FLAGSTAR BANCORP INC
Form 10-Q
August 09, 2016
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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, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes 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 5, 2016, 56,576,203 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Cash	$ 64	$ 54
Interest-earning deposits	120	154
Total cash and cash equivalents	184	208
Investment securities available-for-sale	1,145	1,294
Investment securities held-to-maturity	1,211	1,268
Loans held-for-sale ($3,071 and $2,541 measured at fair value, respectively)	3,091	2,576
Loans held-for-investment ($88 and $111 measured at fair value, respectively)	5,822	6,352
Loans with government guarantees	435	485
Less: allowance for loan losses	(150)	(187)
Total loans held-for-investment and loans with government guarantees, net	6,107	6,650
Mortgage servicing rights	301	296
Federal Home Loan Bank stock	172	170
Premises and equipment, net	259	250
Net deferred tax asset	333	364
Other assets	920	639
Total assets	$ 13,723	$ 13,715
Liabilities and Stockholders' Equity		
Noninterest bearing deposits	$ 2,109	$ 1,574
Interest bearing deposits	6,462	6,361
Total deposits	8,571	7,935
Short-term Federal Home Loan Bank advances	1,069	2,116
Long-term Federal Home Loan Bank advances	1,577	1,425
Other long-term debt	247	247
Representation and warranty reserve	36	40
Other liabilities ($84 and $84 measured at fair value, respectively)	624	423
Total liabilities	12,124	12,186
Stockholders' Equity		
Preferred stock $0.01 par value, liquidation value $1,000 per share, 25,000,000 shares authorized; 266,657 issued and outstanding, respectively	267	267
Common stock $0.01 par value, 70,000,000 shares authorized; 56,575,779 and 56,483,258 shares issued and outstanding, respectively	1	1
Additional paid in capital	1,491	1,486
Accumulated other comprehensive (loss) income	(19)	2
Accumulated deficit	(141)	(227)
Total stockholders' equity	1,599	1,529
Total liabilities and stockholders' equity	$ 13,723	$ 13,715

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest Income	(Unaudited)			
Loans	$82	$ 74	$166	$ 139
Investment securities	17	15	34	29
Interest-earning deposits and other	—	1	—	1
Total interest income	99	90	200	169
Interest Expense				
Deposits	11	11	22	20
Short-term debt	1	—	3	—
Long-term debt	8	4	15	7
Other debt	2	2	4	4
Total interest expense	22	17	44	31
Net interest income	77	73	156	138
Provision (benefit) for loan losses	(3)	(13)	(16)	(17)
Net interest income after provision (benefit) for loan losses	80	86	172	155
Noninterest Income				
Net gain on loan sales	90	83	165	174
Loan fees and charges	19	19	34	36
Deposit fees and charges	6	6	12	12
Loan administration income	4	7	10	11
Net (loss) return on mortgage servicing rights	(4)	9	(10)	7
Net loss on sale of assets	—	(2)	(2)	(2)
Representation and warranty benefit	4	5	6	7
Other noninterest income (loss)	9	(1)	18	—
Total noninterest income	128	126	233	245
Noninterest Expense				
Compensation and benefits	66	59	134	120
Commissions	14	11	24	21
Occupancy and equipment	21	20	43	40
Asset resolution	1	5	4	13
Federal insurance premiums	3	6	6	12
Loan processing expense	15	14	27	26
Legal and professional expense	6	8	15	17
Other noninterest expense	13	15	23	27
Total noninterest expense	139	138	276	276
Income before income taxes	69	74	129	124
Provision for income taxes	22	28	43	46
Net income	$47	$ 46	$86	$ 78
Income per share				
Basic	$0.67	$ 0.69	$1.23	$ 1.12
Diluted	$0.66	$ 0.68	$1.21	$ 1.11
Weighted average shares outstanding				
Basic	56,574,796	56,436,026	56,544,256	56,410,880
Diluted	57,751,230	57,165,072	57,623,081	56,971,133

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Unaudited)			
Net income	$47	$46	$86	78
Other comprehensive income, net of tax				
Investment securities				
Unrealized gain (loss) (net of tax effect $1, $9, $10 and $1, respectively)	1	(16)	16	—
Net change in unrealized gain (loss) on investment securities, net of tax	1	(16)	16	—
Derivatives and hedging activities				
Unrealized loss (net of tax effect $3, $0, $19 and $0, respectively)	(12)	—	(44)	—
Less: Reclassification of net loss on derivative instruments	3	—	7	—
Net change in derivatives and hedging activities, net of tax	(9)	—	(37)	—
Other comprehensive (loss) income, net of tax	(8)	(16)	(21)	—
Comprehensive income	$39	$30	$65	$ 78

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

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

	Preferred Stock		Common Stock					
	Number of Shares Outstanding	Amount of Preferred Stock	Number of Shares Outstanding	Amount of Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2014	266,657	$ 267	56,332,307	$ 1	$ 1,482	$ 8	$ (385)	$ 1,373
(Unaudited)								
Net income	—	—	—	—	—	—	78	78
Stock-based compensation	—	—	103,719	—	—	—	—	—
Balance at June 30, 2015	266,657	$ 267	56,436,026	$ 1	$ 1,482	$ 8	$ (307)	$ 1,451
Balance at December 31, 2015	266,657	$ 267	56,483,258	$ 1	$ 1,486	$ 2	$ (227)	$ 1,529
(Unaudited)								
Net income	—	—	—	—	—	—	86	86
Total other comprehensive loss	—	—	—	—	—	(21)	—	(21)
Stock-based compensation	—	—	92,521	—	5	—	—	5
Balance at June 30, 2016	266,657	$ 267	56,575,779	$ 1	$ 1,491	$ (19)	$ (141)	$ 1,599

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

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

	Six Months Ended June 30,	
	2016	2015
	(Unaudited)	
Operating Activities		
Net income	$86	$78
Adjustments to reconcile net income to net cash used in operating activities:		
(Benefit) provision for loan losses	(16)	(17)
Representation and warranty (benefit) provision	(6)	(7)
Depreciation and amortization	16	11
Deferred income taxes	31	43
Net gain on loan and asset sales	(163)	(171)
Change in fair value and other non-cash changes	(197)	(334)
Proceeds from sales of loans held-for-sale ("HFS")	9,761	9,764
Origination, premium paid and purchase of loans, net of principal repayments	(14,639)	(14,458)
Decrease (increase) in accrued interest receivable	1	(4)
(Increase) decrease in other assets	(58)	43
Increase in other liabilities	31	6
Net cash used in operating activities	(5,153)	(5,046)
Investing Activities		
Proceeds from sale of available for sale securities including loans that have been securitized	5,943	4,558
Collection of principal on investment securities available-for-sale	68	124
Purchase of investment securities available-for-sale and other	(68)	(724)
Collection of principal on investment securities held-to-maturity ("HTM")	72	—
Purchase of investment securities HTM	(15)	—
Proceeds received from the sale of held-for-investment loans ("HFI")	228	710
Origination and purchase of loans HFI, net of principal repayments	(812)	(1,717)
Purchase of bank owned life insurance	(85)	(150)
Proceeds from the disposition of repossessed assets	9	13
Net (purchase) redemption of Federal Home Loan Bank stock	(2)	42
Acquisitions of premises and equipment, net of proceeds	(25)	(19)
Proceeds from the sale of mortgage servicing rights	21	100
Net cash provided by investing activities	5,334	2,937
Financing Activities		
Net increase in deposit accounts	636	580
Net change in short-term borrowings	(1,047)	—
Proceeds from long-term Federal Home Loan Bank advances	150	14,480
Repayment of long-term Federal Home Loan Bank advances	—	(12,796)
Repayment of long-term debt	—	(50)
Net receipt (disbursement) of payments of loans serviced for others	52	(3)
Net receipt of escrow payments	4	8
Net cash (used in) provided by financing activities	(205)	2,219
Net (decrease) increase in cash and cash equivalents	(24)	110
Beginning cash and cash equivalents	208	136
Ending cash and cash equivalents	$184	$246
Supplemental disclosure of cash flow information		

Interest paid on deposits and other borrowings	$37	$26
Income tax payments	$2	$3
Non-cash reclassification of loans originated HFI to loans HFS	$1,331	$775
Non-cash reclassification of mortgage loans originated HFS to HFI	$—	$27
Non-cash reclassification of mortgage loans HFS to AFS securities	$5,768	$4,566
Mortgage servicing rights resulting from sale or securitization of loans	$122	$146
Non-cash reclassification of loans with government guarantee to other assets	$—	$373

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

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

Note 1 – Basis of Presentation

The accompanying financial statements of Flagstar Bancorp, Inc. ("Flagstar," or the "Company"), including its wholly owned principal subsidiary, Flagstar Bank, FSB (the "Bank"), have been prepared using U.S. generally accepted accounting principles ("GAAP") for interim financial statements. Where we say "we," "us," or "our," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," or "our" will include our wholly owned subsidiary Flagstar Bank, FSB (the "Bank").

