

FLAGSTAR BANCORP INC  
Form 10-K  
March 20, 2012

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2011

**OR**

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

Commission file number: **001-16577**

**FLAGSTAR BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Michigan**  
(State or other jurisdiction of

incorporation or organization)

**5151 Corporate Drive, Troy, Michigan**  
(Address of principal executive offices)

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

**38-3150651**  
(I.R.S. Employer

Identification No.)

**48098-2639**  
(Zip Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>Common Stock, par value \$0.01 per share</b>	<b>New York Stock Exchange</b>
Securities registered pursuant to Section 12(g) of the Act: <b>None</b>	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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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  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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 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  Non-Accelerated Filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The estimated aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing sale price (\$1.19 per share) as reported on the New York Stock Exchange on June 30, 2011, was approximately \$233.2 million. The registrant does not have any non-voting common equity shares.

As of March 15, 2012, 556,963,536 shares of the registrant's Common Stock, \$0.01 par value, were issued and outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to its 2012 Annual Meeting of Stockholders have been incorporated into Part III of this Report on Form 10-K.

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**FORWARD LOOKING STATEMENTS**

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

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

- (1) Volatile interest rates that impact, amongst other things, (i) the mortgage banking business, (ii) our ability to originate loans and sell assets at a profit, (iii) prepayment speeds and (iv) our cost of funds, could adversely affect earnings, growth opportunities and our ability to pay dividends to stockholders;
- (2) Competitive factors for loans could negatively impact gain on loan sale margins;
- (3) Competition from banking and non-banking companies for deposits and loans can affect our growth opportunities, earnings, gain on sale margins, market share and ability to transform business model;
- (4) Changes in the regulation of financial services companies and government-sponsored housing enterprises, and in particular, declines in the liquidity of the residential mortgage loan secondary market, could adversely affect our business;
- (5) Changes in regulatory capital requirements or an inability to achieve or maintain desired capital ratios could adversely affect our growth and earnings opportunities and our ability to originate certain types of loans, as well as our ability to sell certain types of assets for fair market value or to transform our business model;
- (6) General business and economic conditions, including unemployment rates, movements in interest rates, the slope of the yield curve, any increase in mortgage fraud and other related criminal activity and the further decline of asset values in certain geographic markets, may significantly affect our business activities, loan losses, reserves, earnings and business prospects;
- (7) Factors concerning the implementation of proposed refinements and transformation of our business model could result in slower implementation times than we anticipate and negate any competitive advantage that we may enjoy;
- (8) Actions of mortgage loan purchasers, guarantors and insurers regarding repurchases and indemnity demands and uncertainty related to foreclosure procedures could adversely affect our business activities and earnings;
- (9) The Dodd-Frank Wall Street Reform and Consumer Protection Act has resulted in the elimination of the Office of Thrift Supervision, tightening of capital standards, and the creation of a new Consumer Financial Protection Bureau ( CFPB ) and has resulted, or will result, in new laws, regulations and regulatory supervisors that are expected to increase our costs of operations. In addition, the change to the Office of the Comptroller of the Currency ( OCC ) as our primary federal regulator may result in interpretations affecting our operations different than those of the Office of Thrift Supervision ( OTS );

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

- (11) Our compliance with the terms and conditions of the agreement with the U.S. Department of Justice, the impact of performance and enforcement of commitments under, and provisions contained in the agreement, and our accuracy and ability to estimate the financial impact of that agreement, including the fair value of the future payments required, could accelerate our litigation settlement expenses relating thereto;
- (12) The downgrade by Standards & Poor's of the long-term credit rating of the U.S. could materially affect global and domestic financial markets and economic conditions, which may affect our business activities, financial condition, and liquidity; and
- (13) If we do not regain compliance with the New York Stock Exchange ( NYSE ) continued listing requirements, our common stock may be delisted from the NYSE.

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

Please also refer to Item 1A to Part I of this Annual Report on Form 10-K, which is incorporated by reference herein, for further information on these and other factors affecting us.

Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore any of these statements included herein may prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved.

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**PART I**

**ITEM 1. BUSINESS**

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, and Flagstar Capital Markets Corporation ( FCMC ), its wholly-owned subsidiary, which we collectively refer to as the Bank.

**General**

We are a Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank. At December 31, 2011, our total assets were \$13.6 billion, making us the largest publicly held savings bank in the Midwest and one of the top 15 largest savings banks in the United States. We are considered a controlled company for New York Stock Exchange ( NYSE ) purposes because MP Thrift Investments, L.P. ( MP Thrift ) held approximately 64.1 percent of our common stock as of December 31, 2011.

As a savings and loan holding company, we are subject to regulation, examination and supervision by the Board of Governors of the Federal Reserve (the Federal Reserve ). The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency ( OCC ) of the United States Department of the Treasury ( U.S. Treasury ). The Bank is also subject to regulation, examination and supervision by the Federal Deposit Insurance Corporation ( FDIC, ) and the Bank's deposits are insured by the FDIC through the Deposit Insurance Fund ( DIF ). The Bank is also subject to the rule-making supervision and examination authority of the Consumer Financial Protection Bureau (the CFPB ), which is responsible for the principal federal consumer protection laws. The Bank is a member of the Federal Home Loan Bank ( FHLB ) of Indianapolis.

