FLAGSTAR BANCORP INC
Form 10-Q
August 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012
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<br>(State or other jurisdiction of<br>Incorporation or organization) | 38-3150651<br>(I.R.S. Employer<br>Identification No.) |
| 5151 Corporate Drive, Troy, Michigan<br>(Address of principal executive offices) | 48098-2639<br>(Zip code) |

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

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 ninety days.
Yes ý No ¨.
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No ý.

As of August 8, 2012, 557,993,063 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

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## FORWARD – LOOKING STATEMENTS

This report contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Forward-looking statements, by their nature, involve estimates, projections, goals, forecasts, assumptions, risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed in a forward-looking statement. Examples of forward-looking statements include statements regarding our expectations, beliefs, plans, goals, objectives and future financial or other performance. Words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates” and variations of such words and similar expressions are inte to identify such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. Except to fulfill our obligations under the U.S. securities laws, we undertake no obligation to update any such statement to reflect events or circumstances after the date on which it is made.

There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include:

(1) Volatile interest rates that impact, amongst other things, (i) the mortgage banking business, (ii) our ability to originate loans and sell assets at a profit, (iii) prepayment speeds and (iv) our cost of funds, could adversely affect earnings, growth opportunities and our ability to pay dividends to stockholders;

(2) Competitive factors for loans could negatively impact gain on loan sale margins;

(3) Competition from banking and non-banking companies for deposits and loans can affect our growth opportunities, earnings, gain on sale margins, market share and ability to transform business model;

(4) Changes in the regulation of financial services companies and government-sponsored housing enterprises, and in particular, declines in the liquidity of the residential mortgage loan secondary market, could adversely affect our business;

(5) Changes in regulatory capital requirements or an inability to achieve or maintain desired capital ratios could adversely affect our growth and earnings opportunities and our ability to originate certain types of loans, as well as our ability to sell certain types of assets for fair market value or to transform business model;

(6) General business and economic conditions, including unemployment rates, movements in interest rates, the slope of the yield curve, any increase in fraud and other related criminal activity and the further decline of asset values in certain geographic markets, may significantly affect our business activities, loan losses, reserves, earnings and business prospects;

(7) Factors concerning the implementation of proposed refinements and transformation of our business model could result in slower implementation times than we anticipate and negate any competitive advantage that we may enjoy;

(8) Actions of mortgage loan purchasers, guarantors and insurers regarding repurchases and indemnity demands and uncertainty related to foreclosure procedures could adversely affect our business activities and earnings;

(9) The Dodd-Frank Wall Street Reform and Consumer Protection Act has resulted in the elimination of the Office of Thrift Supervision (the “OTS”), tightening of capital standards, and the creation of a new Consumer Financial Protection Bureau and has resulted, or will result, in new laws, regulations and regulatory supervisors that are expected to increase our costs of operations. In addition, the change to the Office of the Comptroller of the Currency (the "OCC") as our primary federal regulator may result in interpretations, or in OCC enforcement actions, different than those of the OTS and may affect our operations and our relationships with institutional counterparties;

(10) Both the volume and the nature of consumer actions and other forms of litigation against financial institutions have increased and to the extent that such actions are brought against us or threatened, the cost of defending such suits as well as potential exposure could increase our costs of operations;

(11) Our compliance with the terms and conditions of the agreement with the U.S. Department of Justice, the impact of performance and enforcement of commitments under, and provisions contained in the agreement, and our accuracy and ability to estimate the financial impact of that agreement, including the fair value of the future payments required, could accelerate our litigation settlement expenses relating thereto;

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(12) The downgrade by Standards & Poor's of the long-term credit rating of the U.S. could materially affect global and domestic financial markets and economic conditions, which may affect our business activities, financial condition, and liquidity;

(13) If we do not regain compliance with the New York Stock Exchange ("NYSE") continued listing requirements, our common stock may be delisted from the NYSE; and

(14) Our potential loss of key personnel or our inability to attract and retain qualified personnel in the future could affect our ability to operate effectively.

All of the above factors are difficult to predict, contain uncertainties that may materially affect actual results, and may be beyond our control. New factors emerge from time to time, and it is not possible for our management to predict all such factors or to assess the effect of each such factor on our business.

Please also refer to Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 and Item 1A to Part II of this Quarterly Report on Form 10-Q, which are incorporated by reference herein, for further information on these and other factors affecting us.

Although we believe that these forward-looking statements are based on reasonable, estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies and other factors. Accordingly, we cannot give you any assurance that our expectations will in fact occur or that actual results will not differ materially from those expressed or implied by such forward-looking statements. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
The consolidated financial statements of the Company are as follows:



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

| | June 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|---|
| Assets | | |
| Cash and cash items | $71,184 | $49,715 |
| Interest-earning deposits | 1,199,205 | 681,343 |
| Cash and cash equivalents | 1,270,389 | 731,058 |
| Securities classified as trading | 169,834 | 313,383 |
| Securities classified as available-for-sale | 424,765 | 481,352 |
| | 2,459,482 | 1,800,885 |

| | | |
|---|---|---|
| Loans held-for-sale ($2,195,679 and $1,629,618 at fair value at June 30, 2012 and December 31, 2011, respectively) | | |
| Loans repurchased with government guarantees | 1,999,110 | 1,899,267 |
| Loans held-for-investment ($20,231 and $22,651 at fair value at June 30, 2012 and December 31, 2011, respectively) | 6,550,257 | 7,038,587 |
| Less: allowance for loan losses | (287,000 ) | (318,000 ) |
| Loans held-for-investment, net | 6,263,257 | 6,720,587 |
| Total interest-earning assets | 12,515,653 | 11,896,817 |
| Accrued interest receivable | 103,985 | 105,200 |
| Repossessed assets, net | 107,235 | 114,715 |
| Federal Home Loan Bank stock | 301,737 | 301,737 |
| Premises and equipment, net | 209,126 | 203,578 |
| Mortgage servicing rights at fair value | 638,865 | 510,475 |
| Other assets | 420,661 | 455,236 |
| Total assets | $14,368,446 | $13,637,473 |
| Liabilities and Stockholders' Equity | | |
| Deposits | $8,922,847 | $7,689,988 |
| Federal Home Loan Bank advances | 3,400,000 | 3,953,000 |
| Long-term debt | 248,585 | 248,585 |
| Total interest-bearing liabilities | 12,571,432 | 11,891,573 |
| Accrued interest payable | 12,271 | 8,723 |
| Representation and warranty reserve | 161,000 | 120,000 |
| Other liabilities ($19,100 and $18,300 at fair value at June 30, 2012 and December 31, 2011, respectively) | 445,394 | 537,461 |
| Total liabilities | 13,190,097 | 12,557,757 |
| Commitments and contingencies – Note 20 | — | — |
| Stockholders' Equity | | |
| Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding at June 30, 2012 and December 31, 2011, respectively | 257,556 | 254,732 |
| Common stock $0.01 par value, 700,000,000 shares authorized; 557,722,618 and 555,775,639 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively | 5,577 | 5,558 |
| Additional paid in capital | 1,468,905 | 1,466,461 |
| Accumulated other comprehensive income (loss) | 8,274 | (7,819 ) |
| Accumulated deficit | (561,963 ) | (639,216 ) |
| Total stockholders' equity | 1,178,349 | 1,079,716 |
| Total liabilities and stockholders' equity | $14,368,446 | $13,637,473 |

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

Flagstar Bancorp, Inc.

