FLAGSTAR BANCORP INC
Form 10-Q
July 29, 2014
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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, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý.
As of July 25, 2014, 56,238,925 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 thousands, except share data)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and cash equivalents		
Cash and cash items ($2,317 and $1,129 of consolidated VIEs, respectively) (1)	$67,924	$55,913
Interest-earning deposits	134,611	224,592
Total cash and cash equivalents	202,535	280,505
Investment securities available-for-sale	1,605,805	1,045,548
Loans held-for-sale ($1,274,667 and $1,140,507 measured at fair value, respectively) (2)	1,342,611	1,480,418
Loans repurchased with government guarantees	1,217,721	1,273,690
Loans held-for-investment, net		
Loans held-for-investment ($228,758 and $238,322 measured at fair value which includes $146,933 and $155,012 of consolidated VIEs, respectively) (1) (2)	4,359,293	4,055,756
Less: allowance for loan losses	(306,000)	(207,000)
Total loans held-for-investment, net	4,053,293	3,848,756
Mortgage servicing rights	289,185	284,678
Repossessed assets, net	31,579	36,636
Federal Home Loan Bank stock	209,737	209,737
Premises and equipment, net	235,202	231,350
Net deferred tax asset	435,217	414,681
Other assets	310,229	301,302
Total assets	$9,933,114	$9,407,301
Liabilities and Stockholders' Equity		
Deposits		
Noninterest bearing	$1,081,026	$930,060
Interest bearing	5,562,883	5,210,266
Total deposits	6,643,909	6,140,326
Federal Home Loan Bank advances	1,031,705	988,000
Long-term debt ($97,722 and $105,813 of consolidated VIEs at fair value, respectively) (1) (2)	345,157	353,248
Representation and warranty reserve	50,000	54,000
Other liabilities ($78,000 and $93,000 measured at fair value and $136 and $136 of consolidated VIEs, respectively) (1) (2)	476,669	445,853
Total liabilities	8,547,440	7,981,427
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	266,657	266,174
Common stock $0.01 par value, 70,000,000 shares authorized; 56,238,925 and 56,138,074 shares issued and outstanding, respectively	562	561
Additional paid in capital	1,480,321	1,479,265
Accumulated other comprehensive income (loss)	6,821	(4,831)
Accumulated deficit	(368,687)	(315,295)

Total stockholders’ equity	1,385,674	1,425,874
Total liabilities and stockholders’ equity	$9,933,114	$9,407,301

(1) Amounts represent the assets and liabilities of consolidated variable interest entities ("VIEs").
(2) Amounts represent the assets and liabilities for which the Company has elected the fair value option.

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)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Interest Income				
Loans	$61,910	$81,731	$120,579	$173,680
Investment securities available-for-sale or trading	9,885	1,838	17,423	3,932
Interest-earning deposits and other	118	1,489	262	2,435
Total interest income	71,913	85,058	138,264	180,047
Interest Expense				
Deposits	7,239	12,148	13,227	25,656
Federal Home Loan Bank advances	600	24,171	1,134	48,332
Other	1,649	1,643	3,277	3,295
Total interest expense	9,488	37,962	17,638	77,283
Net interest income	62,425	47,096	120,626	102,764
Provision for loan losses	6,150	31,563	118,471	51,978
Net interest income after provision for loan losses	56,275	15,533	2,155	50,786
Noninterest Income				
Loan fees and charges	25,301	29,916	37,611	63,276
Deposit fees and charges	5,279	5,193	10,042	10,339
Net gain on loan sales	54,756	144,791	100,100	282,331
Loan administration	13,915	36,157	33,499	56,513
Net transaction costs on sales of mortgage servicing rights	(2,726)	(4,264)	857	(8,483)
Net gain on sale of assets	3,537	1,064	5,752	2,022
Total other-than-temporary impairment loss recognized in earnings	—	(8,789)	—	(8,789)
Net impairment losses recognized in earnings	—	(8,789)	—	(8,789)
Representation and warranty reserve – change in estimate	(5,226)	(28,940)	(3,554)	(46,336)
Other noninterest income (loss)	7,648	44,831	(6,871)	54,029
Total noninterest income	102,484	219,959	177,436	404,902
Noninterest Expense				
Compensation and benefits	55,218	70,935	120,788	148,144
Commissions	8,532	15,402	15,752	32,863
Occupancy and equipment	19,383	22,198	39,793	41,574
Asset resolution	17,934	15,921	29,442	32,366
Federal insurance premiums	6,758	7,791	11,769	19,031
Loan processing expense	8,199	15,389	15,934	32,500
Legal and professional expense	(2,062)	16,390	11,840	45,229
Other noninterest expense	7,391	10,371	15,286	19,279
Total noninterest expense	121,353	174,397	260,604	370,986

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Income (loss) before income taxes	37,406	61,095	(81,013)	84,702
Provision (benefit) for income taxes	11,892	(6,108)	(28,104)	(6,108)
Net income (loss)	25,514	67,203	(52,909)	90,810
Preferred stock dividend/accretion	—	(1,449)	(483)	(2,887)
Net income (loss) applicable to common stock	$25,514	$65,754	$(53,392)	$87,923
Income (loss) per share				
Basic	$0.33	$1.11	$(1.17)	$1.44
Diluted	$0.33	$1.10	$(1.17)	$1.43
Weighted average shares outstanding				
Basic	56,230,458	56,053,922	56,212,422	56,014,126
Diluted	56,822,102	56,419,163	56,212,422	56,417,122