These consolidated financial statements do not include all of the information and footnotes required by GAAP for a full year presentation and certain disclosures have been condensed or omitted in accordance with rules and regulations of the Securities and Exchange Commission. These interim financial statements are unaudited and include, in our opinion, all adjustments necessary for a fair statement of the results for the periods indicated, which are not necessarily indicative of results which may be expected for the full year. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, which is available on our website, at flagstar.com, and on the SEC website, at sec.gov. Certain prior period amounts have been reclassified to conform to the current period presentation.

Note 2 – Investment Securities

As of June 30, 2016 and December 31, 2015, investment securities were comprised of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
June 30, 2016				
Available-for-sale securities				
Agency - Commercial	$626	$ 14	$ —	$640
Agency - Residential	461	12	—	473
Municipal obligations	31	1	—	32
Total available-for-sale securities (1)	$1,118	$ 27	$ —	$1,145
Held-to-maturity securities				
Agency - Commercial	$635	$ 12	$ —	$647
Agency - Residential	576	14	—	590
Total held-to-maturity securities (1)	$1,211	$ 26	$ —	$1,237
December 31, 2015				
Available-for-sale securities				
Agency - Commercial	$766	$ 3	$ (3)	$766
Agency - Residential	514	2	(2)	514
Municipal obligations	14	—	—	14
Total available-for-sale securities (1)	$1,294	$ 5	$ (5)	$1,294
Held-to-maturity securities				
Agency - Commercial	$634	$ —	$ (2)	$632
Agency - Residential	634	—	(4)	630
Total held-to-maturity securities (1)	$1,268	$ —	$ (6)	$1,262

(1)

There were no securities of a single issuer, which are not governmental or government-sponsored, that exceeded 10 percent of stockholders’ equity at June 30, 2016 or December 31, 2015.

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Credit related declines in the available-for-sale and held-to-maturity securities are classified as other than temporary impairments and are reported as a separate component of noninterest income within the Consolidated Statement of Operations. An impaired investment security is considered to be other than temporary if (1) we intend to sell the security; (2) it is more likely than not we will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover all contractually required principal and interest payments.

We evaluate our securities portfolio each quarter to determine if any security is considered to be other than temporarily impaired. In making this evaluation, management considers its ability and intent to hold securities to recover current market losses. During the three and six months ended June 30, 2016 and June 30, 2015, we had no other-than-temporary impairments.

Available-for-sale securities

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

We purchased $40 million and $68 million, respectively, of available-for-sale securities, which included U.S. government sponsored agency mortgage-backed securities and municipal obligations, during the three and six months ended June 30, 2016. We purchased $72 million and $724 million, respectively, of available-for-sale securities, which included U.S. government sponsored agencies comprised of mortgage-backed securities and collateralized mortgage obligations during the three and six months ended June 30, 2015.

Gains (losses) on sales of available-for-sale securities are reported in other noninterest income in the Consolidated Statements of Operations. During both the three and six months ended June 30, 2016, there were $175 million in sales of available-for-sale securities, which did not include those related to mortgage loans that had been securitized for sale in the normal course of business. These sales resulted in a realized gain of $1 million during both the three and six months ended June 30, 2016. During the three and six months ended June 30, 2015, there were no sales of available-for-sale securities, except those related to mortgage loans that had been securitized for sale in the normal course of business.

Held-to-maturity securities

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

Transfers of investment securities into the held-to-maturity category from the available-for-sale category are accounted for at fair value on the date of transfer. The related unrealized gain, net of tax that was included in the transfer is retained in other comprehensive income amortizing as an adjustment to interest income over the remaining life of the securities. During the third quarter 2015, we transferred $1.1 billion of available-for-sale securities to held-to-maturity securities at a premium of $8 million, reflecting our intent and ability to hold those securities to maturity. The related $5 million of unrealized holding gain, net of tax, that was included in the transfer is retained in other comprehensive income (loss) and is being amortized as an adjustment to interest income over the remaining life of the securities. There were no gains or losses recognized as a result of this transfer.

We purchased zero and $15 million of held-to-maturity securities, which included U.S. government sponsored agency mortgage-backed securities during the three and six months ended June 30, 2016, respectively. During the three and six months ended June 30, 2015, we had no purchases of held-to-maturity securities.

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The following table summarizes by duration the unrealized loss positions on investment securities:

	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
	Fair Value	Number of Securities	Unrealized Loss	Fair Value	Number of Securities	Unrealized Loss
Type of Security	(Dollars in millions)					
June 30, 2016						
Available-for-sale securities						
Agency - Commercial	$7	1	$ —	$13	2	$ —
Held-to-maturity securities						
Agency - Commercial	$—	—	$ —	$57	4	$ —
December 31, 2015						
Available-for-sale securities						
Agency - Commercial	$—	—	$ —	$482	27	$ (3)
Agency - Residential	$8	2	$ —	$224	15	$ (2)
Held-to-maturity securities						
Agency - Commercial	$—	—	$ —	$471	27	$ (2)
Agency - Residential	$—	—	$ —	$547	50	$ (4)

The amortized cost and estimated fair value of securities at June 30, 2016, are presented below by contractual maturity:

	Investment Securities Available-for-Sale			Investment Securities Held-to-maturity		
	Amortized Cost	Fair Value	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
June 30, 2016	(Dollars in millions)			(Dollars in millions)		
Due after one year through five years	$18	$18	3.97 %	$—	$—	— %
Due after five years through 10 years	7	7	2.66 %	61	64	2.50 %
Due after 10 years	1,093	1,120	2.59 %	1,150	1,173	2.40 %
Total	$1,118	$1,145		$1,211	$1,237	

We pledge investment securities, primarily municipal taxable and agency collateralized mortgage obligations, to collateralize lines of credit and/or borrowings. At June 30, 2016, we pledged $234 million of investment securities, compared to $14 million at December 31, 2015.

Note 3 – Loans Held-for-Sale

The majority of our mortgage loans originated as loans held-for-sale are sold into the secondary market on a whole loan basis or by securitizing the loans and selling the securities. At June 30, 2016 and December 31, 2015, loans held-for-sale totaled $3.1 billion and $2.6 billion, respectively. For the three and six months ended June 30, 2016, we had net gains on loan sales associated with loans held-for-sale, excluding the gains from the sale of mortgage loans transferred from loans held-for-investment, of $85 million and $151 million, respectively, as compared to $83 million and $174 million during the three and six months ended June 30, 2015, respectively.

At June 30, 2016 and December 31, 2015, $20 million and $35 million, respectively, of loans held-for-sale were recorded at lower of cost or fair value. The remainder of the loans in the portfolio are recorded at fair value as we have elected the fair value option for such loans.

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Note 4 – Loans with Government Guarantees

The majority of loans with government guarantees are insured or guaranteed by the Federal Housing Administration ("FHA") and U.S. Department of Veterans Affairs. FHA loans earn interest at a rate based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent, which is not paid by the FHA until claimed. Certain loans within our portfolio may be subject to indemnifications and insurance limits which exposes us to limited credit risk. We have reserved for this risk as a component of our allowance for loan losses on residential first mortgages.

At June 30, 2016 and December 31, 2015, loans with government guarantees totaled $435 million and $485 million, respectively. At June 30, 2016, repossessed assets and the associated claims recorded in other assets totaled $178 million and $210 million at December 31, 2015.

Note 5 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows:

	June 30, 2016	December 31, 2015
	(Dollars in millions)	
Consumer loans		
Residential first mortgage	$2,075	$ 3,100
Second mortgage	127	135
HELOC	346	384
Other	32	31
Total consumer loans	2,580	3,650
Commercial loans		
Commercial real estate (1)	976	814
Commercial and industrial	615	552
Warehouse lending	1,651	1,336
Total commercial loans	3,242	2,702
Total loans held-for-investment	$5,822	$ 6,352

(1) Includes $221 million and $188 million, respectively, of commercial owner occupied real estate loans at June 30, 2016 and December 31, 2015.

During the six months ended June 30, 2016 and June 30, 2015, we transferred zero and $27 million, respectively, of loans held-for-sale to loans held-for-investment, based upon a change in our intent.

During the six months ended June 30, 2016, we sold nonperforming, TDR and non-agency loans with unpaid principal balances of $110 million. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a loss on sale of $2 million during the six months ended June 30, 2016, which is recorded in net loss on sale of assets on the Consolidated Statements of Operations. The loans sold also resulted in a charge-off of $8 million during the six months ended June 30, 2016.