We operate 113 banking centers (of which 17 are located in retail stores), all located in Michigan. During the fourth quarter 2011, we completed the sale or lease of 27 banking centers in Georgia to PNC Bank, N.A., part of The PNC Financial Services Group, Inc. ( PNC ), and 22 banking centers in Indiana to First Financial Bank, N.A. ( First Financial ). Of the 113 banking centers, 66 facilities are owned and 47 facilities are leased. Through our banking centers, we gather deposits and offer a line of consumer and commercial financial products and services to individuals and businesses. We also gather deposits on a nationwide basis through our internet banking group, and provide deposit and cash management services to governmental units on a relationship basis. We leverage our banking centers and internet banking to cross-sell products to existing customers and increase our customer base. At December 31, 2011, we had a total of \$7.7 billion in deposits, including \$5.5 billion in retail deposits, \$0.7 billion in government funds, \$0.4 billion in wholesale deposits and \$1.1 billion in company-controlled deposits.

We also operate 27 loan origination centers located in 13 states, which originate one-to-four family residential first mortgage loans as part of our retail home lending business. These offices employ approximately 161 loan officers. We also originate retail loans through referrals from our 113 retail banking centers, consumer direct call center and our website, flagstar.com. Additionally, we have wholesale relationships with over 1,900 mortgage brokers and approximately 1,240 correspondents, which are located in all 50 states and serviced by 136 account executives. The combination of our retail, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our residential first mortgage loan products. Our servicing activities primarily include collecting cash for principal, interest and escrow payments from borrowers, and accounting for and remitting principal and interest payments to investors and escrow payments to third parties.

Lastly, we operate a total of four commercial banking offices in Massachusetts, Connecticut, and Rhode Island, which were opened in 2011 as part of the Bank's plan to transform into a full-service and diversified

super community bank. We believe that expanding our commercial banking division, and extending commercial lending to the New England region, will allow us to leverage our retail banking franchise, and that the commercial lending businesses will complement existing operations and contribute to the establishment of a diversified mix of revenue streams.

Our revenues include net interest income from our retail and commercial banking activities, fee-based income from services we provide customers, and non-interest income from sales of residential first mortgage loans to the secondary market, the servicing of loans for others, and the sale of servicing rights related to mortgage loans serviced for others. Approximately 97.4 percent of our total loan originations during the year ended December 31, 2011 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale through U.S. government-sponsored entities, or GSEs (a term generally used to refer collectively or singularly to Fannie Mae and Freddie Mac) and Ginnie Mae.

At December 31, 2011, we had 3,136 full-time equivalent salaried employees of which 297 were account executives and loan officers.

## **Recent Developments**

### *Deferral of Dividend and Interest Payments*

On January 27, 2012, we provided notice to the U.S. Treasury exercising our contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with our participation in the TARP Capital Purchase Program. Under the terms of the preferred stock, we may defer payments of dividends for up to six quarters in total without default or penalty. Concurrently, we also exercised our contractual rights to defer interest payments with respect to trust preferred securities. Under the terms of the related indentures, we may defer interest payments for up to 20 consecutive quarters without default or penalty. We believe in prudent capital stewardship and will refrain from making further payments until our financial condition improves. These payments will be periodically evaluated and reinstated when appropriate, subject to provisions of our supervisory agreement with the Federal Reserve (as successor in interest to the Office of Thrift Supervision) dated January 27, 2010 (the Bancorp Supervisory Agreement).

### *Agreement with U.S. Department of Justice*

On February 24, 2012, we announced that we 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). We entered into the DOJ Agreement pursuant to which we agreed to comply with all applicable HUD and FHA rules related to our continued participation in the direct endorsement lender program, made an initial payment of \$15.0 million, and complete a monitoring period by an independent third party chosen by us and approved by HUD. In addition, we are obligated only upon the occurrence of certain future events (as further described below) to make payments of approximately \$118.0 million (the Additional Payments). The Additional Payments will occur if and only if each of the following events happen: we generate positive income for a sustained period, such that part or all of our Deferred Tax Asset (DTA), which has been offset by a valuation allowance (the DTA Valuation Allowance), is more likely than not to be realized, as evidenced by the reversal of the DTA Valuation Allowance in accordance with accounting principles generally accepted in the United States (U.S. GAAP), we are able to include capital derived from the reversal of the DTA Valuation Allowance in our Tier 1 capital, and our obligation to repay the \$266.7 million in preferred stock held by the U.S. Treasury under the TARP Capital Purchase Program has been either extinguished or excluded from Tier 1 capital for purposes of calculating the Tier 1 capital ratio as described in the paragraph below.

Upon the occurrence of each of the future events described above, and provided doing so would not violate any banking regulatory requirement or the OCC does not otherwise object, we will begin making Additional



Payments provided that (i) each annual payment would be equal to the lesser of \$25 million or the portion of the Additional Payments that remains outstanding after deducting prior payments; and (ii) no obligation arises until our call report as filed with the OCC, including any amendments thereto, for the period ending at least six months prior to the making of such Additional Payments, reflects a minimum Tier 1 capital ratio, after excluding any un-extinguished portion of the TARP preferred stock, of 11 percent (or higher ratio if required by regulators).