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Net income (loss)	$25,514	$67,203	$(52,909)	$90,810
Other comprehensive income, before tax				
Investment securities available-for-sale				
Unrealized gains on investment securities available-for-sale	12,723	1,644	18,657	2,646
Reclassification of gain on sale of investment securities available-for-sale	(452)	—	(675)	—
Subsequent decreases in the fair value of investment securities available-for-sale previously written down as impaired	—	(2,681)	—	(2,681)
Additions for the amount related to the credit loss for which an other-than-temporary impairment was not previously recognized	—	8,789	—	8,789
Total investment securities available-for-sale, before tax	12,271	7,752	17,982	8,754
Other comprehensive income, deferred tax benefit				
Deferred tax benefit related to other comprehensive income resulting from unrealized gains and losses on investment securities available-for-sale	(4,319)	—	(2,119)	—
Deferred tax benefit related to other comprehensive income resulting from the dissolution and sales of investments securities available-for-sale	66	(6,108)	(4,211)	(6,108)
Other comprehensive income, net of tax	8,018	1,644	11,652	2,646
Comprehensive income (loss)	$33,532	$68,847	$(41,257)	$93,456

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 thousands)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2012 (Unaudited)	$260,390	$559	$1,476,569	$ (1,658)	$ (576,498)	$1,159,362
Net income	—	—	—	—	90,810	90,810
Total other comprehensive income	—	—	—	2,646	—	2,646
Restricted stock issued	—	1	(1)	—	—	—
Accretion of preferred stock	2,887	—	—	—	(2,887)	—
Stock-based compensation	—	1	916	—	—	917
Balance at June 30, 2013	$263,277	$561	$1,477,484	$ 988	$ (488,575)	$1,253,735
Balance at December 31, 2013 (Unaudited)	$266,174	$561	$1,479,265	$ (4,831)	$ (315,295)	$1,425,874
Net income	—	—	—	—	(52,909)	(52,909)
Total other comprehensive income	—	—	—	11,652	—	11,652
Restricted stock issued	—	1	(1)	—	—	—
Accretion of preferred stock	483	—	—	—	(483)	—
Stock-based compensation	—	—	1,057	—	—	1,057
Balance at June 30, 2014	$266,657	$562	$1,480,321	$ 6,821	$ (368,687)	$1,385,674

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 thousands)

	Six Months Ended June 30, 2014 (Unaudited)	2013
Operating Activities		
Net (loss) income	$(52,909)	$90,810
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	118,471	51,978
Depreciation and amortization	11,609	11,298
Loss (gain) on fair value of mortgage servicing rights	23,773	(14,862)
Loss of fair value of long-term debt	3,087	—
Net gain on the sale of assets	(8,613)	(12,417)
Net gain on loan sales	(100,100)	(282,331)
Net transaction costs on sales of mortgage servicing rights	(857)	8,483
Net gain on investment securities	(675)	—
Net gain on trading securities	—	(72)
Other than temporary impairment losses on investment securities available-for-sale	—	8,789
Net gain on transferors' interest	—	(45,534)
Proceeds from sales of loans held-for-sale	7,818,749	26,203,971
Origination and repurchase of loans held-for-sale, net of principal repayments	(11,393,059)	(24,235,093)
Net change in:		
Decrease in repurchase loans with government guarantees, net of claims received	55,969	331,977
(Increase) decrease in accrued interest receivable	(9,480)	25,342
Proceeds from sales of trading securities	—	120,122
Increase in other assets	(21,155)	(30,840)
Increase (decrease) in payable for mortgage repurchase option	1,680	(26,954)
Representation and warranty reserve - change in estimate	3,554	46,336
Net charge-offs in representation and warranty reserve	(10,517)	(65,206)
Decrease in other liabilities	(5,310)	(163,294)
Net cash (used in) provided by operating activities	(3,565,783)	2,022,503
Investing Activities		
Proceeds received from the sale of investment securities available-for-sale	4,025,025	—
Repayment of investment securities available-for-sale	69,284	28,409
Purchase of investment securities available-for-sale	(669,383)	(20,000)
Net change from sales of loans held-for-investment	(281,714)	(296,204)
Principal repayments net of origination of loans held-for-investment	(319,044)	1,117,532
Proceeds from the disposition of repossessed assets	21,179	59,499
Acquisitions of premises and equipment, net of proceeds	(16,062)	(19,733)
Proceeds from the sale of mortgage servicing rights	87,973	222,801
Net cash provided by investing activities	2,917,258	1,092,304

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

	Six Months Ended June 30, 2014 (Unaudited)	2013
Financing Activities		
Net increase (decrease) in deposit accounts	503,583	(824,228)
Net increase (decrease) in Federal Home Loan Bank advances	43,705	(280,000)
Payment on long-term debt	(11,178)	—
Net receipt (disbursement) of payments of loans serviced for others	30,992	(279,085)
Net receipt of escrow payments	3,453	20,156
Net cash provided by (used in) financing activities	570,555	(1,363,157)
Net (decrease) increase in cash and cash equivalents	(77,970)	1,751,650
Beginning cash and cash equivalents	280,505	952,793
Ending cash and cash equivalents	$202,535	$2,704,443
Supplemental disclosure of cash flow information		
Loans held-for-investment transferred to repossessed assets	$32,687	$90,212
Interest paid on deposits and other borrowings	$14,368	$74,255
Income taxes paid (refunded)	$(562)	$6,943
Reclassification of loans originated for investment to loans held-for-sale	$288,690	$361,503
Reclassification of mortgage loans originated held-for-sale then to loans held-for-investment	$6,976	$65,299
Reclassification of loans held-for-sale to investment securities available-for-sale	$3,965,971	$—
Mortgage servicing rights resulting from sale or securitization of loans	$119,494	$237,106
Recharacterization of investment securities available-for-sale to loans held-for-investment	$—	$73,283
Reconsolidation of HELOC's of variable interest entities (VIEs)	$—	$170,507
Reconsolidation of long-term debt of VIEs	$—	$119,980

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"), the holding company for Flagstar Bank, FSB (the "Bank") is a Michigan-based savings and loan holding company founded in 1993. The Company's business is primarily conducted through its principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. At June 30, 2014, the Company's total assets were $9.9 billion. The Company has the largest bank headquartered in Michigan and one of the top ten largest savings banks in the United States.