Also, during the six months ended June 30, 2016, we sold performing residential first mortgage loans with unpaid principal balances of $1.2 billion. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a gain of $14 million, which is recorded in net gain on loan sales on the Consolidated Statements of Operations.

During the six months ended June 30, 2015, we sold interest-only residential first mortgage loans with unpaid principal balances totaling $386 million, along with $401 million of nonperforming, TDR and non-agency first mortgage loans. Upon a change in our intent, the loans were transferred to held-for-sale and subsequently sold resulting in a loss on sale of $1 million during the six months ended June 30, 2015. The loans sold also resulted in a charge-off of $51 million during the six months ended June 30, 2015.

During the six months ended June 30, 2016, we purchased jumbo residential first mortgage loans with an unpaid principal balance of $150 million with a premium of $1 million. During the six months ended June 30, 2015, we purchased $197 million of HELOC loans with a premium of $7 million.

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We have pledged certain loans held-for-investment, loans held-for-sale, and loans with government guarantees to collateralize lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the Federal Home Loan Bank of Indianapolis. At June 30, 2016 and December 31, 2015, we pledged $4.9 billion and $5.8 billion, respectively.

Allowance for Loan Losses

We determine the appropriate level of the allowance on at least a quarterly basis. Refer to Note 1, "Description of Business, Basis of Presentation, and Summary of Significant Accounting Policies" to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2015, for a description of the methodology. The allowance for loan losses, other than for loans that have been identified for individual evaluation for impairment, is determined on a loan pool basis by grouping loan types with common risk characteristics to determine our best estimate of incurred losses.

The allowance for loan losses by class of loan are summarized in the following table:

	Residential First Mortgage (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
Three Months Ended June 30, 2016								
Beginning balance allowance for loan losses	$95	$ 10	$ 20	$ 2	$ 19	$ 10	$ 6	$162
Charge-offs (2)	(8)	(1)	—	(1)	—	—	—	(10)
Recoveries	1	1	(1)	—	—	—	—	1
(Benefit) provision	(7)	—	1	—	—	1	2	(3)
Ending balance allowance for loan losses	$81	$ 10	$ 20	$ 1	$ 19	$ 11	$ 8	$150
Three Months Ended June 30, 2015								
Beginning balance allowance for loan losses	$188	$ 12	$ 21	$ —	$ 16	$ 12	$ 4	$253
Charge-offs (2)	(19)	(1)	—	(1)	—	—	—	(21)
Recoveries	1	1	—	1	—	—	—	3
(Benefit) provision	(19)	2	4	1	(1)	—	—	(13)
Ending balance allowance for loan losses	$151	$ 14	$ 25	$ 1	$ 15	$ 12	$ 4	$222
Six Months Ended June 30, 2016								
Beginning balance allowance for loan losses	$116	$ 11	$ 21	$ 2	$ 18	$ 13	$ 6	$187
Charge-offs (2)	(19)	(2)	(1)	(2)	—	—	—	(24)
Recoveries	1	1	—	1	—	—	—	3
Provision (benefit)	(17)	—	—	—	1	(2)	2	(16)
Ending balance allowance for loan losses	$81	$ 10	$ 20	$ 1	$ 19	$ 11	$ 8	$150
Six Months Ended June 30, 2015								
Beginning balance allowance for loan losses	$234	$ 12	$ 19	$ 1	$ 17	$ 11	$ 3	$297
Charge-offs (2)	(60)	(2)	(1)	(1)	—	—	—	(64)

Recoveries	2	1	—	1	2	—	—	6
Provision (benefit)	(25)	3	7	—	(4)	1	1	(17)
Ending balance allowance for loan losses	$151	$ 14	$ 25	$ 1	$ 15	$ 12	$ 4	$222

(1) Includes allowance and charge-offs related to loans with government guarantees.

(2) Includes charge-offs of $2 million and $15 million related to the sale or transfer of loans during the three months ended June 30, 2016 and June 30, 2015, respectively, and $8 million and $51 million related to the sale of loans during the six months ended June 30, 2016 and June 30, 2015, respectively. Also includes charge-offs related to loans with government guarantees of $4 million and $7 million during the three and six months ended June 30, 2016, respectively.

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

	Residential First Mortgage (1)	Second Mortgage	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Warehouse Lending	Total
	(Dollars in millions)							
June 30, 2016								
Loans held-for-investment								
Individually evaluated	$43	$ 27	$ 6	$ —	$ —	$ 1	$ —	$77
Collectively evaluated (2)	2,027	61	296	32	976	614	1,651	5,657
Total loans	$2,070	$ 88	$ 302	$ 32	$ 976	$ 615	$ 1,651	$5,734
Allowance for loan losses								
Individually evaluated	$7	$ 6	$ 3	$ —	$ —	$ —	$ —	$16
Collectively evaluated (2)	74	4	17	1	19	11	8	134
Total allowance for loan losses	$81	$ 10	$ 20	$ 1	$ 19	$ 11	$ 8	$150
December 31, 2015								
Loans held-for-investment								
Individually evaluated	$87	$ 28	$ 3	$ —	$ —	$ 2	$ —	$120
Collectively evaluated (2)	3,007	65	318	31	814	550	1,336	6,121
Total loans	$3,094	$ 93	$ 321	$ 31	$ 814	$ 552	$ 1,336	$6,241
Allowance for loan losses								
Individually evaluated	$12	$ 6	$ 1	$ 1	$ —	$ —	$ —	$20
Collectively evaluated (2)	104	5	20	1	18	13	6	167
Total allowance for loan losses	$116	$ 11	$ 21	$ 2	$ 18	$ 13	$ 6	$187

(1) Includes allowance related to loans with government guarantees.
(2) Excludes loans carried under the fair value option.

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The following table sets forth the loans held-for-investment aging analysis as of June 30, 2016 and December 31, 2015, of past due and current loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due (1)	Total Past Due	Current	Total Investment Loans
	(Dollars in millions)					
June 30, 2016						
Consumer loans						
Residential first mortgage	$3	$ 1	$ 32	$ 36	$2,039	$ 2,075
Second mortgage	—	—	3	3	124	127
HELOC	2	1	9	12	334	346
Other	—	—	—	—	32	32
Total consumer loans	5	2	44	51	2,529	2,580
Commercial loans						
Commercial real estate	—	—	—	—	976	976
Commercial and industrial	—	—	—	—	615	615
Warehouse lending	—	—	—	—	1,651	1,651
Total commercial loans	—	—	—	—	3,242	3,242
Total loans (2)	$5	$ 2	$ 44	$ 51	$5,771	$ 5,822
December 31, 2015						
Consumer loans						
Residential first mortgage	$7	$ 3	$ 53	$ 63	$3,037	$ 3,100
Second mortgage	—	—	2	2	133	135
HELOC	2	1	9	12	372	384
Other	1	—	—	1	30	31
Total consumer loans	10	4	64	78	3,572	3,650
Commercial loans						
Commercial real estate	—	—	—	—	814	814
Commercial and industrial	—	—	2	2	550	552
Warehouse lending	—	—	—	—	1,336	1,336
Total commercial loans	—	—	2	2	2,700	2,702
Total loans (2)	$10	$ 4	$ 66	$ 80	$6,272	$ 6,352

(1) Includes loans that are less than 90 days past due, which have been placed on nonaccrual.
(2) Includes $10 million of loans 90 days or greater past due, accounted for under the fair value option at both June 30, 2016 and December 31, 2015.

For all classes 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 are determined to be nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. 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.

Interest income is recognized on nonaccrual loans using a cash basis method. Interest that would have been accrued on impaired loans totaled less than $1 million and $1 million during the three and six months ended June 30, 2016, respectively, and $1 million and $3 million during the three and six months ended June 30, 2015, respectively. At June 30, 2016 and December 31, 2015, we had no loans 90 days past due and still accruing.

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Troubled Debt Restructuring

We may modify certain loans in both consumer and commercial loan portfolios to retain customers or to maximize collection of the outstanding loan balance. We have programs designed to assist borrowers by extending payment dates or reducing the borrower's contractual payments. All loan modifications are made on a case-by-case basis. Our standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. TDRs result in those instances in which a borrower demonstrates financial difficulty and for which a concession has been granted, which includes reductions of interest rate, extensions of amortization period, principal and/or interest forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. These loans are classified as nonperforming TDRs if the loan was nonperforming prior to the restructuring, or based upon the results of a contemporaneous credit evaluation. Such loans will continue on nonaccrual status until the borrower has established a willingness and ability to make the restructured payments for at least six months, after which they will begin to accrue interest.