Consolidated Statements of Operations

(In thousands, except per share data)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (Unaudited) | | | |
| Interest Income | | | | |
| Loans | $115,611 | $98,155 | $229,519 | $200,269 |
| Securities classified as available-for-sale or trading | 6,850 | 8,949 | 15,421 | 17,046 |
| Interest-earning deposits and other | 462 | 957 | 874 | 1,925 |

| | | | | |
|---|---|---|---|---|
| Total interest income | 122,923 | 108,061 | 245,814 | 219,240 |
| Interest Expense | | | | |
| Deposits | 18,321 | 24,902 | 37,307 | 51,924 |
| FHLB advances | 27,386 | 30,218 | 54,779 | 60,196 |
| Other | 1,738 | 1,617 | 3,517 | 3,223 |
| Total interest expense | 47,445 | 56,737 | 95,603 | 115,343 |
| Net interest income | 75,478 | 51,324 | 150,211 | 103,897 |
| Provision for loan losses | 58,428 | 48,384 | 173,101 | 76,693 |
| Net interest income (expense) after provision for loan losses | 17,050 | 2,940 | (22,890) | 27,204 |
| Non-Interest Income | | | | |
| Loan fees and charges | 34,783 | 14,712 | 64,757 | 30,850 |
| Deposit fees and charges | 5,039 | 7,845 | 9,961 | 15,345 |
| Loan administration | 25,012 | 30,450 | 63,898 | 69,786 |
| Gain (loss) on trading securities | 3,711 | 102 | (2,260) | 28 |
| Loss on transferors’ interest | (1,244) | (2,258) | (1,653) | (4,640) |
| Net gain on loan sales | 212,666 | 39,827 | 417,518 | 90,012 |
| Net loss on sales of mortgage servicing rights | (983) | (2,381) | (3,299) | (2,493) |
| Net gain on securities available-for-sale | 20 | — | 330 | — |
| Net (loss) gain on sale of assets | (26) | 1,293 | — | 256 |
| Total other-than-temporary impairment (loss) gain | (1,707) | 39,725 | 2,810 | 39,725 |
| Gain (loss) recognized in other comprehensive income before taxes | 690 | (55,309) | (5,002) | (55,309) |
| Net impairment losses recognized in earnings | (1,017) | (15,584) | (2,192) | (15,584) |
| Representation and warranty reserve – change in estimate | (46,028) | (21,364) | (106,566) | (41,791) |
| Other fees and charges, net | 8,401 | 5,436 | 21,216 | 12,575 |
| Total non-interest income | 240,334 | 58,078 | 461,710 | 154,344 |
| Non-Interest Expense | | | | |
| Compensation and benefits | 65,402 | 53,719 | 131,390 | 109,459 |
| Commissions | 17,838 | 7,437 | 33,305 | 15,005 |
| Occupancy and equipment | 18,706 | 16,969 | 35,656 | 33,587 |
| Asset resolution | 20,851 | 23,282 | 57,621 | 61,391 |
| Federal insurance premiums | 12,104 | 10,789 | 24,428 | 19,515 |
| Other taxes | 370 | 667 | 1,327 | 1,533 |
| Warrant (income) expense | (551) | (1,998) | 1,998 | (2,825) |
| General and administrative | 34,777 | 20,057 | 72,518 | 40,488 |
| Total non-interest expense | 169,497 | 130,922 | 358,243 | 278,153 |
| Income (loss) before federal income taxes | 87,887 | (69,904) | 80,577 | (96,605) |
| Provision for federal income taxes | 500 | 264 | 500 | 528 |
| Net Income (Loss) | 87,387 | (70,168) | 80,077 | (97,133) |
| Preferred stock dividend/accretion (1) | (1,417) | (4,720) | (2,824) | (9,429) |
| Net income (loss) applicable to common stock | $85,970 | $(74,888) | $77,253 | $(106,562) |
| Income (loss) per share | | | | |
| Basic | $0.15 | $(0.14) | $0.13 | $(0.19) |
| Diluted | $0.15 | $(0.14) | $0.13 | $(0.19) |

(1) The preferred stock dividend/accretion for the three and six months ended June 30, 2012, respectively, represents only the accretion. On January 27, 2012, the Company elected to defer payment of dividends and interest on the preferred stock.

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

Flagstar Bancorp, Inc.

Consolidated Statements of Comprehensive Income (Loss)
(In thousands)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net income (loss) | $87,387 | $(70,168) | $80,077 | $(97,133) |
| Other comprehensive income (loss), before tax: | | | | |
| Securities available-for-sale: | | | | |
| Change in net unrealized loss on sale of securities available-for-sale | 1,110 | (6,180) | 14,231 | 225 |
| Reclassification of gain on sale of securities available-for-sale | (20) | — | (330) | — |
| Additions for the amount related to the credit loss for which an OTTI impairment was not previously recognized | 1,017 | 15,584 | 2,192 | 15,584 |
| Total securities available-for-sale | 2,107 | 9,404 | 16,093 | 15,809 |
| Comprehensive income (loss) | $89,494 | $(60,764) | $96,170 | $(81,324) |

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

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

| | Preferred Stock | Common Stock | Additional Paid in Capital | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2010 (Unaudited) | $249,196 | $5,533 | $1,461,373 | $ (16,165) | $(440,274) | $1,259,663 |
| Net loss | — | — | — | — | (97,133) | (97,133) |
| Total other comprehensive income | — | — | — | 15,809 | — | 15,809 |
| Restricted stock issued | — | 2 | (2) | — | — | — |
| Dividends on preferred stock | — | — | — | — | (6,666) | (6,666) |
| Accretion of preferred stock | 2,763 | — | — | — | (2,763) | — |
| Stock-based compensation | — | 7 | 2,760 | — | — | 2,767 |
| Balance at June 30, 2011 | $251,959 | $5,542 | $1,464,131 | $ (356) | $(546,836) | $1,174,440 |
| Balance at December 31, 2011 (Unaudited) | $254,732 | $5,558 | $1,466,461 | $ (7,819) | $(639,216) | $1,079,716 |
| Net income | — | — | — | — | 80,077 | 80,077 |
| Total other comprehensive income | — | — | — | 16,093 | — | 16,093 |
| Restricted stock issued | — | 6 | (6) | — | — | — |
| Accretion of preferred stock (1) | 2,824 | — | — | — | (2,824) | — |
| Stock-based compensation | — | 13 | 2,450 | — | — | 2,463 |
| Balance at June 30, 2012 | $257,556 | $5,577 | $1,468,905 | $ 8,274 | $(561,963) | $1,178,349 |

(1) The preferred stock dividend/accretion during the six months ended June 30, 2012 represents only the accretion. On January 27, 2012, the Company elected to defer payment of dividends and interest on the preferred stock.

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

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

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2012 | 2011 |
| | (Unaudited) | |
| Operating Activities | | |
| Net income (loss) | $80,077 | $(97,133) |
| Reconciliation of net income (loss) to net cash used in operating activities | | |
| Provision for loan losses | 173,101 | 76,693 |
| Depreciation and amortization | 9,522 | 7,166 |
| Loss on fair value of residential first mortgage servicing rights | 91,583 | 16,596 |
| Stock-based compensation expense | 2,463 | 2,767 |
| Net (gain) loss on the sale of assets | (2,480) | 585 |
| Net gain on loan sales | (417,518) | (90,012) |
| Net loss on sales of mortgage servicing rights | 3,299 | 2,493 |
| Net gain on securities classified as available-for-sale | (330) | — |
| Other than temporary impairment losses on securities classified as available-for-sale | 2,192 | 15,584 |
| Net loss (gain) on trading securities | 2,260 | (28) |
| Net loss on transferor interest | 1,653 | 4,640 |
| Proceeds from sales of loans held-for-sale | 24,729,954 | 10,456,988 |
| Origination and repurchase of mortgage loans held-for-sale, net of principal repayments | (24,941,423) | (9,820,042) |
| Increase in repurchase of mortgage loans with government guarantees, net of claims received | (99,843) | (36,839) |
| Purchase of trading securities | — | (131,754) |
| Decrease (increase) in accrued interest receivable | 1,215 | (7,634) |
| Proceeds from sales of trading securities | 141,220 | — |
| Decrease in other assets | 33,084 | 85,684 |
| Increase (decrease) in accrued interest payable | 3,548 | (2,030) |
| (Decrease) increase liability for checks issued | (3,100) | 2,850 |
| Decrease in payable for mortgage repurchase option | (33,673) | (7,862) |
| Increase in representation and warranty reserve | 41,000 | — |
| Increase (decrease) in other liabilities | 26,980 | (6,406) |
| Net cash (used) provided in operating activities | (155,216) | 472,306 |
| Investing Activities | | |
| Proceeds from the sale of investment securities available-for-sale | 39,881 | — |
| Net repayment (purchase) of investment securities available-for-sale | 30,457 | (75,673) |
| Net proceeds from sales of loans held-for-investment | (268,919) | (20,366) |
| Origination of portfolio loans, net of principal repayments | 234,233 | 191,947 |
| Proceeds from the disposition of repossessed assets | 59,259 | 63,797 |
| Redemption of Federal Home Loan Bank Stock | — | 35,453 |
| Acquisitions of premises and equipment, net of proceeds | (14,534) | (19,457) |
| Proceeds from the sale of mortgage servicing rights | 16,394 | 44,520 |
| Net cash provided by investing activities | 96,771 | 220,221 |
| Financing Activities | | |
| Net increase (decrease) in deposit accounts | 1,232,859 | (593,072) |
| Net decrease in Federal Home Loan Bank advances | (553,000) | (318,512) |
| Net (disbursement) receipt of payments of loans serviced for others | (103,537) | 10,726 |
| Net receipt of escrow payments | 21,454 | 19,346 |

| | | |
|---|---|---|
| Dividends paid to preferred stockholders | — | (6,666) |
| Net cash provided by (used) in financing activities | 597,776 | (888,178) |
| Net increase in cash and cash equivalents | 539,331 | (195,651) |
| Beginning cash and cash equivalents | 731,058 | 953,534 |
| Ending cash and cash equivalents | $1,270,389 | $757,883 |
| Loans held-for-investment transferred to repossessed assets | $250,348 | $100,298 |
| Total interest payments made on deposits and other borrowings | $92,055 | $117,374 |
| Federal income taxes paid | $225 | $— |
| Reclassification of mortgage loans originated for portfolio to mortgage loans held-for-sale | $287,396 | $32,886 |
| Reclassification of mortgage loans originated held-for-sale then transferred to portfolio loans | $18,477 | $12,520 |
| Mortgage servicing rights resulting from sale or securitization of loans | $238,176 | $88,954 |