In preparing these consolidated financial statements, subsequent events were evaluated through the time the financial statements were issued. All material subsequent events have been either recognized in the Consolidated Financial Statements or disclosed in the Notes to the Consolidated Financial Statements.

The Company's operations are conducted through four operating segments: Mortgage Originations, Mortgage Servicing, Community Banking and Other, which includes the remaining reported activities. The Mortgage Originations segment, in which the Company originates or purchases residential first mortgage loans throughout the country and sells them into securitization pools, primarily to Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac") and Government National Mortgage Association ("Ginnie Mae") (collectively, the "Agencies") or as whole loans. The Mortgage Servicing segment services mortgage loans on a fee basis for others and residential mortgages held-for-investment by the Community Banking segment and mortgage servicing rights held by the Other segment. The Company has retained certain loan originations in the held-for-investment portfolio, which are held by the Community Banking segment. Mortgage loans are originated through 32 home loan centers located in 18 states, a direct to consumer call center, the Internet, wholesale brokers and correspondents.

The Company also offers a range of products and services to consumers and businesses through the Community Banking segment. As of June 30, 2014, the Company operated 106 banking centers in Michigan. The Company offers consumer products including deposit accounts, commercial loans and personal loans, including auto and boat loans. The Company offers treasury management services. Commercial products offered include deposit and sweep accounts, telephone banking, term loans and lines of credit, lease financing, government banking products and treasury management services including remote deposit and merchant services.

The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency ("OCC") of the U.S. 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. 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.

Note 2 – Basis of Presentation and Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete financial statements. These interim financial statements include all adjustments, consisting of normal recurring accruals that management believes are necessary for a fair presentation of the results of operations, financial position and cash flows. The results of operations for the three and six months ended June 30, 2014, are not necessarily indicative of the results that may be expected for any other interim period or for the full year ending December 31, 2014. In addition, certain prior period amounts have been reclassified to conform to the current period presentation. These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, which are available on the Company’s Investor Relations web page, at www.flagstar.com, and on the SEC website, at www.sec.gov.

Variable Interest Entities

The accompanying unaudited consolidated financial statements include variable interest entities ("VIEs") in which the Company has determined to have a controlling financial interest. The Company consolidates a VIE if it has: (i) a variable interest in the entity; (ii) the power to direct activities of the VIE that most significantly impact the entity's economic

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performance; and (iii) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE (i.e., the Company is considered to be the primary beneficiary).

At June 30, 2013, the Company became the primary beneficiary of the FSTAR 2005-1 and FSTAR 2006-2 HELOC securitization trusts because the Company obtained the power to direct the activities that most significantly impact the economic performance of the trusts (power to select or remove the servicer) and the obligation to absorb expected losses and receive residual returns (support of the guarantor and holder of residual interests in trusts), which is reflected in the Consolidated Financial Statements as a VIE. See Note 8 for information on VIEs.

Recently Issued Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board ("FASB") or other standard setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the impact of recently issued standards that are not yet effective will not have a material impact on the Consolidated Financial Statements or the Notes thereto or results of operations upon adoption.

In January 2014, the FASB issued ASU No. 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Topic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The guidance amends the guidance in the FASB Accounting Standards Codification Topic 310-40, "Receivables - Troubled Debt Restructurings by Creditors," in efforts to reduce diversity in practice through clarifying when an in substance repossession or foreclosure occurs. This guidance is effective prospectively, for annual and interim periods, beginning after December 15, 2014. The adoption of the guidance is not expected to have a material impact on the consolidated financial statements or the Notes thereto.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments in this guidance will allow discontinued operations to include a component of an entity or a group of components of an entity. A disposal is required to be reported in discontinued operations if it represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. This guidance is effective prospectively, for annual and interim periods, beginning after December 15, 2014. The adoption of the guidance is not expected to have a material effect on the Company’s Consolidated Financial Statements or the Notes thereto.
In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under the amended guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective prospectively, for annual and interim periods, beginning after December 15, 2016. Management is currently evaluating this guidance and does not expect this guidance to have a material impact on the Company’s Consolidated Financial Statements, but significant disclosures to the Notes thereto will be required.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financing, and Disclosures." The amendments in this guidance requires repurchase-to-maturity transactions to be accounted for as secured borrowings. The guidance for certain transactions accounted for as a sale, repurchase agreements, securities lending transactions and repurchase-to-maturity transactions accounted for as secured borrowings is effective prospectively, for annual and interim periods, beginning after December 15, 2014. The adoption of the guidance is not expected to have a material effect on the Company’s Consolidated Financial Statements or the Notes thereto.

Note 3 – Fair Value Measurements

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

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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 follows.

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 expectations that market participants would use in pricing an asset or liability.

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

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

Assets

Investment securities available-for-sale. These securities are comprised of U.S. government sponsored agencies and municipal obligations. The Company measures fair value using prices obtained from pricing services. A review is performed on the security prices received from the pricing services, which includes discussion and analysis of the inputs used by the pricing services to value our securities. Where possible, fair values are generated using market inputs including quoted prices (the closing price in an exchange markets), bid prices (the price at which a buyer stands ready to purchase) and other market information. For fixed income securities that are not actively traded, the pricing services use alternative methods to determine fair value for the securities, including; quotes for similar fixed-income securities, matrix pricing, discounted cash flow using benchmark curves or other factors to determine fair value. U.S. government sponsored agencies are classified within Level 1 of the valuation hierarchy and all other debt securities are classified as Level 2 of the valuation hierarchy.