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

	TDRs		
	Performing	Nonperforming	Total
June 30, 2016	(Dollars in millions)		
Consumer loans			
Residential first mortgage	$21	$ 13	$34
Second mortgage	30	1	31
HELOC	21	7	28
Total consumer loans	72	21	93
Commercial loans			
Commercial and industrial	1	—	1
Total commercial loans	1	—	1
Total TDRs (1)(2)	$73	$ 21	$94
December 31, 2015			
Consumer loans			
Residential first mortgage	$49	$ 27	$76
Second mortgage	32	1	33
HELOC	20	7	27
Total TDRs (1)(2)	$101	$ 35	$136

(1) The allowance for loan losses on consumer TDR loans totaled $12 million and $15 million at June 30, 2016 and December 31, 2015, respectively.

(2) Includes $30 million and $32 million of TDR loans accounted for under the fair value option at June 30, 2016 and December 31, 2015, respectively.

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, but may give rise to potential incremental losses. We measure impairments using a discounted cash flow method for performing TDRs and measure impairment based on collateral values for re-defaulted TDRs.

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The following table provides a summary of newly modified TDRs during the three and six months ended June 30, 2016 and 2015.

	New TDRs			
	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase in Allowance at Modification
Three Months Ended June 30, 2016		(Dollars in millions)		
Residential first mortgages	3	$ 1	$ 1	$ —
Second mortgages	5	—	—	—
HELOC (2)(3)	20	2	2	—
Total TDR loans	28	$ 3	$ 3	$ —
Three Months Ended June 30, 2015				
Residential first mortgages	77	$ 23	$ 22	$ (2)
Second mortgages	35	1	1	—
HELOC (2)	122	8	7	—
Other consumer	3	—	—	—
Total TDR loans	237	$ 32	$ 30	$ (2)
Six Months Ended June 30, 2016				
Residential first mortgages	16	$ 3	$ 4	$ —
Second mortgages	26	1	1	—
HELOC (2)(3)	85	6	5	—
Commercial and industrial	1	2	1	—
Total TDR loans	128	$ 12	$ 11	$ —
Six Months Ended June 30, 2015				
Residential first mortgages	191	$ 53	$ 52	$ (1)
Second mortgages	68	3	2	—
HELOC (2)(3)	158	8	7	—
Other consumer	3	—	—	—
Total TDR loans	420	$ 64	$ 61	$ (1)

(1) Post-modification balances include past due amounts that are capitalized at modification date.
(2) HELOC post-modification unpaid principal balance reflects write downs.
(3) Includes loans carried at the fair value option.

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The following table provides a summary of TDR loans that were modified within the previous 12 months, which subsequently defaulted during the three and six months ended June 30, 2016 and 2015. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted when they are greater than 90 days past due.

	TDRs that were modified in the previous 12 months, which have subsequently defaulted		
	Number of Accounts	Unpaid Principal Balance	Increase in Allowance at Subsequent Default
Three Months Ended June 30, 2015		(Dollars in millions)	
Second mortgages	1	$ —	$ —
Total TDR loans	1	$ —	$ —
Six Months Ended June 30, 2016			
Residential first mortgages	1	$ —	$ —
HELOC (1)	4	—	—
Total TDR loans	5	$ —	$ —
Six Months Ended June 30, 2015			
Second mortgages	1	$ —	$ —
Total TDR loans	1	$ —	$ —

(1) HELOC post-modification unpaid principal balance reflects write downs.

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Impaired Loans

Loans are considered impaired if it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement or when any portion of principal or interest is 90 days past due. The following table presents individually evaluated impaired loans and the associated allowance:

	June 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in millions)					
With no related allowance recorded						
Consumer loans						
Residential first mortgage loans	$2	$ 2	$ —	$20	$ 20	$ —
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
	$3	$ 3	$ —	$25	$ 22	$ —
With an allowance recorded						
Consumer loans						
Residential first mortgage	$41	$ 41	$ 6	$65	$ 67	$ 12
Second mortgage	26	27	7	28	28	6
HELOC	6	6	3	3	3	1
Other consumer	—	—	—	—	—	1
	$73	$ 74	$ 16	$96	$ 98	$ 20
Total						
Consumer loans						
Residential first mortgage	$43	$ 43	$ 6	$85	$ 87	$ 12
Second mortgage	26	27	7	28	28	6
HELOC	6	6	3	3	3	1
Other consumer	—	—	—	—	—	1
Commercial loans						
Commercial and industrial	1	1	—	5	2	—
Total impaired loans	$76	$ 77	$ 16	$121	$ 120	$ 20

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in millions)							
Consumer loans								
Residential first mortgage	$47	$ —	$ 116	$ 1	$60	$ 1	$ 210	$ 2
Second mortgage	27	1	31	—	27	1	31	1
HELOC	5	—	2	—	5	—	2	—
Commercial loans								
Commercial and industrial	1	—	—	—	3	—	—	—
Total impaired loans	$80	$ 1	$ 149	$ 1	$95	$ 2	$ 243	$ 3

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Credit Quality

We utilize an internal risk rating system in accordance with the Rating Credit Risk booklet of the Comptroller's Handbook, April 2011 and the Uniform Retail Credit classification and Account Management Policy issued June 20, 2000 by the Federal Financial Institution Examination Council ("FFIEC") which is applied to all consumer and commercial loans. Descriptions of our internal risk ratings as they relate to credit quality follow the ratings used by the U.S. bank regulatory agencies as listed below.

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

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

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

Substandard. Assets identified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. For HELOC loans and other consumer loans, we evaluate credit quality based on the aging and status of payment activity and any other known credit characteristics that call into question full repayment of the asset. Nonperforming loans are classified as either substandard, doubtful or loss.

Doubtful. An asset classified as doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. A doubtful asset has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Because of high probability of loss, non-accrual accounting treatment is required for doubtful assets.

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

Commercial Loans

Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding LTV. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship.

Consumer Loans

Consumer loans consist of open and closed end loans extended to individuals for household, family, and other personal expenditures, and includes consumer loans, loans to individuals secured by their personal residence, including first mortgage, home equity, and home improvement loans. Because consumer loans are usually relatively small-balance, homogeneous exposures, consumer loans are rated primarily on payment performance. Payment performance is a proxy for the strength of repayment capacity and loans are generally classified based on their payment status rather than by an individual review of each loan.

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In accordance with regulatory guidance, we assign risk ratings to consumer loans in the following manner:
•Consumer loans are classified as Watch once the loan becomes 60 days past due.
•Open and closed-end consumer loans 90 days or more past due are classified Substandard.

Commercial Credit Loans	Commercial Real Estate	Commercial and Industrial	Warehouse	Total Commercial
June 30, 2016	(Dollars in millions)			
Grade				
Pass	$934	$ 562	$ 1,505	$ 3,001
Watch	38	20	146	204
Special mention	3	32	—	35
Substandard	1	1	—	2
Total loans	$976	$ 615	$ 1,651	$ 3,242
December 31, 2015				
Pass	$766	$ 492	$ 1,181	$ 2,439
Watch	42	30	155	227
Special mention	2	21	—	23
Substandard	4	9	—	13
Total loans	$814	$ 552	$ 1,336	$ 2,702

Consumer Credit Loans	Residential First Mortgage	Second Mortgage	HELOC	Other Consumer	Total
June 30, 2016	(Dollars in millions)				
Grade					
Pass	$2,019	$ 93	$ 315	$ 32	$2,459
Watch	21	31	22	—	74
Substandard	35	3	9	—	47
Total loans	$2,075	$ 127	$ 346	$ 32	$2,580
December 31, 2015					
Pass	$2,993	$ 101	$ 353	$ 31	$3,478
Watch	49	32	22	—	103
Substandard	58	2	9	—	69
Total loans	$3,100	$ 135	$ 384	$ 31	$3,650

Note 6 – Variable Interest Entities ("VIEs")

In 2015, we executed clean-up calls of the FSTAR 2005-1 and FSTAR 2006-2 long-term debt associated with the HELOC securitization trusts. The transactions resulted in cash payments of $52 million to the debt bondholders during the year ended December 31, 2015. After payment of the debt, the FSTAR 2005-1 and FSTAR 2006-2 HELOC securitization trusts were dissolved and we no longer have any consolidated VIEs as of December 31, 2015.

We have a continuing involvement, but are not the primary beneficiary for one unconsolidated VIE related to the FSTAR 2007-1 mortgage securitization trust. In accordance with the settlement agreement with MBIA Insurance Corporation ("MBIA"), there is no further recourse to us related to FSTAR 2007-1, unless MBIA fails to meet their obligations. At June 30, 2016 and December 31, 2015, the FSTAR 2007-1 mortgage securitization trust included 2,762 loans and 3,061 loans, respectively, with an aggregate principal balance of $103 million and $117 million, respectively.

