouse advances. In 2018, we originated a total of $32.5 billion in residential mortgage loans and processed $33.9 billion of warehouse lending advances. We face operational risk from, but not limited to, the risk of fraud by employees or persons outside our company, the execution of unauthorized transactions, errors relating to transaction processing and technology, breaches of our internal control systems or failures of those of our suppliers or counterparties, compliance failures, cyber-attacks, technology failures, or unforeseen problems related to system implementations or upgrades, business continuation and disaster recovery issues, and other external events. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. The occurrence of any of these events could result in a financial loss, regulatory action or damage to our reputation.

We may lose market share to our competitors if we are not able to respond to technological change and introduce new products and services.

Financial products and services have become increasingly technologically driven. We may not be able to respond to technological innovations as quickly as our competitors do. Certain of our competitors are making significantly greater investments and allocating significantly more in financial resources toward technological innovations than we historically have. Our ability to meet the needs of our customers and introduce competitive products in a cost-efficient manner depends on our responsiveness to technological advances, investment in new technology as it becomes available, and obtaining and maintaining related essential personnel. Furthermore, the introduction of new technologies and products by financial technology companies and platforms may adversely affect our ability to maintain our customer base, obtain new customers or successfully grow our business. The failure to respond to the product demands of our customers, due to cost, proficiency or otherwise, could have a material adverse impact on our business and therefore on our financial condition and results of operations.

We collect, store and transfer our customers' personally identifiable information. Any cybersecurity attack or other compromise to the security of that information could adversely impact our business and financial condition.

Cybersecurity related attacks are attempted on an ongoing basis which pose a risk of data breaches relative to the processing of consumer transactions that contain customers' personally identifiable information. As a part of conducting business, we receive, transmit and store a large volume of personally identifiable information and other user data either on our network or in the cloud.

Cybersecurity risks for banking institutions have increased significantly in recent years due to new technologies, the reliance on technology to conduct financial transactions and the increased sophistication of organized crime and hackers. A cybersecurity attack or information security breach could adversely impact our ability to conduct business due to the potential costs for remediation, protection and litigation and reputational damage with customers, business partners and investors.
There are myriad federal, state, local and international laws regarding privacy and the storing, sharing, use, disclosure and protection of personally identifiable information and user data. We have policies and processes in place that are intended to meet the requirements of those laws, including security systems to prevent unauthorized access to that information. Nevertheless, those processes and systems may be inadequate. Also, to the extent we rely upon third parties to handle personally identifiable data on our behalf, we may be responsible if such data is compromised or subject to a cybersecurity attack while in the custody and control of those third parties.
Privacy laws are continually evolving and many state and local jurisdictions have laws that differ from federal law or privacy policies, further some of those policies or laws may conflict. If we fail to comply with applicable privacy policies or federal, state, local or international laws and regulations or experience any compromise of security that results in the unauthorized release of personally identifiable information or other user data, those events could damage the reputation of our business, and discourage potential users from utilizing our products and services. In addition, we may have to bear the cost of mitigating identity theft concerns, and may be subject to fines or legal proceedings by governmental agencies or consumers. Any of these events could adversely affect our business and financial condition.

We may be terminated as a servicer or subservicer or incur costs, liabilities, fines and other sanctions if we fail to satisfy our servicing obligations, including our obligations with respect to mortgage loan foreclosure actions.

Servicing revenue makes up approximately 11 percent of our total revenue and contributed approximately $1.8 billion in average custodial deposits during 2018. At December 31, 2018, we had relationships with 7 owners of MSRs, excluding ourselves, in which we act as servicer or subservicer for the mortgage loans they own. Due to the limited number of relationships, discontinuation of existing agreements with any of those third parties or adverse changes in contractual terms could have a significant negative impact to our mortgage servicing revenue. The terms and conditions in which a master servicer may terminate subservicing contracts are broad and, in some instances, could be exercised at the discretion of the master servicer without requiring cause. Additionally, the master servicer directs the oversight of custodial deposits associated with serviced loans and, to the extent allowable, could choose to transfer the oversight of the Bank's custodial deposits to another depository institution. Further, as servicer or subservicer of loans, we have certain contractual obligations, including foreclosing on defaulted mortgage loans or, to the extent applicable, considering alternatives to foreclosure. If we commit a material breach of our obligations as servicer, we may be subject to termination if the breach is not cured within a specified period of time following notice, causing us to lose servicing income.

We may be required to repurchase mortgage loans, pay fees or indemnify buyers against losses.

When mortgage loans are sold by us, we make customary representations and warranties to purchasers, guarantors and insurers, including the Agencies, about the mortgage loans, and the manner in which they were originated. Whole loan sale agreements require us to repurchase or substitute mortgage loans, or indemnify buyers against losses, in the event we breach these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of early payment default of the borrower or we may be required to pay fees. We also are subject to litigation relating to these representations and warranties which may result in significant costs. With respect to loans that are originated through our broker or correspondent channels, the remedies we have available against the originating broker or correspondent, if any, may not be as broad as the remedies available to purchasers, guarantors and insurers of mortgage loans against us. We also face further risk that the originating broker or correspondent, if any, may not have the financial capacity to perform remedies that otherwise may be available. Therefore, if a purchaser, guarantor or insurer enforces its remedies against us, we may not be able to recover losses from the originating broker or correspondent. If repurchase and indemnity demands increase and such demands are valid claims, our liquidity, results of operations and financial condition may also be adversely affected.

For certain investors and/or certain transactions, we may be contractually obligated to repurchase a mortgage loan or reimburse the investor for credit or other losses incurred on the loan as a remedy for servicing errors with respect to the loan. If we have increased repurchase obligations because of claims for which we did not satisfy our obligations, or increased loss severity on such repurchases, we may have a significant reduction to noninterest income or an increase to noninterest expense. We may incur significant costs if we are required to, or if we elect to, re-execute or re-file documents or take other action in our capacity as a servicer in connection with pending or completed foreclosures. We may incur litigation costs if the validity of a foreclosure action is challenged by a borrower. Any of these actions may harm our reputation or negatively affect our servicing business and, as a result, our profitability.

Our representation and warranty reserve, which is based on an estimate of probable future losses, was $7 million at December 31, 2018. This may not be adequate to cover losses for loans that we have sold or securitized for which we may be subsequently required to repurchase, pay fines or fees, or indemnify purchasers and insurers because of violations of customary representations and warranties. Our regulators, as part of their supervisory function, periodically review our representation and warranty reserve for losses. Our regulators may recommend or require us to increase our reserve, based on their judgment, which may differ from that of our management. The repurchase demand pipeline was $9 million UPB at December 31, 2018.

We utilize third party mortgage originators which subjects us to strategic, reputation, compliance and operational risk.

In 2018, approximately 86 percent of our residential first mortgage volume depended upon the use of third party mortgage originators, i.e. mortgage brokers and correspondent lenders, who are not our employees. These third parties originate mortgages and provide services to many different banks and other entities. Accordingly, they may have relationships with or loyalties to such banks and other parties that are different from those they have with or to us. Failure to maintain good relations with such third party mortgage originators could have a negative impact on our market share which would negatively impact our results of operations.

We rely on third party mortgage originators to originate and document the mortgage loans we purchase or originate. While we perform due diligence on the mortgage companies with whom we do business and review the loan files and loan documents we purchase to attempt to detect any irregularities or legal noncompliance, we have less control over these originators than employees of the Bank.

Due to regulatory scrutiny, our third party mortgage originators could choose or be required to either reduce the scope of their business or exit the mortgage origination business altogether. The TILA-RESPA Integrated Disclosure Rule issued by the CFPB establishes comprehensive mortgage disclosure requirements for lenders and settlement agents in connection with most closed-end consumer credit transactions secured by real property. The rule requires certain disclosures to be provided to consumers in connection with applying for and closing on a mortgage loan. The rule also mandates the use of specific disclosure forms, timing of communicating information to borrowers and certain record keeping requirements. The ongoing administrative burden and the system requirements associated with complying with these rules or potential changes to these rules could impact our mortgage volume and increase costs. In addition, these arrangements with third party mortgage originators and the fees payable by us to such third parties could be subject to regulatory scrutiny and restrictions in the future.

The Equal Credit Opportunity Act and the Fair Housing Act, prohibit discriminatory lending practices by lenders, including financial institutions. Mortgage and consumer lending practices raise compliance risks resulting from the detailed and complex nature of mortgage and consumer lending laws regulations imposed by federal regulatory agencies, and the relatively independent and diverse operating channels in which loans are originated. As we originate loans through various channels, we, and our third party mortgage originators, are especially impacted by these laws and regulations and are required to implement appropriate policies and procedures to help ensure compliance with fair lending laws and regulations and to avoid lending practices that result in the disparate treatment of or disparate impact to borrowers across our various locations under multiple channels. Failure to comply with these laws and regulations, by us or our third party mortgage originators, could result in the Bank being liable for damages to individual borrowers or other imposed penalties.

General Risk Factors

MP Thrift, an entity managed and controlled by MatlinPatterson, owns 47.8 percent of our common stock. Future issuance of Flagstar’s common stock in the public market, or as a result of actions taken by MP Thrift, could adversely affect the trading price of Flagstar’s common stock.

As of December 31, 2018, MP Thrift owned 47.8 percent of the Company’s common stock. Sales of a substantial number of shares of Flagstar’s common stock in the public market, or the perception that these sales might occur, may cause the market price of Flagstar’s common stock to decline. Further, a large quantity of our shares introduced into the market, either at once or over time, could increase the supply of Flagstar common stock, thereby putting pressure on our stock price. Pricing pressure could further be exacerbated by low trading volumes and market conditions, both of which may impact the extent of time it may take for pricing to rationalize.

We are subject to various legal or regulatory investigations and proceedings.

At any given time, we are involved with a number of legal and regulatory examinations as a part of the routine reviews conducted by regulators and other parties which may involve consumer protection, employment, tort, and numerous other laws and regulations. Proceedings or actions brought against us may result in judgments, settlements, fines, injunctions, business improvement orders, consent orders, supervisory agreements, restrictions on our business activities, or other results adverse to us, which could materially and negatively affect our business. If such claims and other matters are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact customer demand for those products and services. Some of the laws and regulations to which we are subject may provide a private right of action that a consumer or class of consumers may pursue to enforce these laws and regulations. We have been, and may be in the future, subject to stockholder derivative actions, which could seek significant damages or other relief. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations. Claims asserted against us can be highly complicated and slow to develop, making the outcome of such proceedings difficult to predict or estimate early in the process. As a participant in the financial services industry, it is likely that we will be exposed to a high level of litigation and regulatory scrutiny relating to our business and operations.

In 2018, the Ninth Circuit Federal Court of Appeals held that California state law requiring mortgage servicers to pay interest on certain mortgage escrow accounts was not, as a matter of law, preempted by the National Bank Act (Lusnak v. Bank of America). This ruling goes against the position that regulators, national banks and other federally-chartered financial institutions have taken regarding the preemption of state-law mortgage escrow interest requirements. The opinion issued by the Ninth Circuit Federal Court of Appeals is legal precedent only in certain parts of the western United States. If the Ninth’s Circuit’s holding is more broadly adopted by other Federal Circuits, including those covering states that currently have or in the future may enact statutes requiring the payment of interest on escrow balances or if we would be required to retroactively apply interest on escrows, the Company’s earnings could be adversely affected.

Although we establish accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable and that the amount of loss can be reasonably estimated, we do not have accruals for all legal proceedings where we face a risk of loss. Due to the inherent subjectivity of the assessments and unpredictability of the outcome of legal and regulatory proceedings, amounts accrued may not represent the ultimate loss to us from the legal and regulatory proceedings in question. As a result, our ultimate losses may be significantly higher than the amounts accrued for legal loss contingencies. For further information, see Note 21 - Legal Proceedings, Contingencies and Commitments.

Loss of certain personnel, including key members of the Corporation's management team, could adversely affect the Corporation.

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, we are subject to regulations that allow us to make severance payments only in limited circumstances. Our named executive officers may be entitled to certain severance and change in control benefits. Although we follow certain leading practices with respect to executive compensation including the elimination of supplemental executive retirement plans (SERPs) or other nonqualified plans for executives and avoiding severance payments for "cause" terminations or voluntary resignations, we may be subject to certain legal or regulatory risks associated with previous employment agreements or retirement plans which could impact our liabilities and results of operations related to these matters.

Other Risk Factors

The above description of risk factors is not exhaustive. Other risk factors are described elsewhere herein as well as in other reports and documents that we file with or furnish to the SEC. Other factors that could also cause results to differ from our expectations may not be described herein or in any such report or document.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Flagstar's headquarters is located in Troy, Michigan at 5151 Corporate Drive and we operate a regional office in Jackson, Michigan. We own both the headquarters and regional office buildings.

At December 31, 2018, we operated 160 bank branches in the following states:

	Owned	Leased	Total	Free-Standing Office Building	In-Store Banking Center	Buildings with Other Tenants	Total
Michigan	87	27	114	90	2	22	114
Indiana	27	6	33	31	—	2	33
California	8	—	8	8	—	—	8
Wisconsin	3	1	4	3	—	1	4
Ohio	1	—	1	1	—	—	1
Total	126	34	160	133	2	25	160

We also have 75 retail mortgage locations, 4 wholesale lending offices, and 9 commercial lending offices. These locations are primarily leased and located in 25 states.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is party to legal proceedings incident to its business. For further information, see Note 21 - Legal Proceedings, Contingencies and Commitments.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT’S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock trades on the NYSE under the trading symbol FBC. At December 31, 2018, there were 57,749,464 shares of our common stock outstanding held by 11,746 stockholders of record.

Dividends

We had not paid dividends on our common stock since the fourth quarter 2007. On January 29, 2019, our Board of Directors declared a quarterly cash dividend which will commence in the first quarter of 2019. The declaration and payment of future dividends, if any, will be considered by our Board of Directors in its discretion and will depend on a number of factors, including our financial condition, liquidity, earnings and prospective earnings.