Loans held-for-sale. The Company generally estimates the fair value of loans held-for-sale based on quoted market prices for securities backed by similar types of loans. Where quoted market prices were available, such market prices were utilized as estimates for fair values. Otherwise, the fair value of loans was computed by discounting cash flows using observable inputs inclusive of interest rates, prepayment speeds and loss assumptions for similar collateral. These 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 becomes impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as impaired, the fair value of the impaired loan is estimated using one of several methods, including collateral value, market value of similar debt, or discounted cash flows. The fair value of the underlying collateral is determined, where possible, using market prices derived from appraisals or broker price opinions which are considered to be Level 3. Fair value may also be measured using the present value of expected cash flows discounted at the loan's effective interest rate. The Company records the impaired loans as a non-recurring

Level 3 valuation.

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

The HELOC loans associated with the FSTAR 2005-1 and FSTAR 2006-2 securitization trusts have been recorded in the Consolidated Financial Statement as loans held-for-investment. These loans are recorded at fair value using the present value of expected cash flows discounted at market rates typical of assets with similar risk profiles. The Company records these loans as a recurring Level 3 valuation.

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Also, included in loans held-for-investment are the second mortgage loans associated with the previous FSTAR 2006-1 mortgage securitization trust. The loans are carried at fair value and valued using a discounted estimated net future cash flow model and therefore classified within the Level 3 valuation hierarchy as the model utilizes significant inputs which are unobservable. See Note 8 - Private-Label Securitization and Variable Interest Entities for additional information.

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 fair value estimates based on repossessed asset experience and considered a Level 3 classification.

MSRs. The current market for 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 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 MSRs include mortgage prepayment speeds and discount rates. Management obtains third-party valuations of the MSR portfolio on a quarterly basis from independent valuation experts to assess the reasonableness of the fair value calculated by its internal valuation model. In certain circumstances, based on the probability of the completion of a sale of MSRs pursuant to a bona-fide purchase offer, the Company considers the bid price of that offer and identifiable transaction costs in comparison to the calculated fair value and may adjust the estimate of fair value to reflect the terms of the pending transaction. Due to the nature of the valuation inputs, MSRs are classified within Level 3 of the valuation hierarchy. See Note 9 - 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.

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.

Long-term debt. The Company records the long-term debt associated with the FSTAR 2005-1 and FSTAR 2006-2 HELOC securitization trusts at fair value. The fair value of the debt is estimated using quantitative models which incorporate observable and, in some instances, unobservable inputs including security prices, interest rate yield curves, option volatility, currency, commodity or equity rates and correlations between these inputs. The Company also considers the impact of its own credit spreads in determining the discount rate used to value these liabilities. The credit spread is determined by reference to observable spreads in the secondary bond markets, which are considered to be Level 3. The Company records this debt as a recurring Level 3 valuation.

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, make payments of approximately $118.0 million contingent upon the occurrence of certain future events (the "Additional Payments"), and complete a monitoring period by an independent third party chosen by the Bank and approved by HUD. The Company made the initial payment of $15.0 million on April 3, 2012.

The Company elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. As of June 30, 2014, the Bank has accrued $78.0 million, which represents the fair value

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of the Additional Payments. The signed DOJ Agreement establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability.

At June 30, 2014 and December 31, 2013, the cash flows were discounted using a 8.2 percent and 9.9 percent, respectively, discount rate that is inclusive of the risk free rate based on the expected duration of the liability and an adjustment for non-performance risk that represents the Company's credit risk. The model assumes that the Company will have met substantially all of the stipulations required for the commencement of payments to the DOJ.

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 other noninterest expense on the Consolidated Statements of Operations.

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, 2014 and December 31, 2013, by caption on the Consolidated Statement of Financial Condition and by level in the valuation hierarchy (as described above).

	Level 1	Level 2	Level 3	Total Fair Value
June 30, 2014	(Dollars in thousands)			
Investment securities available-for-sale				
U.S. government sponsored agencies	$1,596,334	$—	$—	$1,596,334
Municipal obligations	—	9,471	—	9,471
Loans held-for-sale				
Residential first mortgage loans	—	1,274,667	—	1,274,667
Loans held-for-investment				
Residential first mortgage loans	—	23,165	—	23,165
Second mortgage loans	—	—	58,660	58,660
HELOC loans	—	—	146,933	146,933
Mortgage servicing rights	—	—	289,185	289,185
Derivative assets				
U.S. Treasury futures	2,737	—	—	2,737
Rate lock commitments	—	—	50,974	50,974
Agency forwards	1,116	—	—	1,116
Interest rate swaps	—	3,530	—	3,530
Total derivative assets	3,853	3,530	50,974	58,357
Total assets at fair value	$1,600,187	$1,310,833	$545,752	$3,456,772
Derivative liabilities				
Forward agency and loans sales	$—	$(28,236)	$—	$(28,236)
Interest rate swaps	—	(3,438)	—	(3,438)
Total derivative liabilities	—	(31,674)	—	(31,674)
Warrant liabilities	—	(8,784)	—	(8,784)
Long-term debt	—	—	(97,722)	(97,722)
Litigation settlement	—	—	(78,000)	(78,000)
Total liabilities at fair value	$—	$(40,458)	$(175,722)	$(216,180)