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

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
Note 1 – Nature of Business

Flagstar Bancorp, Inc. (“Flagstar” or the “Company”), is the holding company for Flagstar Bank, FSB (the “Bank”), a federally chartered stock savings bank founded in 1987. With $14.4 billion in total assets at June 30, 2012, the Company is the largest insured depository institution headquartered in Michigan and is the largest publicly held savings bank headquartered in the Midwest.

The Company is a full-service financial services company, offering a range of products and services to consumers, businesses, and homeowners. As of June 30, 2012, the Company operated 111 banking centers in Michigan, 30 home loan centers in 13 states, and a total of four commercial banking offices in Massachusetts, Connecticut, and Rhode Island. In the second quarter 2012, two banking centers in Michigan were closed to better align the branch structure with the Company's focus on key market areas and to improve banking center efficiencies. The Company originates loans nationwide and is one of the leading originators of residential first mortgage loans. The Company also offers consumer products including deposit accounts, standard and jumbo home loans, home equity lines of credit, and personal loans, including auto and boat loans. The Company also offers commercial loans and treasury management services throughout Michigan and through its four commercial banking offices in Massachusetts, Rhode Island and Connecticut. Commercial products include deposit and sweep accounts, telephone banking, term loans and lines of credit, lease financing, government banking products and treasury management services such as remote deposit and merchant services.

The Company sells or securitizes most of the mortgage loans that it originates and generally retains the right to service the mortgage loans that it sells. These mortgage-servicing rights (“MSRs”) are occasionally sold by the Company in transactions separate from the sale of the underlying mortgages. The Company may also invest in its loan originations to refine the Company's leverage ability and to receive the interest spread between earning assets and paying liabilities.

The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency (“OCC”) of the United States Department of the Treasury (“U.S. Treasury”). The Bank is also subject to regulation, examination and supervision by the Federal Deposit Insurance Corporation (“FDIC”) and the Consumer Financial Protection Bureau (the “CFPB”). The Bank's deposits are insured by the FDIC through the Deposit Insurance Fund (“DIF”). The Company is subject to regulation, examination and supervision by the Board of Governors of the Federal Reserve (“Federal Reserve”). The Bank is also a member of the Federal Home Loan Bank (“FHLB”) of Indianapolis.

Branch Sales

During the fourth quarter 2011, the Bank completed the previously announced sale of 27 banking centers in Georgia and 22 banking centers in Indiana to PNC Bank, N.A., part of The PNC Financial Services Group, Inc. ("PNC") and First Financial Bank, N.A. ("First Financial"), respectively. Management believes that the Company's presence in the Georgia and Indiana markets lacked market density and sufficient scale, and believes that these transactions are consistent with the strategic focus on core Midwest banking markets and on deployment of capital towards continuing growth in commercial and consumer banking in those markets, as well as the emerging Northeast market.

In the Georgia sale, PNC purchased the facilities or assumed the leases associated with the banking centers and purchased associated business and retail deposits in the amount of $211.3 million. PNC paid the net carrying value of the acquired real estate and fixed and other personal assets associated with the banking centers.

In the Indiana sale, First Financial paid a consideration of a seven percent premium on the consumer and commercial deposits in the Indiana banking centers. The total amount of such consumer and commercial deposits was $462.0 million for a gain of $22.1 million. First Financial paid net carrying value on real estate and personal assets of the banking centers and assumed the existing leases on 14 of the banking centers.

The Company predominantly originated residential mortgage loans for sale in the secondary market in both the Georgia and Indiana markets. Accordingly, the amount of loans on the balance sheet was immaterial and no loans were transferred in either transaction.

Supervisory Agreements

The Company and the Bank are subject to supervisory agreements with the Federal Reserve and the OCC (each a “Supervisory Agreement” and together the “Supervisory Agreements”), each as a successor regulator to the Office of Thrift Supervision ("OTS"). The Supervisory Agreements will remain in effect until terminated, modified, or suspended in writing by the Federal Reserve and the OCC, as appropriate, and the respective failure to comply with the Supervisory Agreements could result in the initiation of further enforcement action by the Federal Reserve or the OCC, as appropriate, including the imposition of further operating restrictions, and could result in additional enforcement actions against the Company or the Bank. The Company has taken actions which it believes are appropriate to comply with, and intend to maintain compliance with, all of the requirements of the Supervisory Agreements.

Pursuant to the Company's Supervisory Agreement with the Federal Reserve, as successor to the OTS, dated January 27, 2010, the Company submitted a capital plan to the OTS, predecessor in interest to the Federal Reserve. In addition, the Company agreed to request prior non-objection of the Federal Reserve to pay dividends or other capital distributions; purchases, repurchases or redemptions of certain securities; incurrence, issuance, renewal, rolling over or increase of any debt and certain affiliate transactions; and comply with restrictions on the payment of severance and indemnification payments, director and management changes and employment contracts and compensation arrangements applicable to the Bank.

Pursuant to the Bank's Supervisory Agreement, the Bank agreed to take actions to address a number of banking issues identified by the OCC. The Bank has completed each of the actions set forth below in the manner and within the time periods required by the Bank's Supervisory Agreement.

- Submitted and received non-objection to a revised business plan that addressed the requirements of the Bank Supervisory Agreement;
- Implemented a plan to reduce doubtful or substandard assets;
- Revised the Bank’s policies and procedures governing loan administration;
- Revised the Bank’s liquidity risk management program to enhance the continuous identification and monitoring of funding needs and access to funds to meet those needs;
- Remediated issues related to market risk exposure, including the engagement of a qualified and independent third party to perform a model valuation;
- Revised the Bank’s asset concentration policy for mortgage servicing rights to reflect the revised business plan and remediated mortgage servicing rights issues;
- Established a new written consumer compliance program appropriate for the Bank’s size, complexity, product lines and business operations and compliant with applicable law;
- Revised the Bank’s policies, procedures and systems for compliance with flood insurance requirements and reviewed all loans originated after September 30, 2008 for compliance with flood insurance requirements; and
- Restricted quarterly asset growth to an amount not to exceed net interest credited on deposit liabilities until the revised business plan received non-objection (such plan received non-objection from the OTS concurrent with the execution of the Bank's Supervisory Agreement).

In addition, the Bank agreed to operate within the parameters of the revised business plan, request OCC approval of dividends or other capital distributions, not make certain severance or indemnification payments, notify the OCC of changes in directors or senior executive officers, provide notice of new, renewed, extended or revised contractual arrangements relating to compensation or benefits for any senior executive officer or directors, receive consent to increase salaries, bonuses or director’s fees for directors or senior executive officers, and receive OCC non-objection to certain third party arrangements.

The foregoing summary of the Supervisory Agreements does not purport to be a complete description of all of the terms of the Supervisory Agreements, and is qualified in its entirety by reference to copies of the Supervisory

Agreements filed with the Securities and Exchange Commission (the "SEC") as an exhibit to our Current Report on Form 8-K filed on January 28, 2010.

The Company and the Bank addressed the banking issues identified by the OCC in the manner and within the time periods required for compliance with the Supervisory Agreements, and they do not believe that continued compliance with the Supervisory Agreements will have any material adverse impact on their future financial results. However, the Company and the Bank believe that the enhanced asset and risk management should, over time, improve the Bank's overall credit quality and risk profile through enhanced monitoring of credit quality trends, overall reduction in the level of doubtful and substandard assets, and enhanced compliance activities.