Sale of Unregistered Securities

We made no unregistered sales of our equity securities during the fiscal year ended December 31, 2018.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchases as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan
October 1, 2018 to October 31, 2018	—	—	—	—
November 1, 2018 to November 30, 2018	—	—	—	—
December 1, 2018 to December 31, 2018	4,709	$ 31.51	4,709	28,919

On October 16, 2018, the Board approved the offer to repurchase common stock from beneficial owners of 99 or fewer shares of common stock, commonly referred as an odd-lot buyback. This repurchase offer is complete and expired on January 11, 2019. All repurchased shares are authorized and will be accounted for as treasury stock in the Consolidated Statements of Financial Condition.

On January 31, 2019, our Board of Directors announced an accelerated share repurchase ("ASR") agreement with Wells Fargo, N.A. to repurchase up to $50 million of the Company's common stock. The ASR program commenced on February 1, 2019. Under the terms of the ASR, the Company received an initial delivery of approximately 1.3 million shares which represents 82 percent of the total number of shares expected to be repurchased pursuant to the ASR program, based on the closing price of $30.85 on January 31, 2019. The total number of shares to be repurchased will be based on the average of the Company’s daily volume-weighted average stock price, less a discount, during the term of the ASR program, which is expected to be completed by the end of the second quarter of 2019.

Equity Compensation Plan Information

For information with respect to securities to be issued under our equity compensation plans, see Part III, Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, which information is hereby incorporated by reference.

Performance Graph

CUMULATIVE TOTAL STOCKHOLDER RETURN
COMPARED WITH PERFORMANCE OF SELECTED INDICES
DECEMBER 31, 2013 THROUGH DECEMBER 31, 2018

	Flagstar Bancorp	Nasdaq Financial	Nasdaq Bank	S&P Small Cap 600	Russell 2000
December 31, 2013	100	100	100	100	100
December 31, 2014	80	102	103	104	104
December 31, 2015	118	106	110	101	98
December 31, 2016	137	130	148	126	117
December 31, 2017	191	147	153	141	132
December 31, 2018	135	132	126	127	116

ITEM 6. SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
	2018 (1)	2017 (2)	2016 (3)	2015	2014 (4)
	(In millions, except share data and percentages)				
Summary of Consolidated Statements of Operations					
Net interest income	$497	$ 390	$ 323	$287	$ 247
Provision (benefit) for loan losses	(8)	6	(8)	(19)	132
Noninterest income	439	470	487	470	372
Noninterest expense	712	643	560	536	590
Provision (benefit) for income taxes	45	148	87	82	(34)
Net income (loss)	187	63	171	158	(69)
Preferred stock dividends/accretion	—	—	—	—	(1)
Net income (loss) from continuing operations	$187	$ 63	$ 171	$158	$ (70)
Income (loss) per share:					
Basic	$3.26	$ 1.11	$ 2.71	$2.27	$ (1.72)
Diluted	$3.21	$ 1.09	$ 2.66	$2.24	$ (1.72)
Weighted average shares outstanding:					
Basic	57,520,289	57,093,868	56,569,307	56,426,976	56,246,528
Diluted	58,322,950	58,178,343	57,597,667	57,164,523	56,246,528

(1) Net interest income includes $29 million of pre-tax hedging gains reclassified from AOCI. Noninterest expense includes $15 million of pre-tax acquisition-related expenses related to the Wells Fargo branch acquisition.
(2) Provision for income taxes includes $80 million non-cash charge resulting from the revaluation of the Company's net deferred tax asset (DTA) at a lower statutory rate as a result of the Tax Cuts and Jobs Act.
(3) Noninterest income includes $24 million of pre-tax benefit due to the reduction of the DOJ settlement liability.
(4) Provision for loan losses includes $96 million charge due to changes in estimates related to the loss emergence period on residential loans and the evaluation of risk associated with interest-only loans. Noninterest expense includes $38 million related to CFPB litigation settlement expense.

	December 31,				
	2018	2017	2016	2015	2014
	(In millions, except per share data and percentages)				
Summary of Consolidated Statements of Financial Condition					
Total assets	$18,531	$ 16,912	$ 14,053	$ 13,715	$ 9,840
Loans receivable, net	13,221	12,165	9,465	9,226	6,523
Total deposits	12,380	8,934	8,800	7,935	7,069
Total short-term and long-term Federal Home Loan Bank advances	3,394	5,665	2,980	3,541	514
Long-term debt	495	494	493	247	331
Stockholders' equity (1)	1,570	1,399	1,336	1,529	1,373
Book value per common share	27.19	24.40	23.50	22.33	19.64
Tangible book value per share (2)	23.90	24.04	23.50	22.33	19.64
Number of common shares outstanding	57,749,464	57,321,228	56,824,802	56,483,258	56,332,307

(1) Includes preferred stock totaling $267 million for the years ended December 31, 2015 and December 31, 2014.
(2) Excludes goodwill and intangibles of $190 million and $21 million for the years ended December 31, 2018 and December 31, 2017, respectively. See Non-GAAP Financial Measures for further information.

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	At or For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(In millions, except share data and percentages)				
Average Balances:					
Average interest-earning assets	$16,136	$14,130	$12,164	$10,436	$8,440
Average interest paying liabilities	13,124	11,848	9,757	8,305	6,780
Average stockholders' equity	1,488	1,433	1,464	1,486	1,406
Selected Ratios:					
Interest rate spread (1)	2.81 %	2.56 %	2.45 %	2.58 %	2.80 %
Adjusted interest rate spread (1)(2)	2.58 %	2.56 %	2.45 %	2.58 %	2.80 %
Net interest margin	3.07 %	2.75 %	2.64 %	2.74 %	2.91 %
Adjusted net interest margin (2)	2.89 %	2.75 %	2.64 %	2.74 %	2.91 %
Return (loss) on average assets	1.04 %	0.40 %	1.23 %	1.32 %	(0.71)%
Return (loss) on average equity	12.58 %	4.41 %	11.69 %	10.63 %	(4.97)%
Return (loss) on average common equity	12.6 %	4.4 %	13.0 %	10.5 %	(6.1)%
Equity-to-assets ratio	8.47 %	8.27 %	9.50 %	11.14 %	13.95 %
Common equity-to-assets ratio	8.47 %	8.27 %	9.50 %	9.20 %	11.24 %
Tangible common equity-to-assets ratio (3)	7.45 %	8.15 %	9.50 %	9.20 %	11.24 %
Equity/assets ratio (average for the period)	8.28 %	9.05 %	10.52 %	12.43 %	14.22 %
Efficiency ratio	76.0 %	74.8 %	69.2 %	70.9 %	95.4 %
Bancorp Tier 1 leverage (to adjusted avg. total assets) (4)	8.29 %	8.51 %	8.88 %	11.51 %	N/A
Bank Tier 1 leverage (to adjusted avg. total assets) (4)	8.67 %	9.04 %	10.52 %	11.79 %	12.43 %
Effective tax provision rate (5)	19.4 %	70.1 %	33.7 %	34.2 %	32.9 %
Selected Statistics:					
Mortgage rate lock commitments (fallout-adjusted) (6)	$30,308	$32,527	$29,372	$25,511	$24,007
Mortgage loans originated	$32,465	$34,408	$32,417	$29,368	$24,585
Mortgage loans sold and securitized	$32,076	$32,493	$32,033	$26,307	$24,407
Number of bank branches	160	99	99	99	107
Number of FTE employees	3,938	3,525	2,886	2,713	2,739

(1) Interest rate spread is the difference between the yield earned on average interest-earning assets for the period and the rate of interest paid on average interest-bearing liabilities.

(2) The year ended December 31, 2018, excludes $29 million of hedging gains reclassified from AOCI to net interest income in conjunction with the payment of long-term FHLB advances. See Non-GAAP Financial Measures for further information.

(3) Excludes goodwill and intangibles of $190 million and $21 million for the years ended December 31, 2018 and December 31, 2017, respectively. See Non-GAAP Financial Measures for further information.

(4) Basel III transitional.

(5) The year ended December 31, 2017 includes an $80 million, non-cash charge to the provision for income taxes resulting from the revaluation of the Company's net deferred tax asset (DTA) at a lower statutory rate as a result of the Tax Cuts and Jobs Act.

(6) Fallout-adjusted mortgage rate lock commitments are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on previous historical experience, the level of interest rates and other factors.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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The following is an analysis of our financial condition and results of operations. This should be read in conjunction with our Consolidated Financial Statements and related notes filed with this report in Part II, Item 8. Financial Statements and Supplementary Data.

Overview

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 savings bank founded in 1987. We provide a range of commercial, small business, and consumer banking services and we are the 5th largest bank mortgage originator in the nation. We distinguish ourselves by crafting specialized solutions for our customers, local delivery, high quality customer service and competitive product pricing. For additional details and information on each of our lines of business, see MD&A - Operating Segments and Note 23 - Segment Information.

The year ended December 31, 2018 resulted in net income of $187 million, or $3.21 per diluted share, and adjusted net income of $176 million, or $3.02 per diluted share, when excluding Wells Fargo branch acquisition expenses of $13 million, and related hedging gains of $24 million, both net of taxes. When comparing full year 2018 to full year 2017, net income increased $124 million, or $1.57 per diluted share. Excluding the Wells Fargo branch acquisition expenses and related hedging gains from 2018, and an $80 million charge to the provision for income taxes in 2017 resulting from tax reform, adjusted net income increased $33 million, or $0.55 per diluted share. During 2018, we continued to grow the community bank, strengthened our balance sheet with high quality interest earning assets and stable liquidity, and continued to diversify our earnings.

Three strategic banking acquisitions in 2018 further strengthened the community bank. In the first quarter we acquired eight branches of Desert Community Bank and the mortgage loan warehouse business from Santander Bank, followed by the acquisition of 52 branches from Wells Fargo in the fourth quarter. These acquisitions expanded our banking footprint and added $2.2 billion of deposits and $760 million of loans to our balance sheet as of December 31, 2018.

As a result of our acquisitions and continued organic growth, average interest-earning assets increased $2.0 billion, with broad based growth in both our commercial and consumer loan portfolios, which increased $1.2 billion and $704 million, respectively. The acquired low-cost deposits were the primary driver of the $2.5 billion increase in retail and government deposits in 2018, which provides ample liquidity to fund future balance sheet growth. The increase in earning-assets, along with consistent expansion of our net interest margin reflecting higher yielding loans and low-cost deposits, drove up adjusted net interest income less the hedging gains, $78 million, or 20 percent. Net interest income accounted for 52 percent of total revenues in 2018, compared to 45 percent in 2017.

Our mortgage servicing business continued to gain scale and we ended the year servicing nearly 827,000 accounts, representing an 87 percent increase from the prior year. During 2018, we had $29 billion in MSR sales with subservicing retained on 100 percent of these sales, strengthening our national position as the 6th largest subservicer. This business continues to provide both stable deposits and a reliable, predictable source of fee income.

The mortgage market continued to be challenging throughout 2018 as the national mortgage origination market experienced an 8 percent decline in volume from the prior year. As a result, our mortgage origination volume declined 6 percent to $32 billion, contributing to a $68 million decrease in net gain on loan sales. This loss was partially offset by stronger valuations and lower prepayments on our mortgage servicing assets, which improved $14 million.

Earnings Performance Highlights

	For the Years Ended December 31,				
	2018	2017	2016	Change 2018 vs. 2017	Change 2017 vs. 2016
	(Dollars in millions)				
Net interest income	$497	$390	$323	$107	$67
Provision (benefit) for loan losses	(8)	6	(8)	(14)	14
Total noninterest income	439	470	487	(31)	(17)
Total noninterest expense	712	643	560	69	83
Provision for income taxes	45	148	87	(103)	61
Net income	$187	$63	$171	$124	$(108)
Adjusted net income (1)	$176	$143	$155	$33	$(12)
Income per share:					
Basic	$3.26	$1.11	$2.71	$2.15	$(1.60)
Diluted	$3.21	$1.09	$2.66	$2.12	$(1.57)
Adjusted diluted (1)	$3.02	$2.47	$2.38	$0.55	$0.09

(1) For further information, see MD&A - Use of Non-GAAP Financial Measures.

2018 Compared to 2017

- Net income increased $124 million, or $2.12 per diluted share, to $187 million, or $3.21 per diluted share.
- Adjusted net income increased $33 million, or $0.55 per diluted share, to $176 million, or $3.02 per diluted share, when excluding an $80 million charge due to tax reform in 2017 and Wells Fargo branch acquisition expenses of $13 million, net of tax, and related hedging gains of $24 million, net of tax, in 2018.
- Net interest income increased $107 million, or $78 million, when excluding hedging gains of $29 million which were reclassified from AOCI. The increase in net interest income was primarily driven by 14 percent higher average interest-earning assets, led by commercial loan growth, and net interest margin expansion of 14 basis points.
- The provision for loan losses decreased $14 million, primarily driven by minimal net charge-offs and low levels of delinquencies.
- Noninterest income decreased $31 million, primarily due to a $68 million decrease in net gain on loan sales, partially offset by a $14 million increase in net return on MSRs.
- Noninterest expense increased $69 million, primarily resulting from organic growth and acquisitions which drove higher compensation and benefits, along with an increase in occupancy and equipment expenses.
- Provision for income taxes decreased $103 million, primarily resulting from the revaluation of our DTAs as a result of the new tax legislation in the fourth quarter of 2017 and a lower corporate tax rate throughout 2018.

2017 Compared to 2016

- Net income decreased $108 million, or $1.57 per diluted share, to $63 million, or $1.09 per diluted share.
- Adjusted net income decreased $12 million, or $0.09 per diluted share, to $143 million, or $2.47 per diluted share, when excluding a $16 million, net of tax, decrease in the fair value of the DOJ settlement in 2016 and an $80 million charge due to tax reform in 2017.
- Net interest income increased $67 million, due to interest earning asset growth of $2.0 billion led by higher average LHFS resulting from extending turn times and accumulation of loans in support of residential mortgage backed securitization and commercial lending growth.
-

- The provision for loan losses increased $14 million, primarily due to 2016 sales of consumer loans which resulted in a gain and increases in the provision in 2017 driven by loan growth.
- Noninterest income decreased $17 million, primarily due to a $48 million decrease in net gain on loan sales and a $24 million decrease in the fair value of the DOJ liability settlement in 2016, partially offset by a $48 million increase in the net return on MSRs.
- Noninterest expense increased $83 million, primarily driven by growth initiatives, including our 2017 acquisitions, as well as higher mortgage volume related expenses.