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	Level 1	Level 2	Level 3	Total Fair Value
December 31, 2013	(Dollars in thousands)			
Investment securities available-for-sale				
U.S. government sponsored agencies	$1,028,248	$—	$—	$1,028,248
Municipal obligations	—	17,300	—	17,300
Loans held-for-sale				
Residential first mortgage loans	—	1,140,507	—	1,140,507
Loans held-for-investment				
Residential first mortgage loans	—	18,625	—	18,625
Second mortgage loans	—	—	64,685	64,685
HELOC loans	—	—	155,012	155,012
Mortgage servicing rights	—	—	284,678	284,678
Derivative assets				
U.S. Treasury futures	1,221	—	—	1,221
Forward agency and loan sales	—	19,847	—	19,847
Rate lock commitments	—	—	10,329	10,329
Interest rate swaps	—	1,797	—	1,797
Total derivative assets	1,221	21,644	10,329	33,194
Total assets at fair value	$1,029,469	$1,198,076	$514,704	$2,742,249
Derivative liabilities				
Agency forwards	$(1,665)	$—	$—	$(1,665)
Interest rate swaps	—	(1,797)	—	(1,797)
Total derivative liabilities	(1,665)	(1,797)	—	(3,462)
Warrant liabilities	—	(10,802)	—	(10,802)
Long-term debt	—	—	(105,813)	(105,813)
Litigation settlement	—	—	(93,000)	(93,000)
Total liabilities at fair value	$(1,665)	$(12,599)	$(198,813)	$(213,077)

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable inputs to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 inputs, observable inputs (that is, inputs 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 in the Level 3 rollforward table 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.

The Company had no transfers of assets or liabilities recorded at fair value between the fair value Levels for the three and six months ended June 30, 2014.

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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, 2014 and 2013 (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					
Three Months Ended June 30, 2014	Balance at Beginning of Period	Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Purchases	Sales	Settlements	Balance at End of Period	Unrealized Gains / (Losses) Held at End of Period (3)
Assets	(Dollars in thousands)								
Loans held-for-investment									
Second mortgage loans	$61,540	$848	$385	$—	$—	$—	$(4,113)	$58,660	$1,232
HELOC loans	150,595	(777)	1,426	—	143	—	(4,454)	146,933	7,021
Mortgage servicing rights	320,231	(14,181)	—	—	68,452	(85,317)	—	289,185	(8,803)
Derivative financial instruments									
Rate lock commitments	21,276	66,040	—	—	77,598	(93,571)	(20,369)	50,974	23,855
Totals	$553,642	$51,930	$1,811	$—	$146,193	$(178,888)	$(28,936)	$545,752	$23,305
Liabilities									
Long-term debt	$(101,710)	$—	$(1,763)	$—	$—	$—	$5,751	$(97,722)	$1,763
Litigation settlement	(94,000)	—	16,000	—	—	—	—	(78,000)	—
Totals	$(195,710)	$—	$14,237	$—	$—	$—	$5,751	$(175,722)	$1,763
Three Months Ended June 30, 2013									
Investment securities available-for-sale (1)(2)									
Mortgage securitization	$87,356	$—	$(8,789)	$(356)	$—	$(73,327)	$(4,884)	$—	$—
Loans held-for-investment									
Second mortgage loans	—	—	(7,216)	—	80,543	—	—	73,327	—
HELOC loans	—	—	—	—	170,507	—	—	170,507	—
Transferors' interest	6,872	—	45,708	—	—	—	(52,580)	—	—
Mortgage servicing rights	727,207	62,150	—	—	110,612	(139,302)	(31,648)	729,019	47,018
Totals	$821,435	$62,150	$29,703	$(356)	$361,662	$(212,629)	$(89,112)	$972,853	$47,018
Liabilities									

Derivative financial instruments									
Rate lock commitments	$51,389	$(135,727)	$—	$—	$98,577	$(31,673)	$(6,312)	(23,746)	$(49,779)
Long-term debt	—	—	—	—	(119,980)	—	—	(119,980)	—
Litigation settlement	(19,100)	—	(4,170)	—	—	—	—	(23,270)	—
Totals	$32,289	$(135,727)	$(4,170)	$—	$(21,403)	$(31,673)	$(6,312)	$(166,996)	$(49,779)

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Six Months Ended June 30, 2014	Balance at Beginning of Period	Recorded in Earnings Total Unrealized Gains / (Losses)	Recorded in Earnings Total Realized Gains / (Losses)	Recorded in OCI Total Unrealized Gains / (Losses)	Purchases	Sales	Settlements	Balance at End of Period	Changes In Unrealized Held at End of Period (3)
Assets	(Dollars in thousands)								
Loans held-for-investment									
Second mortgage loans	$64,685	$431	$829	$—	$—	$—	$(7,285)	$58,660	$1,259
HELOC loans	155,012	(2,717)	2,939	—	200	—	(8,501)	146,933	14,278
Mortgage servicing rights	284,678	(23,773)	—	—	119,495	(91,215)	—	289,185	(10,629)
Derivative financial instruments									
Rate lock commitments	10,329	99,029	—	—	136,688	(158,458)	(36,614)	50,974	23,218
Totals	$514,704	$72,970	$3,768	$—	$256,383	$(249,673)	$(52,400)	$545,752	$28,126
Liabilities									
Derivative financial instruments									
Long-term debt	$(105,813)	$—	$(3,087)	$—	$—	$—	$11,178	$(97,722)	$3,084
DOJ litigation	(93,000)	—	15,000	—	—	—	—	(78,000)	—
Totals	$(198,813)	$—	$11,913	$—	$—	$—	$11,178	$(175,722)	$3,084
Six Months Ended June 30, 2013									
Investment securities available-for-sale (1)(2)									
Mortgage securitization	$91,117	$—	$(8,789)	$871	$—	$(73,327)	$(9,872)	$—	$—
Loans held-for-investment									
Second mortgage loans	—	—	(7,216)	—	80,543	—	—	73,327	—
HELOC loans	—	—	—	—	170,507	—	—	170,507	—
Transferor's interest	7,103	(174)	45,708	—	—	—	(52,637)	—	(174)
Mortgage servicing rights	710,791	83,990	—	—	237,106	(233,739)	(69,129)	729,019	65,895
Totals	$809,011	$83,816	$29,703	$871	$488,156	$(307,066)	$(131,638)	$972,853	$65,721
Liabilities									
Derivative financial instruments									
Rate lock commitments	$86,200	$(166,552)	$—	$—	$238,088	$(150,488)	$(30,994)	$(23,746)	$(46,549)
Long-term debt	—	—	—	—	(119,980)	—	—	(119,980)	—

DOJ litigation	(19,100)	—	(4,170)	—	—	—	—	(23,270)	—
Totals	$67,100	$(166,552)	$(4,170)	$—	$118,108	$(150,488)	$(30,994)	$(166,996)	$(46,549)

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

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

(3) Reflects the changes in the unrealized gains (losses) related to financial instruments held at the end of the period.