Troubled Asset Relief Program

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (initially introduced as the Troubled Asset Relief Program (“TARP”)) was enacted, and the U.S. Treasury injected capital into U.S. financial institutions. On January 30, 2009, the Company entered into a letter agreement including the securities purchase agreement with the U.S. Treasury pursuant to which, among other things, the Company sold to the U.S. Treasury preferred stock and warrants. Furthermore, as long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including the Company's common stock, par value $0.01 per share (the “Common Stock”), are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. The preferred stock accrues cumulative dividends quarterly at a rate of 5 percent per annum until January 30, 2014, and 9 percent per annum thereafter.

Note 2 – Basis of Presentation and Accounting Policies

The unaudited consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the SEC. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for complete financial statements. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. In addition, certain prior period amounts have been reclassified to conform to the current period presentation. For further information, reference should be made to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, which are available on the Company’s Investor Relations web page, at www.flagstar.com, and on the SEC website, at www.sec.gov.

Recently Adopted Accounting Standards

On January 1, 2012, the Company adopted the update to Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 220, “Comprehensive Income” and applied the provisions retrospectively. Under the amended guidance, an entity had the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income (“OCI”) either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning comprehensive income, refer to Consolidated Statements of Comprehensive Income and Note 15 - Stockholders'

Equity.

On January 1, 2012, the Company prospectively adopted the update to FASB ASC Topic 820, “Fair Value Measurement.” The amended guidance did not modify the requirements for when fair value measurements apply, rather it generally represents clarifications on how to measure and disclose fair value under Topic 820, Fair Value Measurement. The guidance is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (“IFRS”), by ensuring that fair value has the same meaning in U.S. GAAP and IFRS and respective disclosure requirements are the same except for inconsequential differences in wording and style. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning fair value, refer to Note 3 - Fair Value Accounting.

On January 1, 2012, the Company adopted FASB ASC Topic 860, “Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreements.” Under the amended guidance, a transferor maintains effective control over transferred financial assets if there is an agreement that both entitles and obligates the transferor to repurchase the financial assets before maturity. In addition, the following requirements must be met: (i) the financial asset to be repurchased or redeemed are the same or substantially the same as those transferred, (ii) the agreement is to repurchase or redeem the transferred financial asset before maturity at a fixed or determinable price, and (iii) the agreement is entered into contemporaneously with, or in contemplation of the transfer. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto.

On July 1, 2011, the Company adopted the update to FASB ASC Topic 310, “Receivables - A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring” and applied the provisions retrospectively to January 1, 2011. The troubled debt restructuring (“TDR”) guidance clarifies whether loan modifications constitute TDRs, include factors and examples for creditors to consider in evaluating whether a restructuring results in a delay in payment that is insignificant, prohibit creditors from using the borrower's effective rate test to evaluate whether the restructuring constitutes as a TDR and a concession has been granted to the borrower, and clarifies the guidance for creditors to use in determining whether a borrower is experiencing financial difficulties. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning TDRs, refer to Note 7 - Loans Held-for-Investment.

Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update (“ASU”) No. 2011-10, “Property, Plant, and Equipment (Topic 360): Derecognition of in Substance Real Estate - a Scope Clarification.” The guidance represents the consensus reached in Emerging Issues Task Force Issue No. 10-E, “Derecognition of in Substance Real Estate” and applies to a parent that ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. ASU 2011-10 provides that when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. ASU 2011-10 should be applied on a prospective basis to deconsolidation events occurring after the effective date; with prior periods not adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities. This guidance is effective prospective for annual and interim periods beginning on or after June 15, 2012. Early adoption is permitted. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.” The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on its financial position. The FASB issued common disclosure requirements related to offsetting arrangements to allow investors to better compare financial statements prepared in accordance with IFRS or U.S. GAAP. The objective of this guidance is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. This guidance is effective retrospectively, for annual and interim periods, beginning on or after January 1, 2013. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

Note 3 – Fair Value Accounting

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

Valuation Hierarchy

U.S. GAAP establishes a three level valuation hierarchy for disclosure of fair value measurements that is based on the transparency of the inputs used in the valuation process. The three levels of the hierarchy, highest ranking to lowest, are as follow:

Level 1 -Quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Company can participate as of the measurement date;
Level 2 -Quoted prices for similar instruments in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
Level 3 -Unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing and asset or liability.

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

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

Assets
Securities classified as trading. These securities are comprised of U.S. government sponsored agency mortgage-backed securities, U.S. Treasury bonds and non investment grade residual securities that arose from private label securitizations of the Company. The U.S. government sponsored agency mortgage-backed securities and U.S. Treasury bonds trade in an active, open market with readily observable prices and are therefore classified within the Level 1 valuation hierarchy. The non investment grade residual securities do not trade in an active, open market with readily observable prices and are therefore classified within the Level 3 valuation hierarchy. Under Level 3, the fair value of residual securities is determined by discounting estimated net future cash flows using expected prepayment rates and discount rates that approximate current market rates. Estimated net future cash flows include assumptions related to expected credit losses on these securities. The Company maintains a model that evaluates the default rate and severity of loss on the residual securities collateral, considering such factors as loss experience, delinquencies, loan-to-value ratios, borrower credit scores and property type. At June 30, 2012 and December 31, 2011, the Company had no Level 3 securities classified as trading. See Note 9 - Private-Label Securitization Activity, for the key assumptions used in the residual interest valuation process.

Securities classified as available-for-sale. These securities are comprised of U.S. government sponsored agency mortgage-backed securities and CMOs. Where quoted prices for securities are available in an active market, those securities are classified within Level 1 of the valuation hierarchy. Where quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows and those securities are classified within Level 2 of the valuation hierarchy. Where markets are illiquid and fair values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement, those securities are classified within Level 3 of the valuation hierarchy. Due to illiquidity in the markets, the Company determined the fair value of the FSTAR 2006-1 securitization trust using a discounted estimated net future cash flow model and therefore classified it within the Level 3 valuation hierarchy as the model utilizes significant inputs which are unobservable.

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

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

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

Included in loans held-for-investment is the transferor's interest on the home equity line of credit (“HELOC”) securitizations. The Company fair value of the transferor's interest is based on the claims due to the note insurer and continuing credit losses on the loans underlying the securitizations, which are considered to be Level 3. See Note 9 - Private-Label Securitization Activity, for the key assumptions used in the transferor's interest valuation process.

Repossessed assets. Loans on which the underlying collateral has been repossessed are adjusted to fair value less costs to sell upon transfer to repossessed assets. Subsequently, repossessed assets are carried at the lower of carrying value or fair value, less anticipated marketing and selling costs. Fair value is generally based upon third-party appraisals or internal estimates and considered a Level 3 classification.

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Residential MSRs. The current market for residential MSRs is not sufficiently liquid to provide participants with quoted market prices. Therefore, the Company uses an option adjusted spread valuation approach to determine the fair value of residential MSRs. This approach consists of projecting servicing cash flows under multiple interest rate scenarios and discounting these cash flows using risk adjusted discount rates. The key assumptions used in the valuation of residential MSRs include mortgage prepayment speeds and discount rates. Management obtains third party valuations of the residential MSR portfolio on a quarterly basis from independent valuation experts to assess the reasonableness of the fair value calculated by its internal valuation model. Due to the nature of the valuation inputs, residential MSRs are classified within Level 3 of the valuation hierarchy. See Note 10 - Mortgage Servicing Rights, for the key assumptions used in the residential MSR valuation process.

Derivative financial instruments. Certain classes of derivative contracts are listed on an exchange and are actively traded, and they are therefore classified within Level 1 of the valuation hierarchy. These include U.S. Treasury futures and U.S. Treasury options. The Company's forward loan sale commitments and interest rate swaps are valued based on quoted prices for similar assets in an active market with inputs that are observable and are classified within Level 2 of the valuation hierarchy. Rate lock commitments are valued using internal models with significant unobservable market parameters and therefore are classified within Level 3 of the valuation hierarchy. The Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. The derivatives are reported in either “other assets” or “other liabilities” on the Consolidated Statements of Financial Condition.