Net Interest Income

The following table presents on a consolidated basis interest income from average assets and liabilities, expressed in dollars and yields:

	For the Years Ended December 31,								
	2018			2017			2016		
	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate
	(Dollars in millions)								
Interest-Earning Assets									
Loans held-for-sale	$4,196	$ 190	4.52 %	$4,146	$ 165	3.99 %	$3,134	$ 113	3.62 %
Loans held-for-investment									
Residential first mortgage	2,949	105	3.56 %	2,549	85	3.35 %	2,328	74	3.16 %
Home Equity	690	36	5.21 %	471	24	5.06 %	475	24	5.17 %
Other	111	6	5.73 %	26	1	4.51 %	29	1	4.73 %
Total Consumer loans	3,750	147	3.93 %	3,046	110	3.62 %	2,832	99	3.52 %
Commercial Real Estate	2,063	109	5.23 %	1,579	68	4.25 %	1,004	35	3.46 %
Commercial and Industrial	1,288	69	5.32 %	981	47	4.73 %	631	27	4.22 %
Warehouse Lending	1,318	69	5.14 %	890	43	4.73 %	1,346	58	4.22 %
Total Commercial loans	4,669	247	5.23 %	3,450	158	4.51 %	2,981	120	3.97 %
Total loans held-for-investment (1)	8,419	394	4.65 %	6,496	268	4.09 %	5,813	219	3.75 %
Loans with government guarantees	303	11	3.53 %	290	13	4.30 %	435	16	3.59 %
Investment securities	3,094	86	2.76 %	3,121	80	2.57 %	2,653	68	2.56 %
Interest-bearing deposits	124	2	1.83 %	77	1	1.15 %	129	1	0.50 %
Total interest-earning assets	16,136	$ 683	4.21 %	14,130	$ 527	3.71 %	12,164	$ 417	3.42 %
Other assets	1,844			1,716			1,743		
Total assets	$17,980			$15,846			$13,907		
Interest-Bearing Liabilities									
Retail deposits									
Demand deposits	$764	$ 7	0.93 %	$514	$ 1	0.19 %	$489	$ 1	0.18 %
Savings deposits	3,300	29	0.87 %	3,829	29	0.76 %	3,751	29	0.78 %
Money market deposits	288	2	0.49 %	255	1	0.50 %	278	1	0.44 %
Certificates of deposit	2,015	34	1.70 %	1,187	14	1.18 %	990	10	1.05 %
Total retail deposits	6,367	72	1.12 %	5,785	45	0.78 %	5,508	41	0.76 %
Government deposits									
Demand deposits	259	1	0.57 %	222	1	0.45 %	228	1	0.39 %
Savings deposits	535	8	1.41 %	406	3	0.68 %	442	2	0.52 %
Certificates of deposit	355	5	1.44 %	329	2	0.82 %	382	2	0.40 %
Total government deposits	1,149	14	1.23 %	957	6	0.67 %	1,052	5	0.45 %
Wholesale deposits and other	401	8	2.02 %	23	—	1.35 %	—	—	— %
Total interest-bearing deposits	7,917	94	1.18 %	6,765	51	0.77 %	6,560	46	0.71 %
Short-term FHLB advances and other	3,521	68	1.93 %	3,356	37	1.09 %	1,249	5	0.44 %
Long-term FHLB advances	1,192	(4)	(0.32)%	1,234	24	1.92 %	1,584	27	1.72 %
Less: Swap gain reclassified out of OCI (5)	—	29	— %	—	—	— %	—	—	— %
Adjusted long-term FHLB advances (5)	1,192	25	2.12 %	1,234	24	1.92 %	1,584	27	1.72 %
Other long-term debt	494	28	5.56 %	493	25	5.08 %	364	16	4.34 %
Adjusted total interest-bearing liabilities (5)	13,124	215	1.63 %	11,848	137	1.15 %	9,757	94	0.97 %

Noninterest-bearing deposits (2)	2,858	2,142	2,202
Other liabilities	510	423	484
Stockholders’ equity	1,488	1,433	1,464
Total liabilities and stockholders' equity	$17,980	$15,846	$13,907
Adjusted net interest income (5)	$468	$ 390	$ 323
Adjusted interest rate spread (3) (5)	2.58 %	2.56 %	2.45 %
Adjusted net interest margin (4) (5)	2.89 %	2.75 %	2.64 %
Ratio of average interest-earning assets to interest-bearing liabilities	122.9 %	119.3 %	124.7 %

(1) Includes nonaccrual loans, for further information relating to nonaccrual loans, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Policies.

(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.

(5) The year ended December 31, 2018, excludes $29 million of hedging gains reclassified from AOCI in conjunction with the payment of long-term FHLB advances. See Non-GAAP Financial Measures for further information.

Rate/Volume Analysis

The following tables present 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 variances are allocated to rate.

	For the Years Ended December 31,					
	2018 Versus 2017 Increase (Decrease) Due to:			2017 Versus 2016 Increase (Decrease) Due to:		
	Rate	Volume	Total	Rate	Volume	Total
	(Dollars in millions)					
Interest-Earning Assets						
Loans held-for-sale	$23	$ 2	$25	$15	$ 37	$52
Loans held-for-investment						
Residential first mortgage	7	13	20	5	6	11
Home equity	2	10	12	—	—	—
Other	1	4	5	—	—	—
Total Consumer loans	10	27	37	5	6	11
Commercial Real Estate	20	21	41	13	20	33
Commercial and Industrial	8	14	22	5	15	20
Warehouse Lending	6	20	26	4	(19)	(15)
Total Commercial loans	34	55	89	22	16	38
Total loans held-for-investment	44	82	126	27	22	49
Loans with government guarantees	(3)	1	(2)	2	(5)	(3)
Investment securities	7	(1)	6	—	12	12
Interest-earning deposits	—	1	1	—	—	—
Total interest-earning assets	$71	$ 85	$156	$44	$ 66	$110
Interest-Bearing Liabilities						
Interest-bearing deposits	$34	$ 9	$43	$3	$ 3	$6
Short-term FHLB advances and other	30	1	31	22	9	31
Long-term FHLB advances (1)	2	(1)	1	2	(5)	(3)
Other long-term debt	2	1	3	4	5	9
Total interest-bearing liabilities (1)	68	10	78	31	12	43
Change in net interest income (1)	$3	$ 75	$78	$13	$ 54	$67

(1) The year ended December 31, 2018, excludes $29 million of hedging gains reclassified from AOCI in conjunction with the payment of long-term FHLB advances. See Non-GAAP Financial Measures for further information.

2018 Compared to 2017

For the year ended December 31, 2018, net interest income increased $107 million, or $78 million when excluding a $29 million hedging gain, compared to the same period in 2017. The increase was primarily driven by growth in average interest earning assets, led by increases in our higher yielding commercial loan portfolio, and a 14 basis point increase in net interest margin.

Our net interest margin for the year ended December 31, 2018 was 2.89 percent, compared to 2.75 percent for the year ended December 31, 2017. The increase in net interest margin was primarily due to growth in our commercial loan portfolio, partially offset by higher average rates on deposits. Loans-held-for-investment saw a 56 basis point increase in average yield, primarily due to higher yields on our commercial loans, driven by increases in LIBOR rates during 2018. In comparison, our interest bearing deposit costs increased 41 basis points, representing a deposit beta of 41 percent, which is the change in the annualized rate of our deposits divided by the change in the Federal Reserve discount rate. The average yield on our LHFI portfolio, influenced by our variable rate commercial loan portfolio, was more responsive to changes in market rates than our deposit costs. Deposit costs increased due to higher rates and an increase in use of wholesale deposits. Wholesale deposits, which experienced a rate increase of 61 basis points, were primarily utilized as an additional funding source prior to the acquisition of the deposits from Wells Fargo.

Average interest-earnings assets increased $2.0 billion for the year ended December 31, 2018, compared to the same period in 2017, primarily due to growth in the LHFI portfolio. Average commercial loans increased $1.2 billion with broad based growth across CRE, C&I, and the warehouse loan portfolios. We continued to grow CRE and C&I loans, and the acquisition of the Santander warehouse lending business in the first quarter of 2018 increased average warehouse loans $493 million during the year. The consumer loan portfolio increased $704 million, primarily due to the addition of residential first mortgages and HELOCs to the LHFI portfolio.

Average interest-bearing liabilities increased $1.3 billion for the year ended December 31, 2018, compared to the full year in 2017, primarily due to a $1.2 billion increase in interest bearing deposits. The increase in average deposits is primarily attributable to the acquisition of deposits from DCB, which impacted the full year average by $478 million, and one month of Wells Fargo deposits, which impacted the full year average by $147 million. Average wholesale deposits increased $378 million, primarily to provide additional funding prior to the acquisition of the Wells Fargo deposits.

2017 Compared to 2016

Net interest income increased $67 million for the year ended December 31, 2017, compared to the same period in 2016. The increase was primarily driven by growth in average interest-earning assets of 16 percent, led by higher average LHFS balances and growth of our higher yielding commercial LHFI portfolios.

Our net interest margin for the year ended December 31, 2017 was 2.75 percent, as compared to 2.64 percent for the year ended December 31, 2016. The increase in net interest margin was driven by a higher average yield on interest earning assets due to the growth in our commercial loan portfolio. This was partially offset by an increase in interest expense resulting from a full year of interest on our long-term senior debt which was issued in July 2016.

Average interest-earnings assets increased $2.0 billion for the year ended December 31, 2017, compared to the same period in 2016. The increase was due to a $1.0 billion increase in LHFS due to extending turn times and accumulation of loans in support of residential mortgage backed securitization. The CRE and C&I portfolios increased $925 million, or 57 percent, as we continued to focus our efforts on building a broad-based, higher yielding commercial loan portfolio.

Average interest-bearing liabilities increased $2.1 billion for the year ended December 31, 2017, compared to the full year in 2016, primarily due to an increase in FHLB advances used to fund balance sheet growth in excess of deposit growth. Average interest-bearing deposits increased $205 million, or 3 percent, for the year ended December 31, 2017, compared to the same period in 2016, driven by higher average retail deposits, partially offset by lower average government deposits. Our costs remained well managed in a rising interest rate environment, despite a slight extension of duration due to a higher percentage of certificates of deposit.

Provision (Benefit) for Loan Losses

2018 Compared to 2017

The provision for loan losses was a benefit of $8 million for the year ended December 31, 2018, compared to a provision of $6 million for the year ended December 31, 2017. The improvement in the provision reflects our continued strong credit quality with consistently low levels of charge-offs, low delinquencies, and growth of the portfolio in areas we believe to pose lower levels of credit risk.

2017 Compared to 2016

The provision for loan losses increased $14 million to $6 million for the year ended December 31, 2017, compared to a benefit of $8 million for the year ended December 31, 2016. The increase was primarily due to loan growth of $1.6 billion in our commercial and consumer portfolios. The benefit in 2016 resulted from the sale of consumer loans with a UPB of $1.3 billion, of which $110 million were nonperforming.

For further information, see MD&A - Credit Risk.

Noninterest Income

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

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in millions)		
Net gain on loan sales	$200	$268	$316
Loan fees and charges	87	82	76
Net return (loss) on mortgage servicing rights	36	22	(26)
Loan administration income	23	21	18
Deposit fees and charges	21	18	22
Other noninterest income	72	59	81
Total noninterest income	$439	$470	$487

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in millions)		
Mortgage rate lock commitments (fallout-adjusted) (1)	$30,308	$32,527	$29,372
Net margin on mortgage rate lock commitments (fallout-adjusted) (1) (2)	0.65 %	0.82 %	1.02 %
Net margin on loans sold and securitized	0.62 %	0.82 %	0.94 %

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

(2) Gain on sale margin is based on net gain on loan sales (excludes net gain on loan sales of $2 million, $1 million, and $15 million from loans transferred from HFI for the years ended December 31, 2018, December 31, 2017 and December 31, 2016, respectively) to fallout-adjusted mortgage rate lock commitments.

2018 Compared to 2017

Total noninterest income decreased $31 million during the year ended December 31, 2018 from the year ended December 31, 2017, primarily due to the following:

- Net gain on loan sales decreased $68 million. Lower mortgage origination volume and pricing competition experienced in the mortgage market throughout 2018 impacted both net gain on loan sale margin, which decreased 17 basis points, and fall-out adjusted lock volume which decreased $2.2 billion. The lower margin was primarily driven by secondary margin compression and a shift in channel mix toward the lower margin, but lower cost delegated correspondent channel, partially offset by an improvement in securitization performance. The full year 2018 saw the benefit of our 2017 delegated correspondent lending and retail lending related acquisitions, which provided a boost to fall-out adjusted lock volume in those channels. Our total fall-out adjusted lock volume decreased 6.8 percent, despite the 8.3 percent decline in the overall mortgage origination market experienced during 2018.
- Net return on MSRs, including the impact of hedges, increased $14 million, primarily due to higher net return from the MSR asset resulting from lower prepayments and stronger valuations, along with a higher average MSR balance.
- Other noninterest income increased $13 million, primarily due to higher FHLB stock dividend income attributable to an increase in FHLB stock holdings and a supplemental dividend from the FHLB received in the first quarter of 2018, higher rental income within the equipment finance operating lease portfolio, an increase in investment and insurance income and a gain from the sale of our wealth management business.

2017 Compared to 2016

Total noninterest income decreased $17 million during the year ended December 31, 2017 from the year ended December 31, 2016, primarily due to the following:

- Net gain on loan sales decreased $48 million. Market conditions impacted the net gain on loan sales margin which decreased 12 basis points with fallout adjusted lock yields decreasing 20 basis points to 0.82 percent. As a result of our 2017 mortgage acquisitions, the decrease in margin was partially offset by a 10.7 percent increase in fallout adjusted mortgage rate lock volume. Despite the 14 percent decline in the overall mortgage origination market experienced in 2017, we maintained our market share. In addition, the decrease in net gain on loan sales was partially attributable to extending turn times on sales of certain LHFS, which shifts earnings from net gain on loan sales to net interest income as well as the sale of nonperforming LHFI that occurred in 2016 which resulted in a $14 million gain.