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Note 7 – Mortgage Servicing Rights

We have investments in mortgage servicing rights ("MSRs") resulting from the sale of loans to the secondary market and retaining the servicing. The primary risk associated with MSRs is the potential reduction in value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates or government intervention. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. We also utilize derivatives as economic hedges to offset changes in the fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. Our portfolio of MSRs is highly sensitive to movements in interest rates. There is also a risk of valuation decline due to higher than expected increases in default rates, which we do not believe can be effectively managed using derivatives. See Note 8 of the Notes to the Consolidated Financial Statements, herein, for further information regarding the derivative instruments utilized to manage our MSR risks.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Balance at beginning of period	$281	$279	$296	$258
Additions from loans sold with servicing retained	65	77	122	146
Reductions from sales	—	(49)	(24)	(71)
Changes in fair value due to (1)				
Decrease in MSR due to pay-offs, pay-downs and run-off	(15)	(11)	(26)	(26)
Changes in estimates of fair value (2)	(30)	21	(67)	10
Fair value of MSRs at end of period	$301	$317	$301	$317

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

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

	June 30, 2016			December 31, 2015		
		Fair value due to			Fair value due to	
	Actual	10% adverse change	20% adverse change	Actual	10% adverse change	20% adverse change
	(Dollars in millions)					
Option adjusted spread	8.37 %	$293	$ 285	8.24 %	$287	$ 279
Constant prepayment rate	16.38 %	287	274	12.63 %	285	275
Weighted average cost to service per loan	$70.99	297	293	$71.86	292	288

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

See Note 18 of the Notes to the Consolidated Financial Statements, herein, for further fair value disclosures relating to mortgage servicing rights.

Contractual servicing and subservicing fees. Contractual servicing and subservicing fees, including late fees and other ancillary income are presented below. Contractual servicing fees are included within net (loss) return on mortgage servicing rights on the Consolidated Statements of Operations. Contractual subservicing fees including late fees and other ancillary

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income are included within loan administration income on the Consolidated Statements of Operations. Subservicing fee income is recorded for fees earned, net of third party subservicing costs, for loans subserviced.

The following table summarizes the servicing fees:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Income on mortgage servicing rights				
Servicing fees, ancillary income and late fees (1)	$ 21	$ 17	$ 38	$ 34
Changes in fair value (2)	(45)	12	(93)	(14)
Gain on MSR derivatives (3)	19	(14)	45	(5)
Net transaction costs	1	(6)	—	(8)
Total (loss) return, included in net return on mortgage servicing rights	$ (4)	$ 9	$ (10)	$ 7

(1) Servicing fees are recorded on the accrual basis. Ancillary income and late fees are recorded on a cash basis.
(2) Includes a $2 million gain related to the sale of MSRs during the three and six months ended June 30, 2015.
(3) Changes in the derivatives utilized as economic hedges to offset changes in fair value of the MSRs.

The agency servicing fees, ancillary income and late fees increased during the six month ended June 30, 2016, as compared to the six month ended June 30, 2015, primarily driven by the higher amount of loans serviced and fewer MSR sales during 2016.

The following table summarizes income and fees associated on our mortgage loans subserviced:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Income on mortgage loans subserviced				
Subservicing fees, ancillary income and late fees (1)	$7	$ 9	$14	$16
Other servicing charges	(3)	(2)	(4)	(5)
Total income, included in loan administration	$4	$ 7	$10	$11

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

The subservice fees decreased during the six month ended June 30, 2016, as compared to the six month ended June 30, 2015, primarily due to a decrease in subservice volume near the end of 2015.

Note 8 – Derivative Financial Instruments

Derivative financial instruments are recorded at fair value in other assets and other liabilities on the Consolidated Statements of Financial Condition after taking into account the effects of legally enforceable bilateral collateral and master netting agreements. The Company is exposed to non-performance risk by the counterparties to its various derivative financial instruments. The Company believes that the non-performance risk inherent in all its derivative contracts is minimal based on credit standards and the collateral provisions of the derivative agreements. A majority of the Company's derivatives are centrally cleared through a Central Counterparty Clearing House or consist of residential mortgage interest rate lock commitments further limiting non-performance risk.

Derivatives not designated as hedging instruments: The Company maintains a derivative portfolio of interest rate swaps, futures and forward commitments used to manage exposure to changes in interest rates, MSR asset values and to meet the needs of customers. The Company also enters into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Market risk on interest rate lock commitments and mortgage loans held-for-sale is managed using corresponding forward sale commitments.

Changes in fair value of derivatives not designated as hedging instruments are recognized in the Consolidated Statements of Income.

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Derivatives designated as hedging instruments: We have designated certain interest rate swaps as cash flow hedges of certain interest rate payments of our variable-rate Federal Home Loan Bank (FHLB) advances. We have also designated certain interest rate swaps as fair value hedges of certain FHLB advances.

Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income on the Consolidated Statement of Financial Condition and reclassified into interest expense in the same period in which the hedge transaction is recognized in earnings. At June 30, 2016, we had $40 million (net-of-tax) recorded of unrealized losses on derivatives classified as cash flow hedges recorded in accumulated other comprehensive income (loss), compared to $3 million at December 31, 2015. The estimated amount to be reclassified from other comprehensive income into earnings during the next 12 months represents $8 million of losses (net-of-tax). Changes in the fair value of the derivatives designated as a fair value hedge are recorded in interest expense, in the same line as changes in the fair value of the FHLB debt, the hedged item, in the current period to the extent it is effective.

Derivatives that are designated in hedging relationships are assessed for effectiveness using regression analysis at inception and throughout the hedge period. All hedge relationships were highly effective as of June 30, 2016. Cash flows and the profit impact associated with designated hedges are reported in the same category as the underlying hedged item.

The net gain (loss) recognized in income on derivative instruments, net of the impact of offsetting positions, were as follows:

		Three Months Ended June 30,		Six Months Ended June 30,	
	Location of Gain/(Loss)	2016	2015	2016	2015
		(Dollars in millions)			
Derivatives not designated as hedging instruments:					
U.S. Treasury, swap and euro dollar futures	Net (loss) return on mortgage servicing rights	$ 1	$ (3)	$ 4	$ 3
Interest rate swaps and swaptions	Net (loss) return on mortgage servicing rights	13	(8)	28	(8)
Mortgage backed securities forwards	Net (loss) return on mortgage servicing rights	5	(3)	13	—
Rate lock commitments and forward agency and loan sales	Net gain on loan sales	(6)	10	(1)	20
Rate lock commitments	Other noninterest income	—	(1)	1	—
Interest rate swaps	Other noninterest	(1)	—	1	—

	income				
Total derivative (loss) gain		$ 12	$ (5)	$ 46	$ 15

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The notional amount, estimated fair value and maturity of our derivative financial instruments were as follows:

	Notional Amount	Fair Value	Expiration Dates
	(Dollars in millions)		
June 30, 2016			
Derivatives designated as hedging instruments:			
Assets			
Interest rate swaps on FHLB advances	$250	$ 2	2020
Liabilities (1)			
Interest rate swaps on FHLB advances	$825	$ 56	2023-2025
Derivatives not designated as hedging instruments:			
Assets (2)			
U.S. Treasury, swap and euro dollar futures	$749	$ 3	2016-2020
Mortgage backed securities forwards	468	4	2016
Rate lock commitments	6,305	83	2016
Interest rate swaps and swaptions	2,337	88	2016-2046
Total derivative assets	$9,859	$ 178	
Liabilities (1)			
U.S. Treasury, swap and euro dollar futures	$7,903	$ 3	2016-2019
Mortgage backed securities forwards	6,054	58	2016
Rate lock commitments	46	—	2016
Interest rate swaps	510	18	2016-2026
Total derivative liabilities	$14,513	$ 79	
December 31, 2015			
Derivatives designated as hedging instruments:			
Liabilities (1)			
Interest rate swaps on FHLB advances	$825	$ 4	2023-2025
Derivatives not designated as hedging instruments:			
Assets (2)			
U.S. Treasury, swap and euro dollar futures	$1,892	$ —	2016-2019
Mortgage backed securities forwards	1,931	7	2016
Rate lock commitments	3,593	26	2016
Interest rate swaps and swaptions	1,554	25	2016-2035
Total derivative assets	$8,970	$ 58	
Liabilities (1)			
U.S. Treasury, swap and euro dollar futures	$768	$ 1	2016-2019
Mortgage backed securities forwards	2,655	6	2016
Rate lock commitments	168	—	2016
Interest rate swaps	422	7	2016-2025
Total derivative liabilities	$4,013	$ 14	

(1) Derivatives liabilities are included in other liabilities on the Consolidated Statements of Financial Condition.
(2) Derivative assets are included in other assets on the Consolidated Statements of Financial Condition.