Equity-linked transaction and option commitment. The equity-linked transaction and option commitment serves as a hedge (off-set) to the market risk incurred with the Company's participation of equity-linked certificates of deposit. The option represents the premium over the total notional amount of the hedge. The valuations are based on counter-party risk systems measuring the present value of each instrument and its future payments. The risk systems take into consideration economic terms of the trade and current market levels including spot rates, and underlying volatility and correlation among other factors.

Liabilities

Warrants. Warrant liabilities are valued using a binomial lattice model and are classified within Level 2 of the valuation hierarchy. Significant observable inputs include expected volatility, a risk free rate and an expected life. Warrant liabilities are reported in “other liabilities” on the Consolidated Statements of Financial Condition.

Litigation settlement. On February 24, 2012, the Company announced that the Bank had entered into an agreement (the “DOJ Agreement”) with the U.S. Department of Justice ("DOJ") relating to certain underwriting practices associated with loans insured by the Federal Housing Administration ("FHA") of the Department of Housing and Urban Development ("HUD"). The Bank and the DOJ entered into the DOJ Agreement pursuant to which the Bank agreed to comply with all applicable HUD and FHA rules related to the continued participation in the direct endorsement lender program, make an initial payment of $15.0 million within 30 business days of the effective date of the DOJ Agreement (paid on April 3, 2012), make payments of approximately $118.0 million contingent upon the occurrence of certain future events (as further described below) (the "Additional Payments"), and complete a monitoring period by an independent third party chosen by the Bank and approved by HUD.

Based on analysis of the DOJ Agreement, the Company recorded a liability of $33.3 million at December 31, 2011. During the six months ended June 30, 2012, the Company recorded an increase to the liability of $0.8 million, principally representing the recognition of the periodic effect of discounting. During the second quarter 2012, a payment of $15.0 million was paid bringing the liability at June 30, 2012 to $19.1 million, which represents the estimated fair value of the $118.0 million Additional Payments. Future changes in the fair value of the Additional

Payments could affect in future earnings each quarters.

The Company has elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. The signed settlement contract with the DOJ establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability. The Company made the fair value election as of December 31, 2011, the date the Company first recognized the financial instrument in its financial statements.

The specific terms of the payment structure are as follow:

- The Company generates positive income for a sustained period, such that part or all of the Deferred Tax Asset ("DTA"), which has been offset by a valuation allowance ("DTA Valuation Allowance"), is likely to be realized, as evidenced by the reversal of the DTA Valuation Allowance in accordance with U.S. GAAP;

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- The Company is able to include capital derived from the reversal of the DTA Valuation Allowance in the Bank's Tier 1 capital, which is the lesser of 10 percent of Tier 1 capital or the amount of the DTA that the Company expects to recover within one year based on financial projections;

- The Company's obligation to repay the $266.7 million in preferred stock held by the U.S. Treasury under the TARP Capital Purchase Program has been either extinguished or excluded from Tier 1 capital for purposes of calculating the Tier 1 capital ratio as described in the paragraph below;

- Upon the occurrence of each of the future events described above, and provided doing so would not violate any banking regulatory requirement or the OCC does not otherwise object, the Company will begin making Additional Payments provided that (i) each annual payment would be equal to the lesser of $25 million or the portion of the Additional Payments that remains outstanding after deducting prior payments; and (ii) no obligation arises until the Company's call report as filed with the OCC, including any amendments thereto, for the period ending at least six months prior to the making of such Additional Payments, reflects a minimum Tier 1 capital ratio of 11 percent (or higher if required by regulators), after excluding any unextinguished portion of the preferred stock held by U.S. Treasury under the TARP Capital Purchase Program; and

- In no event will the Company be required to make an Additional Payment if doing so would violate any material banking regulatory requirement or the OCC (or any successor regulator under the safety and soundness program) objects in writing to the making of an Additional Payment.

The fair value of the DOJ Agreement is based on a discounted cash flow valuation model that incorporates the Company's current estimate of the most likely timing and amount of the cash flows necessary to satisfy the obligation. These cash flow estimates are reflective of the Company's detailed financial and operating projections for the next three years, as well as more general growth earnings and capital assumptions for subsequent periods.

The timing of each of the metrics is dependent on the preceding metric being achieved and actual Bank operating results and forecasted assumptions could materially change the value of the liability. As the Bank's profitability increases, the value of the deferred liability would also increase.

The cash flows are discounted using a 15.6 percent discount rate that is inclusive of the risk free rate based on the expected duration of the liability and an adjustment for nonperformance risk that represents the Company's credit risk. The model assumes 12 quarters of profitability prior to reversing the valuation allowance associated with the deferred tax asset.

The liability is classified within Level 3 of the valuation hierarchy given the projections of earnings and growth rate assumptions are unobservable inputs. The litigation settlement is included in other liabilities on the Consolidated Financial Statements and changes in the fair value of the litigation settlement will be recorded each quarter in general and administrative expense within non-interest expense on the Consolidated Statements of Operations.

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Assets and liabilities measured at fair value on a recurring basis
The following tables present the financial instruments carried at fair value as of June 30, 2012 and December 31, 2011, by caption on the Consolidated Statement of Financial Condition and by the valuation hierarchy (as described above).

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| June 30, 2012 | (Dollars in thousands) | | | |
| Securities classified as trading: | | | | |
| U.S. Treasury bonds | $169,834 | $— | $— | $169,834 |
| Securities classified as available-for-sale: | | | | |
| Non-agency collateralized mortgage obligations | — | 204,326 | 100,306 | 304,632 |
| U.S. government sponsored agencies | 100,133 | — | — | 100,133 |
| Municipal obligations | — | 20,000 | — | 20,000 |
| Loans held-for-sale: | | | | |
| Residential first mortgage loans | — | 2,195,679 | — | 2,195,679 |
| Loans held-for-investment: | | | | |
| Residential first mortgage loans | — | 20,231 | — | 20,231 |
| Transferor's interest | — | — | 7,660 | 7,660 |
| Residential mortgage servicing rights | — | — | 638,865 | 638,865 |
| Equity-linked CD purchase option | 436 | — | — | 436 |
| Derivative assets: | | | | |
| Agency forwards | 6,357 | — | — | 6,357 |
| Rate lock commitments | — | — | 132,388 | 132,388 |
| U.S. Treasury futures | 7,057 | — | — | 7,057 |
| Interest rate swaps | — | 4,938 | — | 4,938 |
| Total derivative assets | 13,414 | 4,938 | 132,388 | 150,740 |
| Total assets at fair value | $283,817 | $2,445,174 | $879,219 | $3,608,210 |
| Derivative liabilities: | | | | |
| Forward agency and loan sales | $— | $(46,294) | $— | $(46,294) |
| Interest rate swaps | — | (4,938) | — | (4,938) |
| Total derivative liabilities | — | (51,232) | — | (51,232) |
| Warrant liabilities | — | (4,409) | — | (4,409) |
| Equity-linked CD written option | (436) | — | — | (436) |
| Litigation settlement | — | — | (19,100) | (19,100) |
| Total liabilities at fair value | $(436) | $(55,641) | $(19,100) | $(75,177) |

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| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| December 31, 2011 | (Dollars in thousands) | | | |
| Securities classified as trading: | | | | |
| U.S. Treasury bonds | $313,383 | $— | $— | $313,383 |
| Securities classified as available-for-sale: | | | | |
| Non-agency collateralized mortgage obligations | — | — | 365,256 | 365,256 |
| U.S. government sponsored agencies | 116,096 | — | — | 116,096 |
| Loans held-for-sale: | | | | |
| Residential first mortgage loans | — | 1,629,618 | — | 1,629,618 |
| Loans held-for-investment: | | | | |
| Residential first mortgage loans | — | 22,651 | — | 22,651 |
| Residential mortgage servicing rights | — | — | 510,475 | 510,475 |
| Derivative assets: | | | | |
| U.S. Treasury futures | 3,316 | — | — | 3,316 |
| Rate lock commitments | — | — | 70,965 | 70,965 |
| Agency forwards | 9,362 | — | — | 9,362 |
| Interest rate swaps | — | 3,296 | — | 3,296 |
| Total derivative assets | 12,678 | 3,296 | 70,965 | 86,939 |
| Total assets at fair value | $442,157 | $1,655,565 | $946,696 | $3,044,418 |
| Derivative liabilities: | | | | |
| Forward agency and loan sales | $— | $(42,978) | $— | $(42,978) |
| Interest rate swaps | — | (3,296) | — | (3,296) |
| Total derivative liabilities | — | (46,274) | — | (46,274) |
| Warrant liabilities | — | (2,411) | — | (2,411) |
| Litigation settlement (1) | — | — | (18,300) | (18,300) |
| Total liabilities at fair value | $— | $(48,685) | $(18,300) | $(66,985) |

(1) Does not include the $15.0 million payment required to be paid within 30 business days after the effective date of the DOJ Agreement, which was paid on April 3, 2012.