- Net return on MSRs, including the impact of hedges, increased $48 million primarily driven by a more stable prepayment environment as a result of higher market interest rates, partially offset by a decrease in servicing fee income resulting from a lower MSR balance and higher transaction costs due to MSR sales that occurred in 2017.
- Other noninterest income decreased $22 million primarily due to a $24 million reduction in the DOJ settlement liability that occurred in the third quarter of 2016 and a $6 million decrease in the representation and warranty benefit driven by lower recoveries. These decreases were partially offset by increased rental income attributable to growth in operating leases, and higher investment and insurance revenues.

Noninterest Expense

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

	For the Years Ended December 31,				
	2018	Wells Fargo Branch Acquisition Expenses	Adjusted 2018 (1)	2017	2016
	(Dollars in millions)				
Compensation and benefits	$318	$ 3	$ 315	$299	$269
Occupancy and equipment	127	3	124	103	85
Commissions	80	—	80	72	55
Loan processing expense	59	—	59	57	55
Legal and professional expense	28	3	25	30	29
Federal insurance premiums	22	—	22	16	11
Intangible asset amortization	5	—	5	—	—
Other noninterest expense	73	6	67	66	56
Total noninterest expense (1)	$712	$ 15	$ 697	$643	$560

(1) See Non-GAAP Financial Measures for further information.

	For the Years Ended December 31,		
	2018	2017	2016
Efficiency ratio	76.0 %	74.8 %	69.2 %
Average number FTE	3,655	3,303	2,850

2018 Compared to 2017

Total noninterest expense increased $69 million during the year ended December 31, 2018, compared to the year ended December 31, 2017. Expenses related to the 2018 Wells Fargo branch acquisition totaled $15 million and primarily included costs related to integration, marketing, legal and consulting. Excluding these expenses, adjusted noninterest expense increased $54 million during the year ended December 31, 2018, compared to the year ended December 31, 2017, primarily due to the following:

- Compensation and benefits expense increased $16 million, primarily due to a higher headcount resulting from acquisitions and growth in our community bank, partially offset by cost management and lower incentive compensation.
- Occupancy and equipment increased $21 million, primarily due to a higher average depreciable asset base resulting from technology upgrades and software, along with increases in vendor services to support business growth.
-

Commission expense increased $8 million, primarily due to an increase in originations in the higher commission earning retail channel, driven from the acquisition of Opes in 2017.

- Legal and professional expense decreased $5 million, primarily due to fewer significant legal matters in 2018 and higher acquisition related expenses in 2017.
- FDIC insurance premiums increased $6 million, primarily driven by growth in our total assets.
- Intangible asset amortization increased to $5 million, primarily due to the amortization of the intangible assets associated with our 2018 banking acquisitions.

- Other noninterest expense increased $1 million, primarily due to increases in advertising expense to raise brand awareness and charitable contributions, primarily offset by a reduction in the value of a contingent consideration liability.

2017 Compared to 2016

Total noninterest expense increased $83 million during the year ended December 31, 2017 from the year ended December 31, 2016, primarily due to the following:

- Compensation and benefits expense increased $30 million, primarily due to higher headcount resulting from acquisitions and additions to the Community Banking segment to support growth in both our C&I and CRE portfolios. Our average full-time equivalent employees increased overall by 16 percent from December 31, 2016 to a total average of 3,303 full-time equivalent employees at December 31, 2017, of which 444 were Opes average full-time equivalent employees.
- Occupancy and equipment increased $18 million, primarily due to a higher average depreciable asset base and increased utilization of vendor services to support the needs of our growing business.
- Commission expense increased $17 million, primarily due to higher loan originations and a shift in channel mix to delegated retail channels with higher commission rates resulting from our mortgage acquisitions.
- FDIC insurance premiums increased $5 million, primarily driven by growth in our commercial portfolios.
- Other noninterest expense increased $10 million, primarily due to an increase in advertising expenses due to direct mail and brand awareness campaigns that were launched to drive deposit growth. The remaining increase is attributable to higher business development costs related to acquisitions and an increase in charitable activities.

Provision for Income Taxes

The H.R.1, originally known as the Tax Cuts and Jobs Act, which was signed in December 2017, included various changes to the U.S. tax code that had an impact on us, including, but not limited to, the following:

- Reduction in the statutory corporation tax rate from a maximum rate of 35 percent to a flat rate of 21 percent effective January 1, 2018
- Repeal of the corporate alternative minimum tax ("AMT")
- Immediate expensing of capital investments
- Modifications to the provisions of future generated net operating losses
- Additional limitations on the deductibility of performance-based compensation for named executive officers.

2018 Compared to 2017

Our provision for income taxes for the year ended December 31, 2018 was $45 million, compared to a provision of $148 million for the year ended December 31, 2017. The decrease in the provision for income taxes was primarily due to the change related to the revaluation of deferred tax assets during the fourth quarter of 2017, resulting from the passage of the new tax legislation. The Company's effective tax rate for the year ended December 31, 2018 was 19.4 percent. Our effective tax rate differs from the combined federal and state statutory rate primarily due to a change in our valuation allowance for net deferred tax assets at the state level, higher tax exempt earnings, and stock based compensation.

2017 Compared to 2016

Our provision for income taxes for the year ended December 31, 2017 was $148 million, compared to a provision of $87 million for the year ended December 31, 2016. The increase in the provision for income taxes was primarily due to the charge to the provision for income taxes of approximately $80 million from the revaluation of our DTAs as a result of the new tax legislation. Excluding this charge, the Company's adjusted effective tax rate was 32.1 percent. This adjusted effective tax rate differs from the combined federal and state statutory rate primarily due to benefits from tax-exempt earnings and stock-based compensation.

For further information, see Note 19 - Income Taxes.

Fourth Quarter Results

The following table sets forth selected quarterly data:

	Three Months Ended		
	December 31, 2018 (Unaudited)	September 30, 2018 (Unaudited)	December 31, 2017 (Unaudited)
	(Dollars in millions)		
Net interest income	$152	$ 124	$ 107
Provision (benefit) for loan losses	(5)	(2)	2
Total noninterest income	98	107	124
Total noninterest expense	189	173	178
Provision for income taxes	12	12	96
Net income	$54	$ 48	$ (45)
Adjusted net income (1)	$42	$ 49	$ 35
Income per share:			
Basic	$0.94	$ 0.84	$ (0.79)
Diluted	$0.93	$ 0.83	$ (0.79)
Adjusted diluted (1)	$0.72	$ 0.85	$ 0.60

(1) For further information, see MD&A - Use of Non-GAAP Financial Measures.

Fourth Quarter 2018 compared to Third Quarter 2018

Net income for the three months ended December 31, 2018 was $54 million, or $0.93 per diluted share, as compared to $48 million, or $0.83 per diluted share, for the three months ended September 30, 2018. The $6 million increase in net income was primarily due to the following:

- Net interest income rose $28 million, primarily due to $29 million of hedging gains reclassified from AOCI in conjunction with the payment of long-term FHLB advances. Excluding this gain, net interest income remained relatively flat, reflecting seasonal declines in LHFS and warehouse loans largely offset by an expanded net interest margin driven by one month of the lower cost deposits acquired from the Wells Fargo branch acquisition.
- Noninterest income decreased $9 million, primarily due to a decrease in net gain on loan sales driven by 36 percent lower fallout-adjusted lock volume partially offset by a 9 basis points improvement in margin. The decrease in fallout-adjusted locks reflected anticipated seasonal factors and overall lower mortgage volume.
- Noninterest expense increased by $16 million, primarily due to $14 million of expenses attributable to the Wells Fargo branch acquisition, which included integration costs, advertising, and legal and consulting fees, partially offset by lower commissions reflecting lower mortgage volume.

Fourth Quarter 2018 compared to Fourth Quarter 2017

Net income for the three months ended December 31, 2018 was $54 million, or $0.93 per diluted share, as compared to a net loss of $45 million, or $0.79 per diluted share, for the three months ended December 31, 2017. The fourth quarter 2017 included a non-cash charge of $80 million to the provision for income taxes, due to the revaluation of our net deferred tax asset under the new Tax Cuts and Jobs Act. Excluding this charge, the increase in net income was primarily due to the following:

- Net interest income rose $45 million, primarily due to $29 million of hedging gains reclassified from AOCI in conjunction with the payment of long-term FHLB advances. Excluding this gain, the increase in net interest income was driven by a $1.6 billion increase in average LHFI, led by equal growth in our commercial and consumer loan portfolios. The increase in net interest income was further the result of a 23 basis point increase in net interest margin, excluding the hedging gains, primarily due to an increase in market rates, a higher yielding loan portfolio, and continued deposit price discipline coupled with the benefit of one month of lower cost Wells Fargo deposits.

- Noninterest income decreased $26 million, due to a $45 million decrease in net gain on loan sales primarily driven by secondary margin compression partially offset by an improvement in securitization performance. The decrease in net gain on loan sales was offset by a $14 million increase in net return on MSRs, resulting from lower prepayments and stronger valuations, along with a higher average MSR balance.

- Noninterest expense increased $11 million, primarily due to $14 million of expenses related to the Wells Fargo branch acquisition which included integration costs, advertising, and legal and consulting fees.

Operating Segments

Our operations are conducted through three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. The Other segment includes the remaining reported activities. The operating segments have been determined based on the products and services offered and reflect the manner in which financial information is currently evaluated by management. Each of the operating segments is complementary to each other and because of the interrelationships of the segments, the information presented is not indicative of how the segments would perform if they operated as independent entities.

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 23 - Segment Information.

Community Banking

Our Community Banking segment services 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 loans, and provides deposit and fee based services to consumer, business, and mortgage lending customers.

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

Our Community Banking segment has seen continued growth, both organically and through strategic acquisitions. Our commercial loan portfolio has grown 18 percent in the last twelve months, to $5.0 billion, at December 31, 2018, boosted by the Santander warehouse business acquisition. Average deposits for the year ended December 31, 2018 have increased to $8.9 billion, compared to $7.5 billion, for the year ended December 31, 2017. The DCB branch acquisition and the acquisition of the 52 Wells Fargo branches in the fourth quarter 2018, expanded our banking footprint and added $2.2 billion in deposits as of December 31, 2018 to the Community Banking segment. For further information on our banking acquisitions, see Note 2 - Acquisitions.

	For the Years Ended December 31,		
Community Banking	2018	2017	2016
	(Dollars in millions)		
Summary of Operations			
Net interest income	$314	$238	$206
(Provision) benefit for loan losses	(2)	(4)	10
Net interest income after (provision) benefit for loan losses	312	234	216
Net gain (loss) on loan sales	(12)	(10)	6
Other noninterest income	40	31	28
Total noninterest income	28	21	34
Compensation and benefits	(70)	(62)	(56)
Other noninterest expense and directly allocated overhead	(110)	(92)	(89)

Total noninterest expense	(180)	(154)	(145)
Income before indirect overhead allocations and income taxes	160	101	105
Overhead allocations	(39)	(41)	(35)
(Provision) for income taxes	(25)	(21)	(24)
Net income	$96	$39	$46
Key Metrics			
Efficiency Ratio	52.5 %	59.5 %	60.4 %
Return on average assets	1.1 %	0.6 %	0.8 %
Average number of FTE employees	861	688	661

2018 compared to 2017

The Community Banking segment reported net income of $96 million for the year ended December 31, 2018, compared to net income of $39 million for the year ended December 31, 2017. The $57 million increase was primarily due to $76 million higher net interest income, primarily driven by a $1.2 billion increase in average commercial loans due to organic growth in our CRE and C&I portfolios and enhanced by the acquisition of the Santander warehouse business during 2018. Through this growth the loan portfolios have retained high credit quality, resulting in $2 million lower provision year over year. Noninterest income also increased $7 million, primarily from higher deposit fees driven by the acquisitions of DCB and Wells Fargo branches, as well as the sale of our wealth management business. To support our investments relating to organic growth, acquisitions, and the diversification of our product offerings such as Indirect Lending, our operating costs increased $26 million, primarily due to increases in compensation and benefits, occupancy and equipment and FDIC premiums.

2017 compared to 2016

The Community Banking segment reported net income of $39 million for the year ended December 31, 2017, compared to net income of $46 million for the year ended December 31, 2016. The $7 million decrease was primarily due to a $15 million increase in noninterest expense primarily driven by higher compensation and benefits expense to support strategic growth initiatives and increased FDIC premiums due to higher balances. In addition, the provision for loan losses increased $14 million and noninterest income decreased $13 million, driven by a decrease in net gain on loan sales, primarily due to the sale of performing residential loans out of the LHFI portfolio during 2016. These were partially offset by an increase in net interest income of $32 million primarily due to loan growth as our CRE and C&I portfolios increased by $671 million and $427 million, respectively, during the year ended December 31, 2017.

Mortgage Originations

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

Mortgage Originations	For the Years Ended December 31, 2018	2017	2016
	(Dollars in millions)		
Summary of Operations			
Net interest income	$128	$129	$90
(Provision) benefit for loan losses	(2)	(4)	(2)
Net interest income after (provision) benefit for loan losses	126	125	88
Net gain on loan sales	212	278	310
Other noninterest income	101	92	43
Total noninterest income	313	370	353
Compensation and benefits	(105)	(100)	(81)
Other noninterest expense and directly allocated overhead	(161)	(163)	(123)
Total noninterest expense	(266)	(263)	(204)
Income before indirect overhead allocations and income taxes	173	232	237
Overhead allocation	(68)	(63)	(54)
(Provision) for income taxes	(22)	(59)	(64)
Net income	$83	$110	$119
Key Metrics			
Efficiency Ratio	60.4%	52.7%	46.0%
Return on average assets	1.5%	2.0%	2.7%
Mortgage rate lock commitments (fallout-adjusted) (1)	$30,308	$32,527	$29,372
Average number of FTE employees	1,517	1,440	1,063

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

2018 compared to 2017

The Mortgage Originations segment reported net income of $83 million for the year ended December 31, 2018, compared to $110 million for the year ended December 31, 2017. The $27 million decrease was primarily due to a $66 million decrease in net gain on loan sales driven by a 17 basis point decline in net gain on loan sale margin and $2.2 billion lower fallout-adjusted rate locks. The decrease in volume was primarily driven by overall lower mortgage market volume. Additionally, continued excess operating capacity across the industry and pricing competition continues to put pressure on our mortgage business. Lower margin was primarily driven by secondary margin compression and a shift in channel mix toward the lower margin, but lower cost delegated correspondent channel, partially offset by an improvement in securitization performance. The decrease in net gain on loan sales was partially offset by a $14 million increase in net return on MSRs primarily driven by lower prepayments and stronger valuations, along with a higher average MSR balance.