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

	Gross Amount	Gross Amounts Netted in the Statement of Financial Position	Net Amount Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments	Cash Collateral
	(Dollars in millions)				
June 30, 2016					
Derivatives designated as hedging instruments:					
Assets					
Interest rate swaps on FHLB advances (1)	$2	$ 2	$ —	$ —	$ —
Liabilities					
Interest rate swaps on FHLB advances (1)	$56	$ 2	$ 54	$ —	$ 35
Derivatives not designated as hedging instruments:					
Assets					
U.S. Treasury, swap and euro dollar futures	$3	$ 3	$ —	$ —	$ —
Mortgage backed securities forwards	4	—	4	—	—
Interest rate swaps and swaptions (1)	88	—	88	—	19
Total derivative assets	$95	$ 3	$ 92	$ —	$ 19
Liabilities					
U.S. Treasury, swap and euro dollar futures	$3	$ 3	$ —	$ —	$ 5
Mortgage backed securities forwards	58	—	58	—	62
Interest rate swaps and swaptions (1)	18	—	18	—	14
Total derivative liabilities	$79	$ 3	$ 76	$ —	$ 81
December 31, 2015					
Derivatives designated as hedging instruments:					
Liabilities					
Interest rate swaps on FHLB advances	$4	$ —	$ 4	$ —	$ 19
Derivatives not designated as hedging instruments:					
Assets					
Mortgage backed securities forwards	$7	$ —	$ 7	$ —	$ 4
Interest rate swaps and swaptions (1)	25	—	25	—	10
Total derivative assets	$32	$ —	$ 32	$ —	$ 14
Liabilities					

U.S. Treasury, swap and euro dollar futures	$1	$ —	$ 1	$ —	$ 2
Mortgage backed securities forwards	6	—	6	—	8
Interest rate swaps and swaptions (1)	7	—	7	—	12
Total derivative liabilities	$14	$ —	$ 14	$ —	$ 22

(1) Additional funds are pledged to a Central Counterparty Clearing House in the amount of $32 million as of June 30, 2016 and $7 million as of December 31, 2015 to maintain initial margin requirements. This collateral is in addition to the amount required to be maintained for potential market changes shown in the cash collateral column above.

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We pledged a total of $116 million of cash collateral to counterparties and had an obligation to return cash of $19 million at June 30, 2016 for derivative activities. We pledged a total of $41 million of cash collateral to counterparties and had an obligation to return cash of $14 million at December 31, 2015 for derivative activities. The net cash pledged is restricted and is included in other assets on the Consolidated Statements of Financial Condition.

Note 9 – Debt

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

	June 30, 2016		December 31, 2015	
	Amount	Rate	Amount	Rate
	(Dollars in millions)			
Short-term adjustable rate	$1	0.70%	$—	— %
Short-term fixed rate term advances	1,068	0.40%	2,116	0.32%
Long-term LIBOR adjustable advances	1,025	0.80%	825	0.70%
Long-term fixed rate advances (1)	552	1.44%	600	1.37%
Total	$2,646	0.77%	$3,541	0.59%

(1) Includes the current portion of fixed rate advances of $125 million and $175 million at June 30, 2016 and December 31, 2015, respectively.

We settled $375 million in long-term fixed rate Federal Home Loan Bank advances during the fourth quarter 2015, which resulted in a gain on extinguishment of debt of $3 million, included in other noninterest income.

We are required to maintain a minimum amount of qualifying collateral. In the event of default, the Federal Home Loan Bank advance is similar to a secured borrowing, whereby the Federal Home Loan Bank has the right to sell the pledged collateral to settle the fair value of the outstanding advances.

At June 30, 2016, we had the authority and approval from the Federal Home Loan Bank to utilize a line of credit of up to $7.0 billion and we may access that line to the extent that collateral is provided. At June 30, 2016, we had $2.6 billion of advances outstanding and an additional $0.9 billion of collateralized borrowing capacity available at Federal Home Loan Bank. The advances can be collateralized by non-delinquent single-family residential first mortgage loans, loans with government guarantees, certain other loans and investment securities.

At June 30, 2016, $1.0 billion of the outstanding advances were adjustable rate based on the three-month LIBOR index. Interest rates on these advances reset every three months and the advances may be prepaid without penalty, with notification at scheduled three month intervals after an initial 12 month lockout period.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Maximum outstanding at any month end	$2,646	$2,198	$3,557	$2,198
Average outstanding balance	2,460	1,828	2,841	1,497
Average remaining borrowing capacity	983	1,503	843	1,697
Weighted average interest rate	1.42 %	0.90 %	1.25 %	0.97 %

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The following outlines our Federal Home Loan Bank advance final maturity dates as of June 30, 2016:

	June 30, 2016
	(Dollars in millions)
2016	$ 1,194
2017	50
2018	125
2019	—
Thereafter	1,277
Total	$ 2,646

Trust Preferred Securities

We sponsor nine trust subsidiaries, which issued trust preferred securities to third-party investors and loaned the proceeds to us in the form of junior subordinated notes included in long-term debt. The notes held by each trust are the sole assets of that trust.

The junior subordination notes (trust preferred securities) are callable by us. Interest is payable quarterly at a rate equal to the interest rate being earned by the trust; however, we may defer interest payments for up to 20 quarters without default or penalty. In January 2012, we exercised our contractual rights to defer interest payments with respect to junior subordinated notes. At June 30, 2016, we have deferred for 18 quarters and have $31 million accrued for these deferred interest payments. We brought payments current as of July 14, 2016. For further information on the subsequent event related to our redemption of TARP, see Note 21 of the Notes to the Consolidated Financial Statements, herein.

The following table presents the carrying value on each of our junior subordinated notes, along with the related interest rates of the long-term debt as of the dates indicated:

	June 30, 2016		December 31, 2015	
	(Dollars in millions)			
Trust Preferred Securities				
Floating Three Month LIBOR				
Plus 3.25%, matures 2032	$26	3.89%	$26	3.85%
Plus 3.25%, matures 2033	26	3.88%	26	3.57%
Plus 3.25%, matures 2033	26	3.88%	26	3.85%
Plus 2.00%, matures 2035	26	2.63%	26	2.32%
Plus 2.00%, matures 2035	26	2.63%	26	2.32%
Plus 1.75%, matures 2035	51	2.40%	51	2.26%
Plus 1.50%, matures 2035	25	2.13%	25	1.82%
Plus 1.45%, matures 2037	25	2.10%	25	1.96%
Plus 2.50%, matures 2037	16	3.15%	16	3.01%
Total long-term debt	$247		$247	

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Note 10 - Representation and Warranty Reserve

The following table shows the activity impacting the representation and warranty reserve:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Balance, beginning of period	$40	$53	$40	$53
Provision (release)				
Charged to gain on sale for current loan sales	1	2	3	4
Charged to representation and warranty benefit	(4)	(5)	(6)	(7)
Total	(3)	(3)	(3)	(3)
Charge-offs, net	(1)	(2)	(1)	(2)
Balance, end of period	$36	$48	$36	$48

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

Due to our sustained low level of charge-offs and a lower level of open and forecasted future repurchase demands, we have reduced our estimate of probable losses related to our representation and warranty liability as of June 30, 2016 compared to June 30, 2015. We have recognized benefits recorded in the representation and warranty provision (benefit) on the Consolidated Statements of Operations during the three and six months ended June 30, 2016.

Note 11 — Warrants

May Investor Warrant

We granted warrants (the "May Investor Warrants") to the May Investors on January 30, 2009 under anti-dilution provisions applicable to certain investors (the "May Investors") in our May 2008 private placement capital raise.

For the six months ended June 30, 2016, there were no May Investor Warrants exercised. The May Investors held warrants to purchase 615,962 shares at an exercise price of $10.00 at June 30, 2016.

The May Investor Warrants do not meet the definition of a contract that is indexed to our own stock under U.S. GAAP. Therefore, the May Investor Warrants are classified as "other liabilities" on the Consolidated Statements of Financial Condition and are measured at fair value. Warrant liabilities are valued using a binomial lattice model and are classified within Level 2 of the valuation hierarchy. Significant observable inputs include share price, expected volatility, a risk free rate and an expected life.

At June 30, 2016 and December 31, 2015, the liability from May Investors Warrants amounted to $9 million and $8 million, respectively. Warrant liabilities are reported in "other liabilities" on the Consolidated Statements of Financial Condition. See Note 18 of the Notes to the Consolidated Financial Statements, herein, for further recurring fair value disclosures. The warrants are accounted for under the equity method.