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources). Also, the Company manages the risk associated with the observable components of Level 3 financial instruments using securities and derivative positions that are classified within Level 1 or Level 2 of the valuation hierarchy; these Level 1 and Level 2 risk management instruments are not included below, and therefore the gains and losses in the tables do not reflect the effect of the Company's risk management activities related to such Level 3 instruments. If the market for an instrument becomes more liquid or active and pricing models become available which allow for readily observable inputs, the Company will transfer the instruments from Level 3 to Level 2 valuation hierarchy.

Interest rate swap derivatives were transferred from Level 1 to Level 2 during the fourth quarter 2011 because the derivatives are not actively being traded on a listed exchange. The interest rate swap derivatives are valued based on quoted prices for similar assets in an active market with inputs that are observable and are now classified within Level 2 of the valuation hierarchy.

Non-agency collateralized mortgage obligations were transferred from Level 3 to Level 2 during the six months ended June 30, 2012 due to increased market liquidity and an increase in the number of available pricing models. The non-agency collateralized mortgage obligations are valued based on pricing provided by external pricing services.

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Transferor's interest were transferred into Level 3 during the six months ended June 30, 2012 due to the assumptions utilized in the valuation of the claims to the note insurer and continuing credit losses on the loans underlying the securitization. Transferor's interest are valued based on pricing of the loans underlying the securitization and are now classified within Level 3 of the valuation hierarchy.

The Company had no transfers of assets or liabilities recorded at fair value for three and six months ended June 30, 2011. The Company reclassified the 2011 nonrecurring hierarchy disclosures for impaired loans and repossessed assets from Level 2 to Level 3 to reflect that the appraised values, broker price opinions or internal estimates contain unobservable inputs. The impact of the transfer did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto and was limited to disclosure.

Fair value measurements using significant unobservable inputs

The tables below include a roll forward of the Consolidated Statement of Financial Condition amounts for the three and six months ended June 30, 2012 and 2011 (including the change in fair value) for financial instruments classified by the Company within Level 3 of the valuation hierarchy.

| | | Recorded in Earnings | | Recorded in OCI | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| For the Three Months Ended June 30, 2012 | Balance at Beginning of Period | Total Unrealized Gains / (Losses) | Total Realized Gains / (Losses) | Total Unrealized Gains / (Losses) | Issuances | Purchases | Sales | Settlements | Transfers In (Out) | Balance at End of Period | Changes In Unrealized Held at End of Period (4) |
| Assets | (Dollars in thousands) | | | | | | | | | | |
| Securities classified as available-for-sale (1)(2)(3) | | | | | | | | | | | |
| Non-agency collateralized mortgage obligations | $105,034 | $— | $— | $1,006 | $— | $— | $(5,734) | $— | $— | $100,306 | $1,006 |
| Loans held-for-investment | | | | | | | | | | | |
| Transferor's interest | 8,985 | — | (1,244) | — | — | — | (81) | — | — | 7,660 | — |
| Residential mortgage servicing rights | 596,830 | (55,491) | — | — | — | 126,691 | — | (29,165) | — | 638,865 | — |
| Derivative financial instruments: | | | | | | | | | | | |
| Rate lock commitments | 68,248 | 186,426 | — | — | — | 215,389 | (249,745) | (87,930) | — | 132,388 | — |
| Totals | $779,097 | $130,935 | $(1,244) | $1,006 | $— | $342,080 | $(255,560) | $(117,095) | $— | $879,219 | $1,006 |
| Liabilities | | | | | | | | | | | |
| Litigation settlement | $(19,100) | $— | $— | $— | $— | $— | $— | $— | $— | $(19,100) | $— |

For the Three Months Ended June 30, 2011

Securities classified as

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| available-for-sale: (1)(2)(3) | | | | | | | | | | | |
| Non-agency collateralized mortgage obligations | $444,957 | $— | $— | $(5,363) | $— | $— | $(20,829) | $— | $— | $418,765 | $10,221 |
| Residential mortgage servicing rights | 635,122 | (95,976) | — | — | — | 38,255 | — | — | — | 577,401 | — |
| Derivative financial instruments: | | | | | | | | | | | |
| Rate lock commitments | 13,780 | 44,792 | — | — | — | 48,215 | (95,867) | — | — | 10,920 | — |
| Totals | $1,093,859 | $(51,184) | $— | $(5,363) | $— | $86,470 | $(116,696) | $— | $— | $1,007,086 | $10,221 |

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| | | Recorded in Earnings | | Recorded in OCI | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| For the Six Months Ended June 30, 2012 | Balance at Beginning of Period | Total Unrealized Gains / (Losses) | Total Realized Gains / (Losses) | Total Unrealized Gains / (Losses) | Issuances | Purchases | Sales | Settlements | Transfers In (Out) | Balance at End of Period | Chang In Unreal Held a of Peri |
| Assets | (Dollars in thousands) | | | | | | | | | | |
| Securities classified as available-for-sale (1)(2)(3) | | | | | | | | | | | |
| Non-agency collateralized mortgage obligations | $365,256 | $— | $— | $1,691 | $— | $— | $(11,713) | $— | $(254,928) | $100,306 | $1,691 |
| Loans held-for-investment | | | | | | | | | | | |
| Transferor's interest | — | — | (1,653) | — | — | — | (281) | — | 9,594 | 7,660 | — |
| Residential mortgage servicing rights | 510,475 | (35,586) | — | — | — | 238,175 | (18,202) | (55,997) | — | 638,865 | — |
| Derivative financial instruments: | | | | | | | | | | | |
| Rate lock commitments | 70,965 | 234,765 | — | — | — | 386,537 | (408,913) | (150,966) | — | 132,388 | — |
| Totals | $946,696 | $199,179 | $(1,653) | $1,691 | $— | $624,712 | $(439,109) | $(206,963) | $(245,334) | $879,219 | $1,691 |
| Liabilities | | | | | | | | | | | |
| Litigation settlement | $(18,300) | $— | $(800) | $— | $— | $— | $— | $— | $— | $(19,100) | $— |
| For the Six Months Ended June 30, 2011 | | | | | | | | | | | |
| Securities classified as available-for-sale: (1)(2)(3) | | | | | | | | | | | |
| Non-agency collateralized mortgage obligations | $467,488 | $— | $2,359 | $— | $— | $— | $(51,082) | $— | $— | $418,765 | $17,94 |
| Residential mortgage servicing rights | 580,299 | (91,853) | — | — | — | 88,955 | — | — | — | 577,401 | — |
| Derivative financial instruments: | | | | | | | | | | — | |
| Rate lock commitments | 14,396 | 38,590 | — | — | — | 97,059 | (139,125) | — | — | 10,920 | — |
| Totals | $1,062,183 | $(53,263) | $2,359 | $— | $— | $186,014 | $(190,207) | $— | $— | $1,007,086 | $17,94 |

(1)

Realized gains (losses), including unrealized losses deemed other-than-temporary and related to credit issues, are reported in non-interest income.

(2) U.S. government agency securities classified as available-for-sale are valued predominantly using quoted broker/dealer prices with adjustments to reflect for any assumptions a willing market participant would include in its valuation. Non-agency securities classified as available-for-sale are valued using internal valuation models and pricing information from third parties.

(3) Management had anticipated that the non-agency securities would be classified under Level 2 of the valuation hierarchy. However, due to illiquidity in the markets, the fair value of these securities has been determined using internal models and therefore is classified within Level 3 of the valuation hierarchy and pricing information from third parties.

(4) Changes in the unrealized gains (losses) related to financial instruments held at the end of the period.