2017 compared to 2016

The Mortgage Originations segment reported net income of $110 million for the year ended December 31, 2017, compared to $119 million for the year ended December 31, 2016. During 2017, we acquired Opes Advisors, a California based retail mortgage originator, which contributed to a $68 million increase in noninterest expense driven by higher compensation and benefits, as well as higher commissions resulting from increased mortgage volume. In addition, net gain on loan sales decreased $32 million driven by a 21 basis point decrease in margin resulting from competitive factors and a shift in product mix with higher correspondent volume resulting from our acquisition of Stearns Lending. These decreases were partially offset by a $48 million increase in net return on MSRs and a $39 million increase in net interest income resulting from increased mortgage volume and longer turn times to take advantage of attractive spreads.

The following tables disclose residential first mortgage loan originations by channel, type and mix:

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Correspondent	$24,093	$25,769	$24,488	$20,543	$18,052
Broker	3,967	5,025	5,890	7,335	5,339
Retail	4,405	3,614	2,039	1,490	1,194
Total	$32,465	$34,408	$32,417	$29,368	$24,585
Purchase originations	$22,041	$19,357	$13,672	$13,696	$14,654
Refinance originations	10,424	15,051	18,745	15,672	9,931
Total	$32,465	$34,408	$32,417	$29,368	$24,585
Conventional	$15,654	$16,962	$18,156	$17,571	$15,158
Government	9,329	8,635	7,859	6,385	6,134
Jumbo	7,482	8,811	6,402	5,412	3,293
Total	$32,465	$34,408	$32,417	$29,368	$24,585

Correspondent. In the correspondent channels, an unaffiliated bank or mortgage company completes the loan paperwork and also funds the loan at closing. After the bank or mortgage company has funded the transaction, we purchase the loan at an agreed upon price. We perform a full review of each loan, whether purchased in bulk or not, purchasing only those loans that were originated in accordance with our underwriting guidelines. Correspondents apply to the Bank and may be approved for delegated underwriting authority. Delegated correspondents assume the risks associated with the underwriting of the loan and earn more on loans sold compared to non-delegated correspondents. Non-delegated correspondents earn commissions and administrative fees for closing and funding loans which are then underwritten by the Bank. Loans originated through the correspondent lending channel typically result in a lower gain on sale margin but also have lower costs. At December 31, 2018, we had active relationships with 558 delegated correspondents and 601 non-delegated correspondents servicing borrowers in all 50 states.

Broker. In a broker transaction, an unaffiliated mortgage broker completes several steps of the loan origination process including the loan paperwork, but the loans are underwritten by us on a loan-level basis to our underwriting standards and we fund and close the loan in the Bank's name, thereby becoming the lender of record. At December 31, 2018, we had active broker relationships with nearly 900 mortgage brokers servicing borrowers in all 50 states.

Retail. In our distributed retail channel, loans are originated through our nationwide network of stand-alone home loan centers. At December 31, 2018, we maintained 75 retail locations in 24 states representing the combined retail branches of Flagstar Bank and its Opes Advisors mortgage division. In a direct-to-consumer lending transaction, loans are originated through our direct-to-consumer team or from one of our two national call centers, both of which may leverage our existing customer relationships. When loans are originated on a retail basis, most aspects of the lending process are completed internally, including the origination documentation (inclusive of customer disclosures), as well as the funding of the transactions, which typically results in higher internal costs but also higher gain on sale margins.

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 supports interest-earning asset generation in the Community Bank and Mortgage Origination 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	For the Years Ended December 31, 2018	2017	2016
	(Dollars in millions)		
Summary of Operations			
Net interest income	$7	$11	$21
Noninterest income	94	66	60
Compensation and benefits	(19)	(16)	(15)
Other noninterest expense and directly allocated overhead	(70)	(61)	(63)
Total noninterest expense	(89)	(77)	(78)
Income before indirect overhead allocations and income taxes	12	—	3
Overhead allocations	(20)	(23)	(23)
Benefit for income taxes	2	8	7
Net loss	$(6)	$(15)	$(13)
Key Metrics			
Efficiency Ratio	87.7%	100.0%	96.3%
Return on average assets	(18.0)%	(41.7)%	(46.4)%
Average number of residential loans serviced	562,419	405,568	361,265
Average number of FTE employees	228	199	194

2018 compared to 2017

The Mortgage Servicing segment reported a net loss of $6 million for the year ended December 31, 2018, compared to a net loss of $15 million for the year ended December 31, 2017. The improvement was primarily due to growth in our subservicing business, which increased by nearly 400,000 loans, or 87 percent, for the year ended December 31, 2018 compared to the year ended December 31, 2017. The increase in loan servicing volume drove higher noninterest income, including a $19 million increase in loan administration income and a $9 million increase in ancillary fees, offset by a decrease in net interest income, driven by higher interest paid on custodial balances and an increase in noninterest expense to support the growth in volume.

2017 compared to 2016

The Mortgage Servicing segment reported a net loss of $15 million for the year ended December 31, 2017, compared to a net loss of $13 million for the year ended December 31, 2016. The decrease in net interest income was primarily due to higher amounts paid to subservice clients for custodial balances which is driven by higher market rates and increased volume. This decrease was partially offset by higher noninterest income primarily due to an increase in the number of loans subserviced for others, which grew by nearly 90,000 loans, or 40.8 percent, for the year ended December 31, 2017 as compared to the year ended December 31, 2016.

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

	December 31, 2018		December 31, 2017		December 31, 2016	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts
	(Dollars in millions)					
Residential loan servicing						
Subserviced for others (2)	$146,040	705,149	$65,864	309,814	$43,127	220,075

Serviced for others	21,592	88,434	25,073	103,137	31,207	133,270
Serviced for own loan portfolio (3)	7,192	32,920	7,013	29,493	5,816	29,244
Total residential loans serviced	$174,824	826,503	$97,950	442,444	$80,150	382,589

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

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

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

At December 31, 2018, the number of residential loans serviced and the UPB of those loans increased by 384,059 and $76.9 billion, respectively, compared to December 31, 2017. Loans subserviced for others drove the increase in total residential loans serviced growing by 395,335 loans and $80.2 billion UPB. We continue to grow our subservicing business by onboarding non-Flagstar originated loans and through the sale of MSRs that were originated by Flagstar where we continue to subservice the underlying loans. Of the $28.8 billion UPB of MSRs sold during 2018, we retained subservicing on 100 percent of these sales. Our continued growth in our subservicing business and the strength of our platform has made us the 6th largest subservicer in the nation with capacity for further growth.

Loans Serviced for Others

The following table presents the characteristics of the mortgage loans serviced for others.

	At December 31,		
	2018	2017	2016
	(Dollars in millions)		
Average UPB per loan	$244	$243	$234
Weighted average service fee (basis points)	36.0	28.8	26.6
Weighted average coupon	4.38 %	4.05 %	3.88 %
Weighted average original maturity (months)	352	330	325
Weighted average age (months)	13	11	15
Average current FICO score (1)	697	728	746
Average original LTV ratio	88.6 %	77.7 %	71.9 %
Housing Price Index LTV, as recalculated (2)	83.1 %	73.3 %	65.6 %
Delinquencies:			
30-59 days past due	$535	$250	$155
60-89 days past due	153	71	26
90 days or greater past due	126	125	102
Total past due	$814	$446	$283

(1) Current FICO scores obtained at various times during the life of the loan.

(2) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level FHFA data as of September 30, 2018.

Loans Subserviced for Others

The following table presents the characteristics of the mortgage loans subserviced for others.

	At December 31,		
	2018	2017	2016
	(Dollars in millions)		
Average UPB per loan (thousands)	$207	$213	$196
Weighted average service fee (basis points)	29.3	28.3	31.0
Weighted average coupon	3.99 %	3.85 %	3.83 %
Weighted average original maturity (months)	268	307	337
Weighted average age (months)	38	36	39
Average current FICO score (1)	738	734	728
Average original LTV ratio	51.3 %	71.1 %	81.1 %
Housing Price Index LTV, as recalculated (2)	67.8 %	62.4 %	65.3 %
Delinquencies:			
30-59 days past due	$3,745	$954	$614
60-89 days past due	866	276	164
90 days or greater past due	1,620	692	441
Total past due	$6,231	$1,922	$1,219

(1) Current FICO scores obtained at various times during the life of the loan.

(2) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level FHFA data as of September 30, 2018.

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. In addition, the Other segment includes revenue and expenses not directly assigned or allocated to the Community Banking, Mortgage Originations or Mortgage Servicing segments.

	For the Years Ended December 31,		
Other	2018	2017	2016
	(Dollars in millions)		
Summary of Operations			
Net interest income (1)	$48	$12	$6
(Provision) benefit for loan losses	12	2	—
Net interest income after (provision) benefit for loan losses	60	14	6
Noninterest income (1)	4	13	40
Compensation and benefits	(124)	(121)	(117)
Other noninterest expense and directly allocated overhead (1)	(53)	(28)	(16)
Total noninterest expense	(177)	(149)	(133)
Income (loss) before indirect overhead allocations and income taxes	(113)	(122)	(87)
Overhead allocations	127	127	112
(Provision) benefit for income taxes	—	(76)	(6)
Net income (loss)	$14	$(71)	$19

Key Metrics			
Average number of FTE employees	1,049	976	932

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

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2018 compared to 2017

The Other segment reported net income of $14 million for the year ended December 31, 2018, compared to net loss of $71 million for the year ended December 31, 2017. The increase in net income was primarily due to the charge to the provision for income taxes during the fourth quarter of 2017 of approximately $80 million, resulting from the new tax legislation that required revaluation of our DTAs at a lower corporate statutory rate. In addition, net interest income increased $36 million primarily due to $29 million of hedging gains reclassified from AOCI. Noninterest income also increased $9 million as the result of higher dividend income on FHLB stock and a FHLB stock supplemental dividend which we received in the first quarter of 2018. These increases were partially offset by an increase of $28 million in noninterest expense primarily due to acquisition related expenses from the Wells Fargo branches and additional expenses to support business growth.

2017 compared to 2016

The Other segment reported net loss of $71 million for the year ended December 31, 2017, as compared to net income of $19 million for the year ended December 31, 2016. The decrease in net income was primarily due to the charge to the provision for income taxes of approximately $80 million, resulting from the new tax legislation that required revaluation of our DTAs at a lower corporate statutory rate. In addition, the year ended December 31, 2016 saw an increase in noninterest income primarily due to the $24 million decrease in the fair value of the DOJ settlement liability.

RISK MANAGEMENT

Certain risks are inherent in our business and include, but are not limited to, credit, regulatory compliance, legal, reputation, liquidity, market, operational, and strategic. We continually 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 from unexpected losses arising from these risks.

A discussion of risks affecting us can be found in the Risk Factors section included in Item 1A. of this Form 10-K.

Credit Risk

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

We maintain credit limits, in compliance with regulatory requirements. Under the Home Owners Loan Act (HOLA), the Bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15 percent of Tier 1 and Tier 2 capital plus any portion of the allowance for loan losses not included in the Tier 2 capital. This limit was $256 million as of December 31, 2018. We maintain a more conservative maximum internal Bank credit limit than required by HOLA, of $100 million to any one borrower/obligor relationship, with the exception of warehouse borrower/obligor relationships, which have a higher internal Bank limit of $125 million as all advances are fully collateralized by residential mortgage loans. We have a tracking and reporting process to monitor lending concentration levels and all credit exposures to a single 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 December 31, 2018, we had $5 billion in our commercial loan portfolio with our home builder finance and warehouse lending businesses accounting for 43 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. For all of our commercial loans, we use strict underwriting standards and adhere to granular concentration limits to manage the credit risk in our portfolio.

We have built our consumer loan portfolio by adding high quality first mortgage loans to our balance sheet making up 74.2 percent of our total consumer loan portfolio. We have also grown our home equity loans and lines of credit as well as our other consumer loan portfolio. The consumer loan portfolio has been built on strong underwriting criteria and within concentration limits intended to diversify our risk profile.

Loans held-for-investment

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

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Consumer loans					
Residential first mortgage	$2,999	$2,754	$2,327	$3,100	$2,193
Home equity (1)	731	664	443	519	406
Other	314	25	28	31	31
Total consumer loans	4,044	3,443	2,798	3,650	2,630
Commercial loans					
Commercial real estate	2,152	1,932	1,261	814	620
Commercial and industrial	1,433	1,196	769	552	429
Warehouse lending	1,459	1,142	1,237	1,336	769
Total commercial loans	5,044	4,270	3,267	2,702	1,818
Total loans held-for-investment	$9,088	$7,713	$6,065	$6,352	$4,448

(1) Includes second mortgages, HELOCs, and HELOANs.

Loans held-for-investment increased $1.4 billion at December 31, 2018, from December 31, 2017. The increase was primarily due to continued growth in our Community Banking segment, along with our 2018 acquisitions boosting warehouse lending and consumer loans.

We continue to strengthen our Community Banking segment by growing interest earning assets. Our commercial loan portfolio has grown $774 million, or 18.1 percent, since December 31, 2017, led by a $317 million increase in our warehouse loans, primarily due to our Santander warehouse business acquisition. Our consumer loan portfolio has increased $601 million, or 17.5 percent, since December 31, 2017, led by a $289 million increase in other consumer loans primarily due to new product offerings and a $245 million increase in residential first mortgage loans.