TARP Warrant

On January 30, 2009, we sold to the U.S. Treasury 266,657 shares of Series C fixed rate cumulative non-convertible perpetual preferred stock ("Series C Preferred Stock") and a warrant to purchase up to approximately 645,138 shares of Common Stock at an exercise price of $62.00 per share (the "Warrant") for $267 million. The Series C Preferred Stock qualifies as Tier 1 capital and currently pays cumulative dividends quarterly at a rate of 9 percent per annum. The Warrant is exercisable through 2019 and will remain outstanding subsequent to the redemption of TARP, see further information in Note 21 of the Notes to the Consolidated Financial Statements, herein.

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Note 12 - Accumulated Other Comprehensive Income (Loss)

The following table sets forth the components in accumulated other comprehensive income (loss) for each type of investment securities available-for-sale, investment securities held-to-maturity, and cash flow hedges:

	Held-to-Maturity Securities	Available-for-Sale Securities	Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss) Net of Tax
	(Dollars in millions)			
Accumulated other comprehensive income (loss) ("AOCI")				
Balance at December 31, 2015, net of tax	$5	$ —	$ (3)	$ 2
Net unrealized loss, net of tax	—	16	(44)	(28)
Reclassifications out of AOCI	(1)	1	7	7
Balance at June 30, 2016, net of tax	$4	$ 17	$ (40)	$ (19)
Balance at December 31, 2014, net of tax	$—	$ 8	$ —	$ 8
Balance at June 30, 2015, net of tax	$—	$ 8	$ —	$ 8

Note 13 – Stockholders' Equity

Preferred Stock

Preferred stock with a par value of $0.01 and a liquidation value of $1,000 and additional paid in capital attributable to preferred stock at June 30, 2016 is summarized as follows:

	Rate	Earliest Redemption Date	Shares Outstanding	Preferred Shares
				(Dollars in millions)
Series C Preferred Stock	9.0%	1/31/2012	266,657	$ 267

Our Series C Preferred Stock was issued under the Troubled Asset Relief Program ("TARP") Capital Purchase Program. The U.S. government subsequently sold the Series C Preferred Stock to unrelated third-parties. At June 30, 2016, we have deferred $102 million of dividend payments, which is not reflected in the Consolidated Financial Statements until paid. For further information on the subsequent event related to our redemption of TARP, see Note 21 of the Notes to the Consolidated Financial Statements, herein.

Note 14 – Earnings Per Share

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions, except share data)			
Net income	$47	$ 46	$86	$ 78
Deferred cumulative preferred stock dividends	(8)	(7)	(16)	(15)
Net income applicable to common stock	$39	$ 39	$70	$ 63
Weighted average shares				
Weighted average common shares outstanding	56,574,796	56,436,026	56,544,256	56,410,880
Effect of dilutive securities				
May Investor warrants (1)	349,539	299,391	327,307	266,118
Stock-based awards	826,895	429,655	751,518	294,135
Weighted average diluted common shares	57,751,230	57,165,072	57,623,081	56,971,133
Earnings per common share				
Basic earnings per common share	$0.67	$ 0.69	$1.23	$ 1.12
Effect of dilutive securities				
Stock-based awards	(0.01)	(0.01)	(0.02)	(0.01)
Diluted earnings per share	$0.66	$ 0.68	$1.21	$ 1.11

(1) Exercise price of $10.00 per share and a fair value of $9 million at June 30, 2016.

Under the terms of the Series C Preferred Stock we may defer dividend payments. We elected to defer dividend payments beginning with the February 2012 dividend. Although not included in quarterly net income from continuing operations, the deferral still impacts net income applicable to common stock for the purpose of calculating earnings per share, as shown above. The cumulative amount in arrears as of June 30, 2016 was $102 million. For further information on the subsequent event related to our redemption of TARP, see Note 21 of the Notes to the Consolidated Financial Statements, herein.

Note 15 – Income Taxes

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in millions)			
Provision for income taxes	$22	$28	$43	$46
Effective tax provision rate	32.7%	37.2%	33.4%	37.0%

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

Note 16 — Regulatory Matters

Regulatory Capital

We, along with the Bank, must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that could have a material effect on the Consolidated Financial Statements. On January 1, 2015, the Basel III rules became effective and include transition provisions through 2018.

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To be categorized as "well-capitalized," the Company and the Bank must maintain minimum tangible capital, Tier 1 capital, common equity Tier 1, and total capital ratios as set forth in the table below. We, along with the Bank, are considered "well-capitalized" at both June 30, 2016 and December 31, 2015. There have been no conditions or events that management believes have changed our or the Bank’s category.

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

Bancorp	Actual		For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in millions)					
June 30, 2016						
Tangible capital (to tangible assets)	$1,514	11.59%	N/A	N/A	N/A	N/A
Tier 1 capital (to adjusted tangible assets)	1,514	11.59%	$ 523	4.0%	$ 653	5.0%
Common equity Tier 1 capital (to RWA)	1,086	13.55%	361	4.5%	521	6.5%
Tier 1 capital (to risk-weighted assets)	1,514	18.89%	481	6.0%	642	8.0%
Total capital (to risk-weighted assets)	1,618	20.19%	642	8.0%	802	10.0%
December 31, 2015						
Tangible capital (to tangible assets)	$1,435	11.51%	N/A	N/A	N/A	N/A
Tier 1 capital (to adjusted tangible assets)	1,435	11.51%	$ 499	4.0%	$ 624	5.0%
Common equity Tier 1 capital (to RWA)	1,065	14.09%	340	4.5%	491	6.5%
Tier 1 capital (to risk-weighted assets)	1,435	18.98%	454	6.0%	605	8.0%
Total capital (to risk-weighted assets)	1,534	20.28%	605	8.0%	756	10.0%

N/A - Not applicable

Bank	Actual		For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in millions)					
June 30, 2016						
Tangible capital (to tangible assets)	$1,576	12.03%	N/A	N/A	N/A	N/A
Tier 1 capital (to adjusted tangible assets)	1,576	12.03%	$ 524	4.0%	$ 655	5.0%
Common equity tier 1 capital (to RWA)	1,576	19.58%	362	4.5%	524	6.5%
Tier 1 capital (to risk-weighted assets)	1,576	19.58%	483	6.0%	644	8.0%
Total capital (to risk-weighted assets)	1,679	20.86%	644	8.0%	806	10.0%
December 31, 2015						
Tangible capital (to tangible assets)	$1,472	11.79%	N/A	N/A	N/A	N/A
Tier 1 capital (to adjusted tangible assets)	1,472	11.79%	$ 500	4.0%	$ 625	5.0%
Common equity tier 1 capital (to RWA)	1,472	19.42%	341	4.5%	493	6.5%
Tier 1 capital (to risk-weighted assets)	1,472	19.42%	455	6.0%	607	8.0%
Total capital (to risk-weighted assets)	1,570	20.71%	607	8.0%	758	10.0%

N/A - Not applicable

Note 17 – Legal Proceedings, Contingencies and Commitments

Legal Proceedings

We and our subsidiaries are subject to various pending or threatened legal proceedings arising out of the normal course of business operations. In addition, the Bank is routinely named in civil actions throughout the country by borrowers and former borrowers relating to the origination, purchase, sale, and servicing of mortgage loans. From time to time, governmental agencies also conduct investigations or examinations of various mortgage-related practices of the Bank. In the course of such investigations or examinations, the Bank cooperates with such agencies and provides information as requested.

We assess the liabilities and loss contingencies in connection with such pending or threatened legal and regulatory proceedings on at least a quarterly basis and establish accruals when we believe it is probable that a loss may be incurred and that the amount of such loss can be reasonably estimated. Once established, litigation accruals are adjusted, as appropriate, in light of additional information.

Management does not believe that the amount of any reasonably possible losses in excess of any amounts accrued with respect to ongoing proceedings or any other known claims will be material to our financial statements, or that the ultimate outcome of these actions will have a material adverse effect on our financial condition, results of operations or cash flows.

DOJ litigation settlement

In 2012, the Bank entered into a Settlement Agreement with the United States Department of Justice ("DOJ") which meets the definition of a financial liability (the "DOJ Liability").
In accordance with the Settlement Agreement, we made an initial payment of $15 million and agreed to make future annual payments totaling $118 million. The Settlement Agreement provides that the Bank will make annual payments of up to $25 million towards payment of the $118 million still due upon meeting certain conditions including: (a) the reversal of the deferred tax asset 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") (or, in the absence of repayment, adjusting our Bank Tier 1 Capital Ratio for any unextinguished TARP Preferred); and (c) our Bank's Tier 1 Leverage Capital Ratio is 11 percent or more. Additionally, if the Bank and Bancorp become party to a business combination in which the Bank or Bancorp represent less than 33.3 percent of the resulting company's assets, such annual payments must commence twelve months after the date of that business combination. At June 30, 2016, the TARP Preferred was not repaid and the Bank's Tier 1 Leverage Capital Ratio was below 11 percent after adjusting for the unextinguished TARP Preferred.