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The following tables present the quantitative information about recurring Level 3 fair value financial instruments and the fair value measurements as of June 30, 2014 and December 31, 2013.

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
June 30, 2014	(Dollars in thousands)			
Assets				
Second mortgage loans	$58,660	Discounted cash flows	Discount rate Prepay rate - 12 month historical average CDR rate - 12 month historical average	7.2% - 10.8% (9.0%) 9.2% - 13.7% (11.4%) 2.2% - 3.4% (2.8%)
FSTAR 2005-1 HELOC loans	$74,155	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	5.6% - 8.4% (7.0%) 8.8% - 13.2% (11.0%) 11.7% - 17.5% (14.6%) 80.0% - 120.0% (100.0%)
FSTAR 2006-2 HELOC loans	$72,778	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	7.2% - 10.8% (9.0%) 8.0% - 12.0% (10.0%) 40.0% - 60.1% (50.0%) 80.0% - 120.0% (100.0%)
Mortgage servicing rights	$289,184	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service per loan	7.8% - 11.7% (9.8%) 8.1% - 11.7% (9.9%) 60.4% - 90.6% (75.5%)
Rate lock commitments	$50,974	Consensus pricing	Origination pull-through rate	66.8% - 100.2% (83.5%)
Liabilities				
FSTAR 2005-1 Long-term debt	$(51,363)	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	5.6% - 8.4% (7.0%) 8.8% - 13.2% (11.0%) 11.7% - 17.5% (14.6%) 80.0% - 120.0% (100.0%)
FSTAR 2006-2 Long-term debt	$(46,359)	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	7.2% - 10.8% (9.0%) 8.0% - 12.0% (10.0%) 40.0% - 60.1% (50.0%) 80.0% - 120.0% (100.0%)
Litigation settlement	$(78,000)	Discounted cash flows	Asset growth rate MSR growth rate Return on assets (ROA) improvement Peer group ROA	4.4% - 6.6% (5.5%) 0.9% - 1.4% (1.2%) 0.02% - 0.04% (0.03%) 0.5% - 0.8% (0.7%)

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	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
December 31, 2013	(Dollars in thousands)			
Assets				
Second mortgage loans	$64,685	Discounted cash flows	Discount rate Prepay rate - 12 month historical average CDR rate - 12 month historical average	7.1% - 10.7% (8.9%) 10.5% - 15.7% (13.1%) 2.2% - 3.2% (2.7%)
FSTAR 2005-1 HELOC loans	$78,009	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	5.6% - 8.4% (7.0%) 12.8% - 19.2% (16.0%) 11.6% - 17.4% (14.5%) 80.0% - 120.0% (100.0%)
FSTAR 2006-2 HELOC loans	$77,003	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	7.2% - 10.8% (9.0%) 9.6% - 14.4% (12.0%) 39.9% - 59.8% (49.9%) 80.0% - 120.0% (100.0%)
Mortgage servicing rights	$284,678	Discounted cash flows	Origination adjusted spread Constant prepayment rate Weighted average cost to service per loan	5.9% - 8.9% (7.7%) 9.7% - 14.0% (11.9%) 59.1% - 88.6% (73.8%)
Rate lock commitments	$10,329	Consensus pricing	Origination pull-through rate	65.9% - 98.8% (82.3%)
Liabilities				
FSTAR 2005-1 Long-term debt	$(55,172)	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	5.6% - 8.4% (7.0%) 12.8% - 19.2% (16.0%) 11.6% - 17.4% (14.5%) 80.0% - 120.0% (100.0%)
FSTAR 2006-2 Long-term debt	$(50,641)	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	7.2% - 10.8% (9.0%) 9.6% - 14.4% (12.0%) 39.9% - 59.9% (49.9%) 80.0% - 120.0% (100.0%)
Litigation settlement	$(93,000)	Discounted cash flows	Asset growth rate MSR growth rate Return on assets (ROA) improvement Peer group ROA	4.4% - 6.6% (5.5%) 0.9% - 1.4% (1.2%) 0.02% - 0.04% (0.03%) 0.5% - 0.8% (0.7%)

The significant unobservable inputs used in the fair value measurement of the second mortgage loans associated with the FSTAR 2006-1 mortgage securitization trust are discount rates, prepayment rates and default rates. 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 HELOC loans and long-term debt associated with the FSTAR 2005-1 and FSTAR 2006-2 securitization trusts 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 (decreases) in prepay rates in isolation would result in a higher (lower) fair value measurement while increases (decreases) in loss rates in isolation would result in a lower (higher) fair value. 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 the 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 litigation settlement are future balance sheet and growth rate assumptions for overall asset growth, MSR growth, peer group return on assets and return on

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assets improvement. The current assumptions are based on management's approved, strategic performance targets beyond the current strategic modeling horizon (2014). The Bank's target asset growth rate post 2014 is based off of growth in the balance sheet. Significant increases (decreases) in the bank's 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 peer group's return on assets improvement in isolation would result in a marginally higher (lower) 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.