The following table provides a comparison of activity in our LHFI portfolio:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Balance, beginning of year	$7,713	$6,065	$6,352	$4,448	$4,056
Loans originated and purchased	2,113	2,170	1,771	2,975	894
Change in lines of credit	3,973	2,982	957	678	424
Loans transferred from loans held-for-sale	—	1	2	32	56
Loans transferred to loans held-for-sale	(279)	(130)	(1,309)	(1,198)	(509)
Loan amortization / prepayments	(4,425)	(3,373)	(1,700)	(569)	(451)
Loans transferred to repossessed assets	(7)	(2)	(8)	(14)	(22)
Balance, end of year	$9,088	$7,713	$6,065	$6,352	$4,448

Residential first mortgage loans. We originate or purchase various types of conforming and non-conforming fixed and adjustable rate loans underwritten using Fannie Mae and Freddie Mac guidelines for the purpose of purchasing or refinancing owner occupied and second home properties. We typically hold certain mortgage loans in LHFI that do not qualify for sale to the Agencies or that have an attractive 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.

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

	At December 31,	
	2018	2017
	(Dollars in millions)	
Estimated LTVs (1)		
Less than 80% and refreshed FICO scores (2):		
Equal to or greater than 660	$2,462	$2,496
Less than 660	54	66
80% and greater and refreshed FICO scores (2):		
Equal to or greater than 660	448	179
Less than 660	29	10
U.S. government guaranteed	6	3
Total	$2,999	$2,754
Geographic region		
California	$1,238	$1,125
Michigan	314	265
Washington	195	168
Florida	195	200
Texas	193	182
Illinois	103	101
New York	73	62
Arizona	72	76
Colorado	72	68
Maryland	57	64
Others	487	443
Total	$2,999	$2,754

(1) LTVs reflect loan balance at the date reported, as a percentage of property values as appraised at loan origination.
(2) FICO scores are updated at least on a quarterly basis or more frequently if available.

The following table presents our total residential first mortgage LHFI as of December 31, 2018, by year of origination:

	2018	2017	2016	2015	2014 and Prior	Total
	(Dollars in millions)					
Residential first mortgage loans	$679	$729	$570	$646	$375	$2,999
Percent of total	22.6 %	24.3 %	19.0 %	21.5 %	12.5 %	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 is capped at 43 percent and for HELOCs is capped at 45 percent. We currently limit the maximum CLTV to 89.99 percent and FICO scores to a minimum of 660. Second mortgage loans/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 December 31, 2018, HELOCs and HELOANs in a first lien position totaled $129 million.

Other consumer loans. Our other consumer loan portfolio consists of secured and unsecured loans originated through our branches and our indirect lending business. At December 31, 2018, other consumer loans increased to $314 million compared to $25 million at December 31, 2017. This increase is primarily due to growth of $154 million in our indirect lending business, as Flagstar has established relationships with dealers for the origination of boat and recreational vehicle consumer loans, and an increase in unsecured consumer loans resulting from new product growth and the addition of $74 million of acquired loans from Wells Fargo.

Commercial real estate loans. The commercial real estate portfolio contains loans collateralized by diversified property types which are primarily income producing in the normal course of business. The majority of our retail exposure is to neighborhood strip centers and single tenant locations, which include drug stores, and we have no loans collateralized by malls. Generally, the maximum LTV is 80 percent, or 85 percent for owner-occupied real estate, and debt service coverage of 1.20 to 1.35 times. At December 31, 2018, our average LTV and average debt service coverage for our CRE portfolio was 53 percent and 1.95 times, respectively. Our CRE loans earn interest at a variable rate.

We have established a national home builder finance program and at December 31, 2018, our commercial portfolio contained $718 million in outstanding home builder loans. The majority of these loans are collateralized and included in either the single family residence or land residential categories of our CRE portfolio while the remaining loans are unsecured and included in our C&I portfolio.

The following table presents our home builder finance commitments and outstanding balances by loan category.

	At December 31, 2018	2017
	(Dollars in millions)	
Commitments	$1,422	$1,284
Outstanding balance (UPB)		
Commercial real estate	$591	$497
Commercial and industrial	127	104
Total outstanding balance (UPB)	$718	$601

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

	MI	TX	CO	CA	FL	Other	Total	% by collateral type
	(Dollars in millions)							
December 31, 2018								
Single family residence (1)	$17	$102	$130	$67	$79	$63	$458	21.3 %
Owner occupied	261	4	—	27	5	55	352	16.4 %
Retail (2)	185	1	4	7	—	99	296	13.8 %
Multi family	106	35	18	7	37	40	243	11.3 %
Office	175	—	—	16	3	21	215	10.0 %
Land - Residential (3)	4	45	19	27	26	47	168	7.8 %
Hotel/motel	92	17	—	9	—	33	151	7.0 %
Senior Living facility	17	25	—	—	—	65	107	5.0 %
Industrial	47	—	—	—	—	37	84	3.9 %
All other (4)	37	3	1	2	8	27	78	3.5 %
Total	$941	$232	$172	$162	$158	$487	$2,152	100.0 %
Percent by state	43.7 %	10.8 %	8.0 %	7.5 %	7.3 %	22.7 %	100.0 %	

(1) Includes home builder loans secured by SFR 1-4 properties whether under construction or completed.
(2) Includes multipurpose retail space, neighborhood centers, strip centers and single-use retail space
(3) Includes home builder loans secured by land. Land residential includes development and unimproved vacant land.
(4) All other primarily includes: parking garage, non-profit, mini-storage facilities, data centers, movie theater, 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.

The following table presents our total C&I LHFI by borrower's geographic location and industry type:

	MI	CA	OH	IN	WI	TX	FL	CT	Other	Total	% by industry
	(Dollars in millions)										
December 31, 2018											
Financial & Insurance	$33	$2	$16	$16	$21	$—	$68	$6	$197	$359	25.0 %
Services	103	45	3	7	1	19	2	44	67	291	20.3 %
Manufacturing	108	5	40	1	5	13	—	—	97	269	18.8 %
Home Builder Finance	—	4	6	—	—	78	3	—	36	127	8.9 %
Healthcare	2	14	1	1	19	9	1	—	58	105	7.3 %
Distribution	78	19	2	2	—	—	—	—	—	101	7.0 %
Government & Education	33	4	—	23	—	—	—	23	—	83	5.8 %
Rental & Leasing	57	—	—	1	—	—	—	—	13	71	5.0 %
Servicing Advances	—	—	—	—	—	—	—	—	16	16	1.1 %
Commodities	5	—	—	1	—	—	—	—	5	11	0.8 %
Total	$419	$93	$68	$52	$46	$119	$74	$73	$489	$1,433	100.0 %
Percent by state	29.2 %	6.5 %	4.7 %	3.6 %	3.2 %	8.3 %	5.2 %	5.1 %	34.1 %	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.

The following table presents our warehouse advance amount of loans sold to the Bank:

	For the Years Ended December 31,	
	2018	2017
	(Dollars in millions)	
UPB of warehouse loans sold to the bank	$8,590	$10,824
Loans sold to the bank as a percentage of advances	25.5 %	37.4 %

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 December 31, 2018 was $3.8 billion, of which $1.5 billion was outstanding, compared to $2.8 billion at December 31, 2017, of which $1.1 billion was outstanding. This increase is primarily due to our acquisition of the warehouse lending business from Santander Bank in March of 2018.

Loan Principal Payments

The following tables set forth the expected repayment of our LHFI, both as fixed rate and adjustable-rate loans:

	December 31, 2018			
	Within 1 Year	1 Year to 5 Years	Over 5 Years	Totals (1)
	(Dollars in millions)			
Fixed Rate Loans				
Residential first mortgage	$13	$41	$234	$288
Home Equity	7	31	70	108
Other consumer	18	69	223	310
Commercial real estate	17	64	—	81
Commercial and industrial	48	205	61	314
Total fixed rate loans	$103	$410	$588	$1,101
Adjustable Rate Loans				
Residential first mortgage	$58	$257	$2,373	$2,688
Home Equity	9	41	561	611
Commercial real estate	630	1,466	—	2,096
Commercial and industrial	227	893	—	1,120
Warehouse lending	1,506	—	—	1,506
Total adjustable rate loans	$2,430	$2,657	$2,934	$8,021

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

Credit Quality

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

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 certain information about our nonperforming assets:

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
LHFI					
Consumer Loans					
Residential first mortgages	$11	$12	$18	$27	$72
Home equity	1	1	4	2	2
Commercial Loans					
Commercial and industrial	—	—	—	2	—
Total nonperforming LHFI	12	13	22	31	74
TDRs					
Consumer Loans					
Residential first mortgages	8	12	11	27	43
Home equity	2	4	7	8	3
Total nonperforming TDRs	10	16	18	35	46
Total nonperforming LHFI and TDRs (1)	22	29	40	66	120
Real estate and other nonperforming assets, net	7	8	14	17	19
LHFS	10	9	6	12	15
Total nonperforming assets	$39	$46	$60	$95	$154
Nonperforming assets to total assets (2)	0.16%	0.22%	0.39%	0.61%	1.41 %
Nonperforming LHFI and TDRs to LHFI	0.24%	0.38%	0.67%	1.05%	2.71 %
Nonperforming assets to LHFI and repossessed assets (2)	0.32%	0.48%	0.90%	1.32%	3.12 %

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

(2) Ratio excludes LHFS.

At December 31, 2018, we had $39 million of nonperforming assets compared to $46 million of nonperforming assets at December 31, 2017. This decrease was primarily due to a $6 million reduction in TDRs primarily resulting from principal payments and payoffs during the year ended December 31, 2018. As reflected in the table above, our nonperforming loans have decreased substantially and we have experienced continued improvements in our credit quality ratios since December 31, 2014. The overall improvement in our nonperforming assets and credit quality ratios is due to our continued effort to grow our loan portfolio with strong credit quality loans, combined with a slowing emergence of nonperforming loans driven by decreased levels of delinquencies.

In addition to our focus on improving our loan portfolio with strong credit quality loans, we have historically reduced our balance sheet risk by selling nonperforming loans. During the year ended December 31, 2018, sales of nonperforming and TDR loans were de minimis. The following table sets forth the UPB of nonperforming loans and TDRs sold in prior years:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Nonperforming loans	$—	$14	$110	$109	$62
TDRs	—	11	—	327	30
Total sales of nonperforming loans and TDRs	$—	$25	$110	$436	$92

Delinquencies

The following table sets forth our performing LHFI which are past due 30-89 days:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Performing loans past due 30-89:					
Consumer loans					
Residential first mortgage	$6	$ 4	$ 6	$ 10	$ 37
Home equity	1	1	3	3	7
Other	—	—	1	1	—
Total performing loans past due 30-89 days	$7	$ 5	$ 10	$ 14	$ 44

As a result of our continued focus on growing our loan portfolio with high quality loans, early stage delinquencies remained low as loans 30 to 89 days past due were $7 million and $5 million at December 31, 2018 and December 31, 2017, respectively.

Troubled debt restructurings (held-for-investment)

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

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

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Performing TDRs					
Residential first mortgage	$22	$ 19	$ 22	$49	$306
Home equity	22	24	45	52	56
Total performing TDRs	44	43	67	101	362
Nonperforming TDRs					
Nonperforming TDRs	3	5	8	7	29
Nonperforming TDRs at inception but performing for less than six months	7	11	10	28	17
Total nonperforming TDRs	10	16	18	35	46
Total TDRs	$54	$ 59	$ 85	$136	$408
ALLL on consumer TDR loans	$10	$ 13	$ 9	$15	$81

At December 31, 2018, our total TDR loans decreased to $54 million compared to $59 million at December 31, 2017, primarily due to principal payments and payoffs out-pacing new additions. Of our total TDR loans, 82.0 percent were in performing status at December 31, 2018. For further information, see Note 5 - Loans Held-for-Investment.

Allowance for Loan Losses

The ALLL represents management's estimate of probable losses that are inherent in our LHFI portfolio but which have not yet been realized. For further information, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards and Note 5 - Loans Held-for-Investment.

The ALLL was $128 million and $140 million at December 31, 2018 and 2017, respectively. The decrease from December 31, 2017 was primarily driven by continued strong credit quality, including low levels of net charge-offs and delinquencies, offset by growth in the LHFI portfolio.

The ALLL as a percentage of LHFI decreased to 1.4 percent as of December 31, 2018 from 1.8 percent as of December 31, 2017. This decrease is attributable to loan growth of $1.4 billion UPB, consisting of high credit quality assets in both the consumer and commercial loan portfolios, including growth in our lower risk, fully collateralized warehouse portfolio, in addition to sustained low levels charge-offs and delinquencies. At December 31, 2018, both our consumer loan portfolio and our commercial loan portfolio had a 1.4 percent allowance coverage.

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

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

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

The following tables set forth certain information regarding our ALLL and the ALLL allocation over the past five years:

	At December 31,									
	2018		2017		2016		2015		2014	
	Allowance Amount	Allowance to Total Loans	Allowance Amount	Allowance to Total Loans	Allowance Amount	Allowance to Total Loans	Allowance Amount	Allowance to Total Loans	Allowance Amount	Allowance to Total Loans
	(Dollars in millions)									
Consumer loans										
Residential first mortgage	$38	0.4 %	$47	0.6 %	$65	1.1 %	$116	1.9 %	$234	5.6 %
Home equity	15	0.2 %	22	0.3 %	24	0.4 %	32	0.5 %	31	0.7 %
Other consumer	3	— %	1	— %	1	— %	2	— %	1	— %
Total consumer loans	56	0.6 %	70	0.9 %	90	1.5 %	150	2.4 %	266	6.3 %
Commercial loans										
Commercial real estate	48	0.5 %	45	0.6 %	28	0.5 %	18	0.3 %	17	0.4 %
Commercial and industrial	18	0.2 %	19	0.2 %	17	0.3 %	13	0.2 %	11	0.2 %
Warehouse lending	6	0.1 %	6	0.1 %	7	0.1 %	6	0.1 %	3	0.1 %
Total commercial loans	72	0.8 %	70	0.9 %	52	0.9 %	37	0.6 %	31	0.7 %
Total loans held-for-investment (1)	$128	1.4 %	$140	1.8 %	$142	2.4 %	$187	3.0 %	$297	7.0 %

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

The following table presents changes in our ALLL:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Beginning balance	$140	$142	$187	$297	$207
Provision (benefit) for loan losses (1)	(8)	6	(15)	(19)	132
Charge-offs					
Consumer loans					
Residential first mortgage	(4)	(8)	(29)	(87)	(38)
Home equity	(2)	(3)	(4)	(7)	(9)
Other consumer	(2)	(2)	(3)	(4)	(2)
Total consumer loans	(8)	(13)	(36)	(98)	(49)
Commercial loans					
Commercial real estate	—	(1)	—	—	(3)
Commercial and industrial	—	—	—	(3)	—
Total commercial loans	—	(1)	—	(3)	(3)
Total charge offs	(8)	(14)	(36)	(101)	(52)
Recoveries					
Consumer loans					
Residential first mortgage	2	1	2	3	3
Home equity	1	2	—	2	1
Other consumer	1	1	3	3	3
Total consumer loans	4	4	5	8	7
Commercial loans					
Commercial real estate	—	1	1	2	3
Commercial and industrial	—	1	—	—	—
Total commercial loans	—	2	1	2	3
Total recoveries	4	6	6	10	10
Charge-offs, net of recoveries	(4)	(8)	(30)	(91)	(42)
Ending balance	$128	$140	$142	$187	$297
Net charge-off to LHFI ratio (2)	0.04 %	0.12 %	0.52 %	1.85 %	1.07 %

(1) Does not include $7 million provision expense recorded in the Consolidated Statements of Operations to reserve for repossessed loans with government guarantees at December 31, 2016. There was no provision for loan losses for repossessed loans with government guarantees recorded during the years ended December 31, 2018, 2017, 2015, and 2014.