We elected to account for the DOJ Liability under the fair value option. To determine the fair value, we utilize a discounted cash flow model. Key assumptions for the discounted cash flow model include using a discount rate as of June 30, 2016 of 6.9 percent; probability weightings of multiple cash flow scenarios and possible outcomes which contemplate the above conditions and estimates of forecasted net income, size of the balance sheet, capital levels, dividends and their impact on the timing of cash payments and the assumptions we believe a market participant would make to transfer the liability. The fair value of the DOJ Liability was $84 million at both June 30, 2016 and December 31, 2015. For further information on the settlement agreement and the redemption of the TARP preferred, which occurred on July 29, 2016, see Note 21 of the Notes to the Consolidated Financial Statements and the capital section within Management's Discussion and Analysis within this Form 10-Q, herein.

Other litigation accruals

At June 30, 2016 and December 31, 2015, excluding the fair value liability relating to the DOJ litigation settlement, our total accrual for contingent liabilities and settled litigation was $9 million and $2 million, respectively. The increase in liability was due to the settlement of a class action lawsuit during the period which was not paid as of June 30, 2016.

Commitments

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

	June 30, 2016	December 31, 2015
	(Dollars in millions)	

Commitments to extend credit		
Mortgage loans interest-rate lock commitments	$6,398	$ 3,792
HELOC commitments	161	150
Other consumer commitments	33	22
Warehouse loan commitments	779	871
Standby and commercial letters of credit	18	13
Commercial and industrial commitments	157	151
Other commercial commitments	723	497

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Commitments to extend credit are agreements to lend. Since many of these commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements. Commitments generally have fixed expiration dates or other termination clauses. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us, upon extension of credit is based on management's credit evaluation of the counterparties.

We enter into mortgage interest-rate lock commitments with our customers. These commitments are considered to be derivative instruments and changes in the fair value of these commitments are recorded in the Consolidated Statements of Financial Condition in other assets. Further discussion on derivative instruments is included in Note 8 of the Notes to the Consolidated Financial Statements, herein.

We have unfunded commitments under our contractual arrangement with the HELOC borrowers. Commitments to extend, originate or purchase credit are primarily lines of credit to consumers and have specified rates and maturity dates. Many of these commitments also have adverse change clauses, which allow us to cancel the commitment due to deterioration in the borrowers’ creditworthiness.

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

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

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

Commercial and industrial and other commercial commitments are conditional commitments issued under various terms to lend funds to business and other entities. These commitments include revolving credit agreements, term loan commitments and short-term borrowing agreements. Many of these loan commitments have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements.

These instruments involve, to varying degrees, elements of credit and interest rate risk beyond the amount recognized on the Consolidated Statements of Financial Condition. Our exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. We utilize the same credit policies in making commitments and conditional obligations as we do for balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract.

We maintain a reserve for the estimate of probable credit losses inherent in unfunded commitments to extend credit. Unfunded commitments to extend credit include unfunded loans with available balances, new commitments to lend that are not yet funded, and standby and commercial letters of credit. The balance of $3 million and $2 million for June 30, 2016 and December 31, 2015, respectively, is reflected in other liabilities on the Consolidated Statements of Financial Condition.

Note 18 – Fair Value Measurements

We utilize fair value measurements to record or disclose the fair value on certain assets and liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability through an orderly transaction between market participants at the measurement date. The determination of fair values of financial instruments often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation models rely on market-based parameters when available, such as interest rate yield curves or credit spreads. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, our future earnings, interest rates and other relevant inputs. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. Refer to Note 24 to the consolidated financial statements of the Annual Report on Form 10-K for the year ended December 31, 2015 for a description of our valuation methodologies and information about the fair value hierarchy.

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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, 2016 and December 31, 2015, by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy.

	Level 1	Level 2	Level 3	Total Fair Value
June 30, 2016	(Dollars in millions)			
Investment securities available-for-sale				
Agency - Commercial	$—	$640	$—	$ 640
Agency - Residential	—	473	—	473
Municipal obligations	—	32	—	32
Loans held-for-sale				
Residential first mortgage loans	—	3,071	—	3,071
Loans held-for-investment				
Residential first mortgage loans	—	6	—	6
Second mortgage loans	—	—	38	38
HELOC loans	—	—	44	44
Mortgage servicing rights	—	—	301	301
Derivative assets	3	92	83	178
Total assets at fair value	$3	$4,314	$466	$ 4,783
Derivative liabilities	$(3)	$(130)	$—	$ (133)
Warrant liabilities	—	(9)	—	(9)
DOJ litigation settlement	—	—	(84)	(84)
Total liabilities at fair value	$(3)	$(139)	$(84)	$ (226)

	Level 1	Level 2	Level 3	Total Fair Value
December 31, 2015	(Dollars in millions)			
Investment securities available-for-sale				
Agency - Commercial	$—	$766	$—	$ 766
Agency - Residential	—	514	—	514
Municipal obligations	—	14	—	14
Loans held-for-sale				
Residential first mortgage loans	—	2,541	—	2,541
Loans held-for-investment				
Residential first mortgage loans	—	6	—	6
Second mortgage loans	—	—	42	42
HELOC loans	—	—	64	64
Mortgage servicing rights	—	—	296	296
Derivative assets	—	32	26	58
Total assets at fair value	$—	$3,873	$428	$ 4,301
Derivative liabilities	$(1)	$(17)	$—	$ (18)
Warrant liabilities	—	(8)	—	(8)
DOJ litigation settlement	—	—	(84)	(84)
Total liabilities at fair value	$(1)	$(25)	$(84)	$ (110)

We had no transfers of assets or liabilities recorded at fair value between fair value levels during the six months ended June 30, 2016 and 2015.

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We utilized US Treasury future, forward agency and loan sales and interest rate swaps to manage the risk associated with mortgage servicing rights and rate lock commitments. Gains and losses for individual lines in the tables do not reflect the effect of our risk management activities related to such level 3 instruments.

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, 2016 and 2015 (including the change in fair value) for financial instruments classified by us within level 3 of the valuation hierarchy:

		Recorded in Earnings		Recorded in OCI				
Three Months Ended June 30, 2016	Balance at Beginning of Period	Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Purchases / Originations	Sales	Settlements	Balance at End of Period
Assets	(Dollars in millions)							
Loans held-for-investment								
Second mortgage loans	$40	$—	$ —	$ —	$ —	$—	$ (2)	$38
HELOC loans	55	(3)	—	—	—	—	(8)	44
Mortgage servicing rights	281	(44)	—	—	64	—	—	301
Totals	$376	$(47)	$ —	$ —	$ 64	$—	$ (10)	$383
Liabilities								
DOJ litigation settlement	$(84)	$—	$ —	$ —	$ —	$—	$ —	$(84)
Derivative financial instruments (net)								
Rate lock commitments	$61	$58	$ —	$ —	$ 106	$(126)	$ (16)	$83
Three Months Ended June 30, 2015								
Assets								
Other investments	$100	$—	$ —	$ —	$ —	$—	$ —	$100
Investment securities available-for-sale								
Loans held-for-investment								
Second mortgage loans	50	2	—	—	—	—	(4)	48
HELOC loans	113	(2)	—	—	—	—	(18)	93
Mortgage servicing rights	279	10	—	—	77	(49)	—	317
Totals	$542	$10	$ —	$ —	$ 77	$(49)	$ (22)	$558
Liabilities								
Long-term debt	$(70)	$—	$ (1)	$ —	$ —	$24	$ 11	$(36)
DOJ litigation settlement	(82)	(2)	—	—	—	—	—	(84)
Totals	$(152)	$(2)	$ (1)	$ —	$ —	$24	$ 11	$(120)
Derivative financial instruments (net)								
Rate lock commitments	$55	$(30)	$ —	$ —	$ 93	$(75)	$ (13)	$30

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Six Months Ended June 30, 2016	Balance at Beginning of Period	Recorded in Earnings Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Recorded in OCI Total Unrealized Gains / (Losses)	Purchases / Originations	Sales	Settlements	Balance at End of Period
Assets	(Dollars in millions)							
Loans held-for-investment								
Second mortgage loans	$42	$ 1	$ —	$ —	$ —	$—	$ (5)	38
HELOC loans	64	(3)	—	—	—	—	(17)	44
Mortgage servicing rights	296	(92)	—	—	121	(24)	—	301
Totals	$402	$ (94)	$ —	$ —	$ 121	$(24)	$ (22)	$ 383
Liabilities								
DOJ litigation								