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 fair value 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

	Level 3 (Dollars in thousands)
June 30, 2014	
Impaired loans held-for-investment (1)	
Residential first mortgage loans	$86,770
Repossessed assets (2)	31,579
Totals	$118,349
December 31, 2013	
Impaired loans held-for-investment (1)	
Residential first mortgage loans	$68,252
Commercial real estate loans	1,500
Repossessed assets (2)	36,636
Totals	$106,388

(1) The Company recorded $17.3 million and $27.3 million in fair value losses on impaired loans (included in provision for loan losses on Consolidated Statements of Operations) during the three and six months ended June 30, 2014, respectively, compared to $5.1 million and $42.6 million in fair value losses on impaired loans during the three and six months ended June 30, 2013, respectively.

(2) The Company recorded $1.4 million and $2.0 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 $2.1 million and $2.9 million on sales of repossessed assets (both write downs and net gains/losses are included in assets resolution expense on the Consolidated Statements of Operations) during the three and six months ended June 30, 2014, respectively, compared to $1.6 million and $2.4 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 $6.2 million and $10.6 million on sales of repossessed assets during the three and six months ended June 30, 2013, respectively.

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, 2014 and December 31, 2013.

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
June 30, 2014	(Dollars in thousands)			
Impaired loans held-for-investment				
Residential first mortgage loans	$86,770	Fair value of collateral	Loss severity discount	0% - 100% (44.7%)
Repossessed assets	$31,579	Fair value of collateral	Loss severity discount	0% - 100% (44.4%)

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
December 31, 2013	(Dollars in thousands)			
Impaired loans held-for-investment				
Residential first mortgage loans	$68,252	Fair value of collateral	Loss severity discount	0% - 100% (44.9%)
Commercial real estate loans	$1,500	Fair value of collateral	Loss severity discount	0% - 100% (39.6%)
Repossessed assets	$36,636	Fair value of collateral	Loss severity discount	0% - 100% (45.3%)

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The Company has certain impaired residential first mortgage 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.

Fair Value of Financial Instruments

The following table presents the carrying amount and estimated fair value of certain financial instruments that are carried either at fair value or cost.

	June 30, 2014				
		Estimated Fair Value			
	Carrying Value	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial Instruments					
Assets					
Cash and cash equivalents	$202,535	$202,535	$202,535	$—	$—
Investment securities available-for-sale	1,605,805	1,605,805	1,596,334	9,471	—
Loans held-for-sale	1,342,611	1,274,667	—	1,274,667	—
Loans repurchased with government guarantees	1,217,721	1,182,243	—	1,182,243	—
Loans held-for-investment, net	4,053,293	3,834,111	—	23,165	3,810,946
Repossessed assets	31,579	31,579	—	—	31,579
Federal Home Loan Bank stock	209,737	209,737	209,737	—	—
Mortgage servicing rights	289,185	289,185	—	—	289,185
Customer initiated derivative interest rate swaps	3,530	3,530	—	3,530	—
Liabilities					
Retail deposits					
Demand deposits and savings accounts	(4,216,309)	(3,955,213)	—	(3,955,213)	—
Certificates of deposit	(927,353)	(932,419)	—	(932,419)	—
Government deposits	(814,654)	(789,055)	—	(789,055)	—
Wholesale deposits	(267)	(242)	—	(242)	—
Company controlled deposits	(685,326)	(683,166)	—	(683,166)	—
Federal Home Loan Bank advances	(1,031,705)	(1,031,542)	(1,031,542)	—	—
Long-term debt	(345,157)	(190,795)	—	(93,073)	(97,722)
Warrant liabilities	(8,784)	(8,784)	—	(8,784)	—
Litigation settlement	(78,000)	(78,000)	—	—	(78,000)
Customer initiated derivative interest rate swaps	(3,438)	(3,438)	—	(3,438)	—
Derivative Financial Instruments					
Forward agency and loan sales	(28,236)	(28,236)	—	(28,236)	—
Rate lock commitments	50,974	50,974	—	—	50,974

U.S. Treasury and agency futures/forwards	3,853	3,853	3,853	—	—

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	December 31, 2013				
		Estimated Fair Value			
	Carrying Value	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial Instruments					
Assets					
Cash and cash equivalents	$280,505	$280,505	$280,505	$—	$—
Investment securities available-for-sale	1,045,548	1,045,548	1,028,248	17,300	—
Loans held-for-sale	1,480,418	1,469,820	—	1,469,820	—
Loans repurchased with government guarantees	1,273,690	1,212,799	—	1,212,799	—
Loans held-for-investment, net	3,848,756	3,653,292	—	18,625	3,634,667
Repossessed assets	36,636	36,636	—	—	36,636
Federal Home Loan Bank stock	209,737	209,737	209,737	—	—
Mortgage servicing rights	284,678	284,678	—	—	284,678
Customer initiated derivative interest rate swaps	1,797	1,797	—	1,797	—
Liabilities					
Retail deposits					
Demand deposits and savings accounts	(3,919,937)	(3,778,890)	—	(3,778,890)	—
Certificates of deposit	(1,026,129)	(1,034,599)	—	(1,034,599)	—
Government accounts	(602,398)	(596,778)	—	(596,778)	—
Wholesale deposits	(8,717)	(8,716)	—	(8,716)	—
Company controlled deposits	(583,145)	(577,662)	—	(577,662)	—
Federal Home Loan Bank advances	(988,000)	(988,102)	(988,102)	—	—
Long-term debt	(353,248)	(202,887)	—	(97,074)	(105,813)
Warrant liabilities	(10,802)	(10,802)	—	(10,802)	—
Litigation settlement	(93,000)	(93,000)	—	—	(93,000)
Customer initiated derivative interest rate swaps	(1,797)	(1,797)	—	(1,797)	—
Derivative Financial Instruments					
Forward agency and loan sales	19,847	19,847	—	19,847	—
Rate lock commitments	10,329	10,329	—	—	10,329
U.S. Treasury and agency futures/forwards	(444)	(444)	(444)	—	—

The methods and assumptions used by the Company in estimating fair value of financial instruments which are required for disclosure only, are as follows:

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 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 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.