(2) Excludes loans carried at fair value.

The following table provides information on our charge-offs, net of recoveries:

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Charge-offs, net of recoveries	$ 4	$ 8	$ 30	$ 91	$ 42
Charge-offs associated with loans with government guarantees	2	4	14	3	—
	—	1	8	69	15

Charge-offs associated with the sale or transfer of nonperforming loans and TDRs					
Charge-offs, net of recoveries, adjusted	$ 2	$ 3	$ 8	$ 19	$ 27

Net Charge-offs for the year ended December 31, 2018 decreased to $4 million compared to $8 million for the year ended December 31, 2017. As a percentage of average LHFI, net charge-offs for the year ended December 31, 2018 decreased to 0.04 percent from 0.12 percent for the year ended December 31, 2017.

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 prices. Our primary market risk is interest rate risk which impacts our net interest income, fee income related to interest sensitive activities such as mortgage origination and servicing income, and loan and deposit demand.

We are subject to interest rate risk due to:

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

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

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

Net interest income sensitivity

Management uses a simulation model to analyze the sensitivity of net interest income to changes in interest rates across various interest rate scenarios which demonstrates the level of interest rate risk inherent in the existing balance sheet. The analysis holds the current balance sheet values constant and does not take into account management intervention. In addition, we assume certain correlation rates, often referred to as a “deposit beta,” of 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 200 basis points) resulting in the shape of the yield curve remaining unchanged. For the scenarios simulated, our established Board policy limit on the change in net interest income, is 15 percent. At December 31, 2018 and December 31, 2017, the results of the simulation were within the Board policy limits.

December 31, 2018

Scenario	Net interest Income	$ Change	% Change
(Dollars in millions)			
200	$503	$25	5.2 %
Constant	478	—	— %
(200)	449	(29)	(6.1)%

December 31, 2017

Scenario	Net interest Income	$ Change	% Change

(Dollars in millions)			
200	$449	$16	3.6 %
Constant	433	—	— %
(200)	397	(37)	(8.5)%

In the net interest income simulations, our balance sheet exhibits slight asset sensitivity. When interest rates rise our net interest income increases. Conversely, when interest rates fall our net interest income decreases. At December 31, 2018, the $45 million increase in the net interest income in the constant scenario as compared to December 31, 2017, was primarily driven by growth in our net interest earning assets along with a decrease in our cost of funding.

As of December 31, 2018 we have also projected the potential impact to net interest income in a hypothetical "bear flattener" interest rate scenario, in which short-term interest rates have been instantaneously increased by 100 basis points while holding the longer term interest rates constant. Over a 12-month and 24-month period, based on our existing balance sheet, the simulation resulted in a loss of $15 million and $134 million, respectively.

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. The direction of future interest rates not moving in a parallel manner across the yield curve, how the balance sheet will respond and shift based on a change in future interest rates and how the Company will respond are not included in this analysis and limit the predictive value of these scenarios.

Economic value of equity

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

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.

December 31, 2018					December 31, 2017					
Scenario	EVE	EVE%	$ Change	% Change	Scenario	EVE	EVE%	$ Change	% Change	Policy Limits
(Dollars in millions)										
300	$1,617	8.8 %	$ (223)	(12.1)%	300	$1,941	11.6 %	$ (172)	(8.1)%	22.5 %
200	1,720	9.4 %	(120)	(6.5)%	200	2,020	12.0 %	(93)	(4.4)%	15.0 %
100	1,794	9.8 %	(46)	(2.5)%	100	2,089	12.4 %	(24)	(1.2)%	7.5 %
Current	1,840	10.0 %	—	— %	Current	2,113	12.6 %	—	— %	— %
(100)	1,849	10.1 %	9	0.5 %	(100)	2,082	12.4 %	(31)	(1.5)%	7.5 %

Our balance sheet exhibits liability sensitivity in a rising interest rate scenario. The decrease in EVE is the result of the amount of liabilities that would be expected to reprice exceeding the amount of assets repriced in the +200 scenario. At December 31, 2018 and December 31, 2017, for each scenario shown, the percentage change in our EVE is within our internal policy limit.

Derivative financial instruments

As a part of our risk management strategy, we use derivative financial instruments to minimize fluctuation in earnings caused by market risk. We use forward sales commitments to hedge our unclosed mortgage origination pipeline and funded mortgage LHFS. All of our derivatives and mortgage loan production originated for sale are accounted for at fair market value. Changes to mortgage commitments 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, 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 12 - Derivative Financial Instruments and Note 22 - 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 11 - Mortgage Servicing Rights and Note 12 - Derivative Financial Instruments.

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 its ability to, at a reasonable cost, meet loan requests, 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, the repurchase of common stock and the payment of cash dividends, which will commence in the first quarter of 2019. At December 31, 2018, the Company held $201 million of cash at the Bank, or 3.2 years of future cash outflows, dividend payments, share repurchases and debt service coverage when excluding the redemption of $250 million of senior notes which mature on July 15, 2021.

The OCC and the FRB regulates 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. At December 31, 2018, as reported to the OCC, we passed the QTL test. For the year ended December 31, 2018, we paid dividends of $34 million from the Bank to the Bancorp. At December 31, 2018, the Bank is able to pay dividends without regulatory approval up to approximately $177 million.

Bank Liquidity

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

Further, other sources of liquidity include our LHFS portfolio and unencumbered investment securities. We primarily originate agency-eligible LHFS and therefore the majority of new residential first mortgage loan originations are readily convertible to cash, either by selling them as part of our monthly agency sales, RMBS, private party whole loan sales, or by pledging them to the FHLB and borrowing against them. In addition, we have the ability to sell unencumbered investment securities or use them as collateral. At December 31, 2018, we had $1.3 billion available in unencumbered investment securities.

Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. We balance the liquidity of our loan assets to our available funding sources. Our LHFI portfolio is 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 HFI loan-to-deposit ratio was 73 percent at December 31, 2018. Excluding warehouse loans, which have draws that typically pay off within a few weeks, and custodial deposits, which represent mortgage escrow accounts on deposit with the Bank, the HFI loan-to-deposit ratio was 72 percent at December 31, 2018.

As governed and defined by our Board liquidity policy, we maintain adequate excess liquidity levels appropriate to cover unanticipated liquidity needs. In addition to this liquidity, we also maintain targeted minimum levels of unused borrowing capacity as another cushion against unexpected liquidity needs. Each business day, we forecast 90 days of daily cash needs. This allows us to determine our projected near term daily cash fluctuations and also to plan and adjust, if necessary, future activities. As a result, in an adverse environment, we 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 originations, 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:

	December 31, 2018	December 31, 2017	Change
	(Dollars in millions)		
Retail deposits	$8,854	$ 6,497	$2,357
Government deposits	1,202	1,073	129
Wholesale deposits	583	43	540
Custodial deposits	1,741	1,321	420
Total deposits	12,380	8,934	3,446
Federal Home Loan Bank advances and other short-term debt	3,394	5,665	(2,271)
Other long-term debt	495	494	1
Total borrowed funds	3,889	6,159	(2,270)
Total funding	$16,269	$ 15,093	$1,176

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

	December 31, 2018	December 31, 2017	Change
	(Dollars in millions)		
Federal Home Loan Bank advances			
Outstanding Advances	$3,143	$ 5,665	$(2,522)
Borrowing capacity			
Line of credit	30	30	—
Collateralized borrowing capacity	2,810	733	2,077
Total unused borrowing capacity	2,840	763	2,077
FRB discount window			
Collateralized borrowing capacity	409	433	(24)
Unencumbered investment securities			
Agency - Commercial	737	590	147

Agency - Residential	475	562	(87)
Municipal obligations	28	31	(3)
Corporate debt obligations	41	37	4
Total unencumbered investment securities	$1,281	$ 1,220	$61

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Deposits

The following table sets forth the composition of our deposits:

	At December 31,					
	2018			2017		
	Balance	% of Deposits		Balance	% of Deposits	Change
	(Dollars in millions)					
Retail deposits						
Branch retail deposits						
Demand deposit accounts	$1,297	10.5	%	$560	6.3 %	$737
Savings accounts	2,812	22.7	%	3,295	36.9 %	(483)
Money market demand accounts	628	5.1	%	91	1.0 %	537
Certificates of deposit/CDARS (1)	2,387	19.3	%	1,494	16.7 %	893
Total branch retail deposits	7,124	57.6	%	5,440	60.9 %	1,684
Commercial deposits (2)						
Demand deposit accounts	1,243	10.0	%	697	7.8 %	546
Savings accounts	314	2.5	%	258	2.9 %	56
Money market demand accounts	173	1.4	%	102	1.1 %	71
Total commercial deposits	1,730	13.9	%	1,057	11.8 %	673
Total retail deposits	$8,854	71.5	%	$6,497	72.7 %	$2,357
Government deposits						
Demand deposit accounts	$326	2.6	%	$251	2.8 %	$75
Savings accounts	567	4.6	%	446	5.0 %	121
Certificates of deposit/CDARS (1)	309	2.5	%	376	4.2 %	(67)
Total government deposits	1,202	9.7	%	1,073	12.0 %	129
Wholesale deposits	583	4.7	%	43	0.5 %	540
Custodial deposits (3)	1,741	14.1	%	1,321	14.8 %	420
Total deposits (4)	$12,380	100.0	%	$8,934	100.0 %	$3,446

(1) The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was approximately $1.9 billion and $1.4 billion at December 31, 2018 and December 31, 2017, respectively.

(2) Includes 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 and that have been placed on deposit with the Bank.

(4) Total exposure to uninsured deposits over $250,000 was approximately $2.8 billion and $2.6 billion at December 31, 2018 and December 31, 2017, respectively.

Total deposits increased $3.4 billion, or 39 percent, at December 31, 2018, compared to December 31, 2017, primarily due to $1.8 billion and $614 million of deposits added during 2018 from the Wells Fargo Bank and Desert Community Bank branch acquisitions, respectively. In addition, custodial deposits increased $420 million, driven by an 87 percent increase in serviced accounts along with a $540 million increase in wholesale 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 allowed by the Michigan Business and Growth Fund. At December 31, 2018, we were required to hold $93 million in collateral for our government deposits in California that were in excess of $250,000. In Indiana, Wisconsin and Ohio, we may be required to hold collateral against our government deposits based on a variety of factors including, but not limited to, the size of individual deposits and external bank ratings. At December 31, 2018, collateral held on government deposits in these states was de minimis. Government deposit accounts included $309 million of certificates of deposit with maturities typically less than one year and $893 million in checking and savings accounts at December 31, 2018.

Custodial deposits arise due to our servicing or subservicing of loans for others and represent the investor custodial accounts on deposit with the Bank. 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 December 31, 2018, we had $177 million of total CDs enrolled in the CDARS program, a decrease of $13 million from December 31, 2017.

The following table indicates the scheduled maturities of our certificates of deposit with a minimum denomination of $100,000 by acquisition channel as of December 31, 2018:

	Retail Deposits	Government Deposits	Total
	(Dollars in millions)		
Twelve months or less	$1,166	$ 288	$1,454
One to two years	335	12	347
Two to three years	29	1	30
Three to four years	6	1	7
Four to five years	14	—	14
Thereafter	20	—	20
Total	$1,570	$ 302	$1,872

FHLB Advances

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

We rely upon advances from the FHLB as a source of funding for the origination or purchase of loans for sale in the secondary market and for providing duration specific short-term and long-term financing. The outstanding balance of FHLB advances fluctuates from time to time depending on our current inventory of mortgage LHFS and the availability of lower cost funding sources. Our current 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 December 31, 2018, our Board of Directors has authorized and approved a line of credit with the FHLB of up to $10.0 billion, which is further limited based on our total assets and qualified collateral, as determined by the FHLB. At December 31, 2018, we had $3.1 billion of advances outstanding and an additional $2.8 billion of collateralized borrowing capacity available at the FHLB. In the fourth quarter of 2018, $1.1 billion of our outstanding long-term FHLB advances were repaid with proceeds from the Wells Fargo branch acquisition.

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 December 31, 2018, we pledged collateral, which included commercial loans, municipal bonds, and agency bonds, to the Federal Reserve Discount Window amounting to $448 million with a lendable value of $409 million. At December 31, 2017, we pledged collateral to the Federal Reserve Discount Window amounting to $467 million with a lendable value of $433 million. We do not typically utilize this available funding source and at December 31, 2018 and December 31, 2017, we had no borrowings outstanding against this line of credit.

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 December 31, 2018, we are current on all interest payments.

For further information, see Note 14 - Borrowings.