The following tables present the quantitative information about recurring Level 3 fair value financial instruments and the fair value measurements as of June 30, 2012.

| | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| June 30, 2012 | (Dollars in thousands) | | | |
| Assets | | | | |
| FSTAR 2006-1 | $100,306 | Discounted cash flows | Discount rate<br>Prepay rate - 12 month historical average<br>CDR rate - 12 month historical average<br>Loss severity | 7.2% - 10.8% (9.0%)<br>8.2% - 12.3% (10.2%)<br>5.1% - 7.7% (6.4%)<br>80.0% - 120.0% (100.0%) |
| Transferor's interest | $7,660 | Discounted cash flows | Discount rate<br>Prepay rate - 3 month historical average<br>Cumulative loss rate<br>Loss severity | 4.6% - 6.9% (5.7%)<br>7.2% - 10.8% (9.0%)<br>11.3% - 17.0% (14.2%)<br>80.0% - 120.0% (100.0%) |
| Residential mortgage servicing rights | $638,865 | Discounted cash flows | Option adjusted spread<br>Constant prepayment rate<br>Weighted average cost to service per loan | 5.1% - 7.7% (6.4%)<br>15.3% - 22.8% (19.1%)<br>59.9% - 89.9% (74.9%) |
| Rate lock commitments | $132,388 | Mark-to-Market | Origination pull-through rate | 62.1% - 93.1% (77.6%) |
| Liabilities | | | | |
| Litigation settlement | $(19,100) | Discounted cash flows | Asset growth rate<br>MSR growth rate<br>Return on assets (ROA) improvement | 4.4% - 6.6% (5.5%)<br>0.9% - 1.4% (1.2%)<br>0.02% - 0.04% (0.03%) |

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The significant unobservable inputs used in the fair value measurement of the FSTAR 2006-1 securitization trust are discount rates, prepayment rates and default rates. While loss severity (in the event of default) is an unobserveable input, the sensitivity of the fair value to this input is zero because of the insurer coverage on the deal. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases in both prepay rates and default rates in isolation result in a higher fair value; however, generally a change in the assumption used for the probability of default is accompanied by a directionally opposite change in the assumption used for prepayment rates, which would offset a portion of the fair value change.

The significant unobservable inputs used in the fair value measurement of the transferor's interest are discount rates, prepayment rates, loss rates and loss severity. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases in both prepay rates and loss rates in isolation result in a lower fair value; however, generally a change in the assumption used for the loss rate is accompanied by a directionally opposite change in the assumption used for prepayment rates, which would offset a portion of the fair value change. Significant increases (decreases) in the loss severity rate in isolation would result in a significantly lower (higher) fair value measurement.

The significant unobservable inputs used in the fair value measurement of the MSRs are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation would result in a significantly lower (higher) fair value measurement.

The significant unobservable input used in the fair value measurement of the rate lock commitments is the pull through rate. The pull through rate is a statistical analysis of the Company's actual rate lock fallout history to determine the sensitivity of the residential mortgage loan pipeline compared to interest rate changes and other deterministic values. New market prices are applied based on updated loan characteristics and new fall out ratios (i.e., the inverse of the pull through rate) are applied accordingly. Significant increases (decreases) in the pull through rate in isolation would result in a significantly higher (lower) fair value measurement. Generally, a change in the assumption utilized for the probability of default is accompanied by a directionally similar change in the assumption utilized for the loss severity and a directionally opposite change in assumption utilized for prepayment rates.

The significant unobservable inputs used in the fair value measurement of the DOJ Agreement are future balance sheet and growth rate assumptions for overall asset growth, MSR growth, and return on assets improvement. The current assumptions are based on management's strategic performance targets beyond the current strategic modeling horizon (2015). The Bank's target asset growth rate post 2015 is based off of growth in the balance sheet post TARP preferred stock repayment. Significant increases (decreases) in the bank's asset growth rate in isolation would result in a significantly lower (higher) fair value measurement. Significant increases (decreases) in the bank's MSR growth rate in isolation would result in a marginally lower (higher) fair value measurement. Significant increases (decreases) in the bank's return on assets improvement in isolation would result in a marginally higher (lower) fair value measurement.

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The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets are measured at the lower of cost or market and had a fair value below cost at the end of the period as summarized below.

Assets Measured at Fair Value on a Non-recurring Basis

| | Total | Level 3 |
|---|---|---|
| | (Dollars in thousands) | |
| June 30, 2012 | | |
| Impaired loans held-for-investment: (1) | | |
| Residential first mortgage loans | $140,103 | $140,103 |
| Commercial real estate loans | 146,135 | 146,135 |
| Repossessed assets (2) | 107,235 | 107,235 |
| Totals | $393,473 | $393,473 |
| December 31, 2011 | | |
| Impaired loans held-for-investment: (1) | | |
| Residential first mortgage loans | $210,040 | $210,040 |
| Commercial real estate loans | 180,306 | 180,306 |
| Repossessed assets (2) | 114,715 | 114,715 |
| Totals (3) | $505,061 | $505,061 |

(1) The Company recorded $42.1 million and $89.9 million in fair value losses on impaired loans (included in provision for loan losses on the Consolidated Statements of Operations) during the three and six months ended June 30, 2012, respectively, compared to $15.2 million and $29.8 million in fair value losses on impaired loans during the three and six months ended June 30, 2011, respectively.

(2) The Company recorded $4.0 million and $9.8 million in losses related to write-downs of repossessed assets based on the estimated fair value of the specific assets, and recognized net gains of $3.2 million and $2.5 million on sales of repossessed assets during the three and six months ended June 30, 2012, respectively, compared to $5.7 million and $18.9 million in losses related to write-downs of repossessed assets based on the estimated fair value of the specific assets, and recognized net gains of $0.8 million and $0.7 million on sales of repossessed assets during the three and six months ended June 30, 2011, respectively.

(3) As of December 31, 2011, the Company reclassified impaired loans and repossessed assets from Level 2 to Level 3 to reflect that many of the appraised values, price opinions or internal estimates contain unobservable inputs.

The following tables present the quantitative information about non-recurring Level 3 fair value financial instruments and the fair value measurements as of June 30, 2012.

| | Fair Value | Valuation Technique(s) | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| June 30, 2012 | (Dollars in thousands) | | | |
| Impaired loans held-for-investment: | | | | |
| Residential mortgage loans | $140,103 | Fair value of collateral | Loss severity discount | 0% - 100% (47.3%) |
| Commercial real estate loans | $146,135 | Fair value of collateral | Loss severity discount | 0% - 100% (59.2%) |
| Repossessed assets | $107,235 | Fair value of collateral | Loss severity discount | 0% - 100% (40.4%) |

The Company has certain impaired residential and commercial real estate loans that are measured at fair value on a nonrecurring basis. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. Appraisals or other third party price opinions are generally obtained to support the fair value of the collateral and incorporate measures such as recent sales prices for comparable properties. In cases where the carrying value exceeds the fair value of the collateral less cost to sell, an impairment charge is recognized.

Repossessed assets are measured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the repossessed asset. The fair value of repossessed assets, upon initial recognition, are estimated using Level 3 inputs based on customized discounting criteria. The significant unobservable inputs used in the Level 3 fair value measurements of the Company's impaired loans and repossessed assets included in the table above primarily relate to internal valuations or analysis.

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Fair Value of Financial Instruments

The accounting guidance for financial instruments requires disclosures of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate their fair values. Certain financial instruments and all non-financial instruments are excluded from the scope of this guidance. Accordingly, the fair value disclosures required by this guidance are only indicative of the value of individual financial instruments as of the dates indicated and should not be considered an indication of the fair value of the Company.

The following table presents the carrying amount and estimated fair value of certain financial instruments not recorded at fair value in entirety on a recurring basis.