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

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.

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Federal Home Loan Bank advances. Rates currently available 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 current borrowing rates for similar types of borrowing arrangements.

Fair Value Option

The Company elected to measure at fair value certain financial assets and financial liabilities. The Company elected fair value option for the following items to mitigate a divergence between accounting losses and economic exposure.

The Company elected the fair value option for held-for-sale loans, originated post 2009, and the litigation settlement liability to better reflect the management of these financial instruments on a fair value basis. Loans held-for-investment include loans that were originated as loans held-for-sale and later transferred to loans held-for-investment at fair value. 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. Direct loan origination cost and fees on loans held-for-sale are recognized in income at origination.

As of June 30, 2013, the Company dissolved the FSTAR 2006-1 mortgage securitization trust and transferred the second mortgage loans, underlying the collapsed FSTAR 2006-1 mortgage securitization which were carried at fair value in available-for-sale investment securities. The change in fair value relating to the loans is recorded in other noninterest income.

As of June 30, 2013, the Company elected the fair value option for the assets and liabilities of reconsolidated VIEs related to the HELOC securitization trusts with changes in fair value recorded to earnings. The change in fair value relating to the assets and liabilities of these transactions is recorded in other noninterest income. Accordingly, such an election allows the Company to continue fair value accounting through earnings for those interests and eliminate income statement mismatch otherwise caused by differences in the measurement basis of the consolidated VIEs assets and liabilities.

The Company elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. The signed DOJ Agreement establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability.

The following table reflects the change in fair value included in earnings (and the account recorded in) for the assets and liabilities for which the fair value option has been elected.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Assets	(Dollars in thousands)			
Loans held-for-sale				
Net gain on loan sales	$126,400	$(19,336)	$189,401	$68,307
Other noninterest income	—	—	(955)	—
Loans held-for-investment				
Interest income on loans	$—	$(26)	$—	$(806)
Other noninterest income	(2,680)	36,854	(6,949)	36,854
Liabilities				
Long-term debt				

Other noninterest income	$3,987	$—	$8,094	$—
Litigation settlement				
Legal and professional expense	$16,000	$4,170	$15,000	$4,170

The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding as of June 30, 2014 and December 31, 2013 for assets and liabilities for which the fair value option has been elected.

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	June 30, 2014 (Dollars in thousands)			December 31, 2013		
	Unpaid Principal Balance	Fair Value	Fair Value Over / (Under) Unpaid Principal Balance	Unpaid Principal Balance	Fair Value	Fair Value Over / (Under) Unpaid Principal Balance
Assets						
Nonaccrual loans						
Loans held-for-sale	$—	$—	$—	$—	$—	$—
Loans held-for-investment	9,422	3,853	(5,569)	10,764	4,014	(6,750)
Total non-accrual loans	$9,422	$3,853	(5,569)	$10,764	$4,014	$(6,750)
Other performing loans						
Loans held-for-sale	$1,211,118	$1,274,667	$63,549	$1,109,517	$1,140,507	$30,990
Loans held-for-investment	244,969	224,905	(20,064)	257,665	234,308	(23,357)
Total other performing loans	$1,456,087	$1,499,572	$43,485	$1,367,182	$1,374,815	$7,633
Total loans						
Loans held-for-sale	$1,211,118	$1,274,667	$63,549	$1,109,517	$1,140,507	$30,990
Loans held-for-investment	254,391	228,758	(25,633)	268,429	238,322	(30,107)
Total loans	$1,465,509	$1,503,425	$37,916	$1,377,946	$1,378,829	$883
Liabilities						
Long-term debt	$(105,326)	$(97,722)	$(7,604)	$(116,504)	$(105,813)	$(10,691)
Litigation settlement	N/A (1)	(78,000)	N/A (1)	N/A (1)	(93,000)	N/A (1)

(1) Remaining principal outstanding is not applicable to the litigation settlement because it does not obligate the Company to return a stated amount of principal at maturity, but instead return an amount based upon performance on the underlying terms in the Agreement.

Note 4 – Investment Securities

As of June 30, 2014 and December 31, 2013, investment securities were comprised of the following.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
June 30, 2014				
Available-for-sale securities				
U.S. government sponsored agencies	$1,587,394	$12,608	$(3,668)	$1,596,334
Municipal obligations	9,471	—	—	9,471
Total available-for-sale securities	$1,596,865	$12,608	$(3,668)	$1,605,805
December 31, 2013				
Available-for-sale securities				
U.S. government sponsored agencies	$1,037,289	$1,546	$(10,587)	$1,028,248
Municipal obligations	17,300	—	—	17,300
Total available-for-sale securities	$1,054,589	$1,546	$(10,587)	$1,045,548

Available-for-sale securities

The Company purchased $463.8 million and $669.3 million of investment securities, all of which were U.S. government sponsored agencies, during the three and six months ended June 30, 2014, respectively. The Company purchased $20.0 million of investment securities, all of which were municipal obligations, during both the three and six months ended June 30, 2013.

The Company has pledged available-for-sale securities, primarily U.S. government sponsored agencies, to collateralize lines of credit and/or borrowings with Fannie Mae and other institutions. At June 30, 2014, the Company pledged $2.4 million of available-for-sale securities, compared to $7.8 million at December 31, 2013.

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

	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
	Fair Value	Number of Securities	Unrealized Loss	Fair Value	Number of Securities	Unrealized Loss
Type of Security	(Dollars in thousands)					
June 30, 2014						
U.S. government sponsored agencies	$—	—	$—	$465,045	47	$(3,668)
December 31, 2013						
U.S. government sponsored agencies	$—	—				