Contractual Obligations

We have various financial obligations, some of which are contractual obligations, which require future cash payments. For further information on each item, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards, Note 10 - Premises and Equipment, Note 13 - Deposit Accounts and Note 14 - Borrowings.

The following table summarizes contractual obligations at December 31, 2018, and the future periods in which the obligations are expected to be settled in cash:

	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
	(Dollars in millions)				
Deposits without stated maturities	$7,361	$ —	$ —	$ —	$7,361
Certificates of deposits	2,509	705	37	28	3,279
Short-term FHLB advances and other borrowings	3,244	—	—	—	3,244
Long-term FHLB advances	50		—	100	150
Senior notes	—	248	—	—	248
Trust preferred securities	—	—	—	247	247
Operating leases	9	10	3	3	25
DOJ litigation settlement	—	—	—	118	118
Other (1)	24	12	—	1	37
Total	$13,197	$ 975	$ 40	$ 497	$14,709

(1) Includes contracts with vendors and commitments to various limited partnerships that invest in housing projects qualifying for the low income housing tax credit.

Operational Risk

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

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

Loans with government guarantees

Substantially all of our loans with government guarantees continue to be insured or guaranteed by the FHA or the U.S. Department of Veterans Affairs. In the event of a government guaranteed loan borrower default, Flagstar 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.

During the year ended December 31, 2018, we experienced net charge-offs of $2 million related to loans with government guarantees and have reserved for the remaining risks within other assets and as a component of our ALLL on residential first mortgages. These additional expenses or charges arise due to insurance limits on VA insured loans and FHA property foreclosure and preservation requirements that may result in a loss in excess of all, or part of, the guarantee.

Our loans with government guarantees portfolio totaled $392 million at December 31, 2018, as compared to $271 million at December 31, 2017. The increase is primarily due to new purchases out-pacing loans transferred to LHFS and resold to Ginnie Mae.

For further information, see Note 6 - Loans with Government Guarantees.

Regulatory Risks

Supervisory Agreement

The Supervisory Agreement originally dated January 27, 2010, was lifted by the Federal Reserve on August 14, 2018. For further information and a complete description of all of the terms of the Supervisory Agreement, please refer to the copy of the Supervisory Agreement filed with the SEC as an exhibit to our 2016 Form 10-K for the year ended December 31, 2016.

Department of Justice Settlement Agreement

On February 24, 2012, the Bank entered into a Settlement Agreement with the DOJ under which we made an initial payment of $15 million and agreed to make future payments totaling $118 million in annual increments of up to $25 million upon meeting all of the following conditions which are evaluated quarterly and include: (a) the reversal of the DTA valuation allowance, which occurred at the end of 2013; (b) the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "TARP Preferred"), which occurred in July 2016; and (c) the Bank having a Tier 1 Leverage Capital Ratio of 11 percent or greater as filed in the Call Report with the OCC. At December 31, 2018, the Company had a Tier 1 Leverage Capital Ratio of 8.67 percent.

No payment would be required until six months after the Bank files its Call Report 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 of $25 million would be due at that time. The next annual payment is only made if all conditions continue to be satisfied, otherwise payments are delayed until all such conditions are again met. Further, making such a payment must not violate any material banking regulatory requirement, and the OCC must not object in writing.
The combination of (a) future dividends from the Bank to Bancorp and (b) continued growth in earning assets at the Bank are expected to continue to limit the growth rate of the Bank’s Tier 1 Leverage Capital Ratio, which could have an impact on the timing of expected cash flows under the Settlement Agreement.

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

Additionally, if the Bank or Bancorp become party to a business combination in which the Bank and Bancorp represent less than 33.3 percent of the resulting company’s assets, annual payments would 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, which are impacted by estimates of equity, earnings, timing and amount of dividends and growth of the balance sheet and their related impacts on forecasted Tier 1 Leverage Capital Ratio, the likelihood of the Bank or Bancorp being a party to a business combination resulting in terms which would require payments to commence, or any other means by which a payment could be made. For further information on the fair value to the liability, see Note 22 - Fair Value Measurements.

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 8.29 percent at December 31, 2018 providing a 329 basis point stress buffer above the minimum level needed to be considered “well-capitalized.” Additionally, total risk-based capital to RWA was 13.63 percent at December 31, 2018 providing a 363 basis point stress buffer above the minimum level needed to be considered "well-capitalized".

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

Regulatory Capital Simplification

The Bank and Flagstar have been subject to the capital requirements of the Basel III rules since January 1, 2015. On October 27, 2017, the agencies issued a notice of proposed rulemaking (“NPR”) which would simplify certain aspects of the Basel III capital rules. The agencies expect that the capital treatment and transition provisions for items covered by this final rule will change once the simplification proposal is finalized and effective. Specifically, the proposal would increase the individual limit on MSRs and temporary difference DTAs to 25 percent of CET1 and eliminate the aggregate 15 percent CET1 deduction threshold for MSRs and temporary difference DTAs. In response to comments received from bankers and trade associations, the regulators may change these proposed rules prior to issuing them and it is uncertain when the rules will be issued in their final form. We are currently managing our capital in anticipation of the approval of the proposed rule.

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

Flagstar Bancorp	Actual		Well-Capitalized Under Prompt Corrective Action Provisions		Under Proposed Capital Simplification		Excess Capital Over Well-Capitalized Minimum (1)	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Current Rule	Capital Simplification Rules
	(Dollars in millions)							
December 31, 2018								
Tier 1 leverage capital (to adjusted avg. total assets)	$1,505	8.29 %	$ 908	5.0 %	$1,627	8.90 %	$ 597	$ 713
Common equity Tier 1 capital (to RWA)	1,265	10.54 %	780	6.5 %	1,387	10.97 %	485	565
Tier 1 capital (to RWA)	1,505	12.54 %	960	8.0 %	1,627	12.87 %	545	616
Total capital (to RWA)	1,637	13.63 %	1,201	10.0 %	1,758	13.91 %	436	495

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

As presented in the table above, our constraining capital ratio is our total capital to risk weighted assets at 13.63 percent. It would take a $436 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" and an after-tax loss of $495 million, under the proposed capital simplification rules.

In preparation for the NPR, the Basel III implementation phase-in has been halted for the treatment of MSRs and certain DTAs. The agencies issued a final rule that will maintain the capital rules’ 2017 transition provisions for several regulatory capital deductions and certain other requirements that are subject to multi-year phase-in schedules in the regulatory capital rules. Specifically, the final rule will maintain the capital rules’ 2017 transition provisions at 80 percent for the regulatory capital treatment of the following items: (i) MSRs, (ii) DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, (iii) investments in the capital of unconsolidated financial institutions, and (iv) minority interests. As of December 31, 2018, we had $290 million in MSRs, $48 million in DTAs arising from temporary differences and no material investments in unconsolidated financial institutions or minority interest. This final rule will maintain the 2017 transition provisions for certain items for non-advanced approach banks. For additional information on our capital requirements, see Note 20 - Regulatory Capital.

Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes non-GAAP financial measures such as tangible book value per share, tangible common equity to assets ratio, adjusted net income, adjusted diluted earnings per share, adjusted net interest income, adjusted net interest margin and adjusted interest rate spread. 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, adjusted net income, adjusted diluted earnings per share, adjusted net interest income, adjusted net interest margin, adjusted interest rate spread and adjusted noninterest expense. The Company believes that tangible book value per share, tangible common equity to assets ratio, adjusted earnings, and adjusted diluted earnings per share provides a meaningful representation of its operating performance on an ongoing basis. Management uses these measures to assess performance of the Company against its peers and evaluate overall performance. The Company believes these non-GAAP financial measures provide useful information for investors, securities analysts and others because it provides a tool to evaluate the Company’s performance on an ongoing basis and compared to its peers.

The following tables provide a reconciliation of non-GAAP financial measures.

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in millions)				
Total stockholders' equity	$1,570	$1,399	$1,336	$1,529	$1,373
Less: Preferred stock	—	—	—	267	267
Less: Goodwill and intangibles	190	21	—	—	—
Tangible book value	$1,380	$1,378	$1,336	$1,262	$1,106
Number of common shares outstanding	57,749,464	57,321,228	56,824,802	56,483,258	56,332,307
Tangible book value per share	$23.90	$24.04	$23.50	$22.33	$19.64
Total assets	$18,531	$16,912	$14,053	$13,715	$9,840
Tangible common equity to assets ratio	7.45 %	8.15 %	9.50 %	9.20 %	11.24 %

	Three Months Ended			Year Ended		
	December 31, 2018	September 30, 2018	December 31, 2017	December 31, 2018	December 31, 2017	December 31, 2016
	(Dollars in millions)					
Net income (loss)	$54	$ 48	$ (45)	$187	$ 63	$ 171
DOJ adjustment	—	—	—	—	—	(24)
Tax impact of DOJ adjustment	—	—	—	—	—	8
Tax reform impact	—	—	80	—	80	—
Recognition of hedging gains	(29)	—	—	(29)	—	—
Tax impact of hedging gains	5			5		
Wells Fargo acquisition costs	14	1	—	15	—	—
Tax impact of Wells Fargo acquisition costs	(2)	—	—	(2)	—	—
Adjusted net income	$42	$ 49	$ 35	$176	$ 143	$ 155
Deferred cumulative preferred stock dividends (1)	—	—	—	—	—	(18)
Adjusted net income applicable to common stockholders	$42	$ 49	$ 35	$176	$ 143	$ 137
Weighted average diluted common shares	58,385,354	58,332,598	58,311,881	58,322,950	58,178,343	57,597,667
Diluted earnings (loss) per share	$0.93	$ 0.83	$ (0.79)	$3.21	$ 1.09	$ 2.66
Adjusted diluted earnings per share	$0.72	$ 0.85	$ 0.60	$3.02	$ 2.47	$ 2.38
Net interest income				$497	$ 390	$ 323
Hedging gains				(29)	—	—
Adjusted net interest income				$468	$ 390	$ 323
Average interest-earning assets				$16,136	$ 14,130	$ 12,164
Net interest margin				3.07 %	2.75 %	2.64 %
Adjusted net interest margin				2.89 %	2.75 %	2.64 %
Average interest-earning asset yield				4.21 %	3.71 %	3.42 %
Average interest-bearing liability cost				1.40 %	1.15 %	0.97 %
Impact from hedging gains				0.23 %	—	—
Adjusted average interest-bearing liability cost				1.63 %	1.15 %	0.97 %
Interest rate spread				2.81 %	2.56 %	2.45 %
Adjusted interest rate spread				2.58 %	2.56 %	2.45 %
Noninterest expense				$712	$ 643	$ 560
Wells Fargo acquisition costs				15	—	—
Adjusted noninterest expense				$697	$ 643	$ 560

(1) Under the terms of the Series C Preferred Stock, we elected to defer dividends beginning with the February 2012 dividend. Although, while being deferred, the impact was not included in net income from continuing operations, the deferral did impact net income applicable to common stock for the purpose of calculating earnings per share. In July 2016, we ended the deferral and brought current our previously deferred dividends and redeemed the stock.

Accounting and Reporting Developments

For further information of recently issued accounting pronouncements and their expected impact on our Consolidated Financial Statements, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant

Accounting Standards.

Critical Accounting Estimates

Our Consolidated Financial Statements are prepared in accordance with U.S. GAAP and reflect general practices within our industry. Our significant accounting policies are described in Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards. Some of our significant accounting policies require complex judgments and estimates to determine values of assets and liabilities. The more judgmental, uncertain and complex estimates are further discussed below. These estimates are based on information available to management as of the date of the Consolidated Financial Statements. Accordingly, as this information changes, future financial statements could reflect different estimates or judgments.

Allowance for Loan Losses

The ALLL represents management's estimate of probable credit losses inherent in our LHFI portfolio. The ALLL is sensitive to a variety of internal factors, such as the mix and level of loan balances outstanding, TDR volume, net charge-off experience, as well as external factors, such as, property values, the general health of the economy, unemployment rates, bankruptcy filings, peer data, etc. Management considers these variables and all other available information when establishing the final level of the allowance. These variables and others have the ability to result in actual loan losses that differ from the originally estimated amounts.

The ALLL includes a component related to specifically identified impaired loans (TDR and NPL loans) and a collectively evaluated model-based component. For further discussion on the methodologies used in determining our allowance, see Note 1 - Description of Business, Basis of Presentation, and Summary of Significant Accounting Standards.

Specifically identified component

The specifically identified component of the ALLL related to performing TDR loans is generally measured as the difference between the recorded investment in the specific loan and the present value of the cash flows expected to be collected, discounted at the loan's original effective interest rate. Estimating the timing and amounts of future cash flow projections is highly judgmental and based upon assumptions including default rates, prepayment probability and loss severities. All of these estimates and assumptions require significant management judgment and certain assumptions are highly subjective.

Specifically identified collateral dependent NPL loans are generally measured as the difference between the recorded investment in the impaired loan and the underlying collateral value less estimated costs to sell. These estimates are dependent on third party property valuations which may be influenced by factors such as the current and future level of home prices, the duration of current overall economic conditions, and other macroeconomic and portfolio-specific factors.

Model based component

The model-based component of the ALLL is calculated on our non-impaired consumer and commercial LHFI portfolio by applying average historical loss rates experienced during an identified look back period to outstanding principal balances over an estimated loss emergence period. For portfolios that do not have adequate loss experience and purchased portfolios, we utilize peer loss data in determining the ALLL. The loss emergence period represents the time period between the date at which the loss is estimated to have been incurred and the ultimate realization of that loss (by a charge-off). Estimated loss emergence periods may vary by product and may change over time; management applies judgment in estimating loss emergence periods, using available credit information and trends.

The historical loss model calculation is then adjusted by taking other qualitative factors into consideration, such as current economic events that have occurred but may not yet be reflected in the historical loss estimates and model imprecision. These adjustments are determined by analyzing the historical loss experience for each major product segment and its underlying credit characteristics. It is difficult to predict whether historical loss experience is indicative of future loss levels, therefore, management applies judgment in making adjustments deemed necessary based on the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, the potential impact of payment recasts, changes in concentrations of credit, and other internal or external factor changes. The application of different inputs into the model calculation and the assumptions used by management to adjust the model calculation are subject to significant management judgment and may result in actual loan losses that differ from the originally estimated amounts.