| | June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| | Carrying Value | Total | Level 1 | Level 2 | Level 3 |
| | (Dollars in thousands) | | | | |
| Financial Instruments | | | | | |
| Assets: | | | | | |
| Cash and cash equivalents | $1,270,389 | $1,270,389 | $1,270,389 | $— | $— |
| Securities classified as trading | 169,834 | 169,834 | 169,834 | — | — |
| Securities classified as available-for-sale | 424,765 | 424,765 | 100,133 | 224,326 | 100,306 |
| Loans held-for-sale | 2,459,482 | 2,495,820 | — | 2,495,820 | — |
| Loans repurchased with government guarantees | 1,999,110 | 1,879,164 | — | 1,879,164 | — |
| Loans held-for-investment, net | 6,263,257 | 6,273,505 | — | — | 6,273,505 |
| Accrued interest receivable | 103,985 | 103,985 | — | 103,985 | — |
| Repossessed assets | 107,235 | 107,235 | — | — | 107,235 |
| FHLB stock | 301,737 | 301,737 | 301,737 | — | — |
| Mortgage servicing rights | 638,865 | 638,865 | — | — | 638,865 |
| Customer initiated derivative interest-rate swaps | 4,938 | 4,938 | — | 4,938 | — |
| Equity-linked CD purchase option | 436 | 436 | 436 | — | — |
| Liabilities: | | | | | |
| Retail deposits: | | | | | |
| Demand deposits and savings accounts | (2,949,876) | (2,876,204) | — | (2,876,204) | — |
| Certificates of deposit | (3,126,194) | (3,153,767) | — | (3,153,767) | — |
| Government accounts | (721,218) | (717,028) | — | (717,028) | — |
| National certificates of deposit | (339,372) | (345,264) | — | (345,264) | — |
| Company controlled deposits | (1,786,187) | (1,782,872) | — | (1,782,872) | — |
| FHLB advances | (3,400,000) | (3,672,432) | (3,672,432) | — | — |
| Long-term debt | (248,585) | (257,710) | — | (257,710) | — |
| Accrued interest payable | (12,271) | (12,271) | — | (12,271) | — |
| Warrant liabilities | (4,409) | (4,409) | — | (4,409) | |
| Litigation settlement | (19,100) | (19,100) | — | — | (19,100) |
| Customer initiated derivative interest-rate swaps | (4,938) | (4,938) | — | (4,938) | — |
| Equity-linked CD written option | (436) | (436) | (436) | — | — |
| Derivative Financial Instruments: | | | | | |
| Forward delivery contracts | (46,294) | (46,294) | — | (46,294) | — |
| Commitments to extend credit | 132,388 | 132,388 | — | — | 132,388 |
| U.S. Treasury and agency futures/forwards | 13,414 | 13,414 | 13,414 | — | — |

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| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| | Carrying Value | Total | Level 1 | Level 2 | Level 3 |
| | (Dollars in thousands) | | | | |
| Financial Instruments | | | | | |
| Assets: | | | | | |
| Cash and cash equivalents | $731,058 | $731,058 | $731,058 | $— | $— |
| Securities classified as trading | 313,383 | 313,383 | 313,383 | — | — |
| Securities classified as available-for-sale | 481,352 | 481,352 | 116,096 | — | 365,256 |
| Loans held-for-sale | 1,800,885 | 1,823,421 | — | 1,823,421 | — |
| Loans repurchased with government guarantees | 1,899,267 | 1,899,267 | — | 1,899,267 | — |
| Loans held-for-investment, net | 6,720,587 | 6,748,914 | — | — | 6,748,914 |
| Accrued interest receivable | 105,200 | 105,200 | — | 105,200 | — |
| Repossessed assets | 114,715 | 114,715 | — | — | 114,715 |
| FHLB stock | 301,737 | 301,737 | 301,737 | — | — |
| Mortgage servicing rights | 510,475 | 510,475 | — | — | 510,475 |
| Customer initiated derivative interest-rate swaps | 3,296 | 3,296 | — | 3,296 | — |
| Liabilities: | | | | | |
| Retail deposits: | | | | | |
| Demand deposits and savings accounts | (2,520,710) | (2,440,208) | — | (2,440,208) | — |
| Certificates of deposit | (2,972,258) | (3,001,645) | — | (3,001,645) | — |
| Government accounts | (711,097) | (705,991) | — | (705,991) | — |
| National certificates of deposit | (384,910) | (394,442) | — | (394,442) | — |
| Company controlled deposits | (1,101,013) | (1,095,602) | — | (1,095,602) | — |
| FHLB advances | (3,953,000) | (4,195,163) | (4,195,163) | — | — |
| Long-term debt | (248,585) | (80,575) | — | (80,575) | — |
| Accrued interest payable | (8,723) | (8,723) | — | (8,723) | — |
| Warrant liabilities | (2,411) | (2,411) | — | (2,411) | — |
| Litigation settlement | (18,300) | (18,300) | — | — | (18,300) |
| Customer initiated derivative interest-rate swaps | (3,296) | (3,296) | — | (3,296) | — |
| Derivative Financial Instruments: | | | | | |
| Forward delivery contracts | (42,978) | (42,978) | — | (42,978) | — |
| Commitments to extend credit | 70,965 | 70,965 | — | — | 70,965 |
| U.S. Treasury and agency futures/forwards | 12,678 | 12,678 | 12,678 | — | — |

The methods and assumptions were used by the Company in estimating fair value of financial instruments that were not previously disclosed.

Cash and cash equivalents. Due to their short-term nature, the carrying amount of cash and cash equivalents approximates fair value.

Loans repurchased with government guarantees. The fair value of loans is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

Loans held-for-investment. The fair value of loans is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

FHLB stock. No secondary market exists for FHLB stock. The stock is bought and sold at par by the FHLB. Management believes that the recorded value is the fair value.

Accrued interest receivable. The carrying amount is considered a reasonable estimate of fair value.

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Deposit accounts. The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.
FHLB advances. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.
Long-term debt. The fair value of the long-term debt is estimated based on a discounted cash flow model that incorporates the Company's current borrowing rates for similar types of borrowing arrangements.
Accrued interest payable.  The carrying amount is considered a reasonable estimate of fair value.
Fair Value Option

The Company has elected, under the fair value option in ASC 825: Financial Instruments, to record at fair value certain financial assets and financial liabilities. The fair value election is typically made on an instrument by instrument basis. The decision to measure a financial instrument at fair value cannot be revoked once the election is made. Upon adoption of Statement of Financial Accounting Standards ("SFAS") 159: The Fair Value Option for Financial Assets and Financial Liabilities, the Company made a policy decision to elect the fair value option for loans held-for-sale originated post 2009.

The Company has elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. The signed settlement contract with the DOJ establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability. The Company made the fair value election as of December 31, 2011, the date the Company first recognized the financial instrument in its financial statements.

The Company elected the fair value option for held-for-sale loans and the litigation settlement liability to better reflect the management of these financial instruments on a fair value basis. Interest income on loans held-for-sale is accrued on the principal outstanding primarily using the "simple-interest" method. Interest expense on the litigation settlement will be included in the overall change in fair value of the liability each quarter.

At June 30, 2012 and December 31, 2011, the balance of the fair value of the loans held-for-sale was $2.2 billion and $1.6 billion, respectively. The change in fair value included in earnings was $176.9 million and $298.0 million for the three and six months ended June 30, 2012, respectively, compared to $82.8 million and $127.1 million for the three and six months ended June 30, 2011, respectively. Changes in fair value of the loans held-for-sale are recorded in net gain on loan sales on the Company's Consolidated Statements of Operations.

At June 30, 2012 and December 31, 2011, the balance of the fair value of the loans held-for-investment was $20.2 million and $22.7 million, respectively. The change in fair value included in earnings was $0.7 million and $(0.4) million during the three and six months ended June 30, 2012, respectively, compared to $0.3 million and $0.8 million for the three and six months ended June 30, 2011, respectively. Changes in fair value of the loans held-for-investment are reflected in interest income on loans on the Company's Consolidated Statements of Operations.

At June 30, 2012 and December 31, 2011, the fair value of financial liabilities, which related to the DOJ Agreement, was $19.1 million and $18.3 million, respectively, and included in other liabilities in the Consolidated Statements of Financial Condition. There was no increase recorded during the three months ended June 30, 2012 and a $0.8 million increase for the six months ended June 30, 2012, primarily representing the recognition of the periodic effect of discounting. The increase was recorded in general and administrative expense within non-interest expense on the Consolidated Statements of Operations.

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The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding as of June 30, 2012 and December 31, 2011 for assets and liabilities for which the fair value option has been elected.

| | June 30, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | | |
| | Unpaid Principal Balance ("UPB") | Fair Value | Fair Value Over / (Under) UPB | Unpaid Principal Balance | Fair Value | Fair Value Over / (Under) UPB |
| Assets | | | | | | |
| Nonaccrual loans: | | | | | | |
| Loans held-for-sale | $— | $— | $— | $281 | $291 | $10 |
| Loans held-for-investment | 2,907 | 2,847 | (60) | 2,989 | 2,963 | (26) |
| Total loans | 2,907 | 2,847 | (60) | 3,270 | 3,254 | (16) |
| Other performing loans: | | | | | | |
| Loans held-for-sale | 2,084,156 | 2,195,679 | 111,523 | 1,570,302 | 1,629,327 | 59,025 |
| Loans held-for-investment | 16,451 | 17,384 | 933 | 18,699 | 19,688 | 989 |
| Total loans | 2,100,607 | 2,213,063 | 112,456 | 1,589,001 | 1,649,015 | 60,014 |