Based on analysis of the DOJ agreement, we recorded a liability of \$33.3 million, which includes \$18.3 million representing the estimated fair value of the \$118.0 million Additional Payments, or \$(0.06) per share in net loss applicable to common shareholders, recorded in non-interest expense in general and administrative expenses for the year ended December 31, 2011. Future changes in the fair value of the Additional Payments will affect earnings each quarter. See Note 4 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein, for the key assumptions used in valuing the litigation settlement.

### **Business and Strategy**

We, as with the rest of the mortgage industry and most other lenders, were negatively affected in recent years by increased credit losses from the prolonged and unprecedented economic recession. Financial institutions continued to experience significant declines in the value of collateral for real estate loans and heightened credit losses, resulting in record levels of non-performing assets, charge-offs, foreclosures and losses on disposition of the underlying assets. Moreover, liquidity in the debt markets remained low throughout 2011 and 2010, further contributing to the decline in asset prices due to the low level of purchasing activity in the marketplace. Financial institutions also face heightened levels of scrutiny and capital and liquidity requirements from regulators.

We believe that despite the increased scrutiny and heightened capital and liquidity requirements, regulated financial institutions should benefit from reduced competition from unregulated entities that lack the access to and breadth of significant funding sources as well as the capital to meet the financing needs of their customers. We further believe that the business model of banking has changed and that full-service and diversified super community banking organizations will be well suited to take advantage of the changing market conditions.

We believe that our management team has the necessary experience to appropriately manage through the credit and operational issues that are presented in today's challenging markets. We believe that expanding our commercial banking division, and extending commercial lending to the New England region will allow us to leverage our retail banking franchise, and that the commercial lending businesses will complement existing operations and contribute to the establishment of a diversified mix of revenue streams.

We intend to continue to seek ways to maximize the value of our mortgage business while limiting risk, with a critical focus on expense management, improving asset quality while minimizing credit losses, increasing profitability, and preserving capital. We expect to pursue opportunities to build our core deposit base through our existing branch banking structure and to serve the credit and non-credit needs of the business customers in our markets, as we diversify our businesses and risk through executing our business plan and transitioning to a full-service and diversified super community banking model.

### **Operating Segments**

Our business is comprised of two operating segments – banking and home lending. Our banking operation currently offers a line of consumer and commercial financial products and services to individuals, small and middle market businesses and large corporate borrowers. Our home lending operation originates, acquires, sells and services mortgage loans on one-to-four family residences. Each operating segment supports and complements the operations of the other, with funding for the home lending operation primarily provided by deposits and borrowings obtained through the banking operation. Financial information regarding the two operating segments is set forth in Note 31 of the Notes to Consolidated Financial Statements, in Item 8. Financial

Statements and Supplementary Data, herein. A more detailed discussion of the two operating segments is set forth below.

***Banking Operation***

Our deposit-related banking operation is composed of two delivery channels: Retail Banking and Government Banking.

Retail Banking consisted of 113 banking centers located throughout Michigan at December 31, 2011. During the fourth quarter 2011, we completed the sale or lease of the 27 banking centers in Georgia to PNC and 22 banking centers in Indiana to First Financial.

Government Banking is engaged in providing deposit and cash management services to governmental units on a relationship basis throughout Michigan and deposit services to governmental units throughout Georgia.

In addition to deposits, our banking operation may borrow funds by obtaining advances from the FHLB or other federally backed institutions or by entering into repurchase agreements with correspondent banks using investments as collateral.

Our banking operation may invest these funds in a variety of consumer and commercial loan products. Commercial and industrial loans, direct financing leases and various other financial products are available to small and middle market business, as well as large corporate borrowers.

Our retail strategy revolves around two major initiatives: improving cross sale ratios with existing customers and acquiring new customers.

To improve cross sale ratios with existing customers, 10 primary products have been identified as key products on which to focus our sales efforts. These products produce incremental relationship profitability and improve customer retention. Key products include mortgage loans, bill pay (with online banking), debit and credit cards, money market demand accounts, checking accounts, savings accounts, certificates of deposit, lines of credit, consumer loans and investment products. At December 31, 2011, our cross sale ratios using this product set was 3.3 for the banking operation. We continue to formulate and implement strategies to further improve our cross sale ratios.

To enhance new customers and cross sale ratios, we have performed customer segmentation analyses to identify the consumer profiles that best match our product and service platform. After determining the propensity of each customer to purchase specific products offerings, we then market to those customers with a targeted approach. This includes offering banking products to mortgage customers, including those mortgage customers who reside within the Retail Banking delivery channel footprint and have a loan that we service. During 2011, we introduced a new suite of personal deposit products, complemented by a full line of services which include enhanced online banking with purchase rewards, programs associated with managing customer finances, and mobile banking applications which allow customers to always be connected.

A major initiative to assist in the cross sale ratio improvement and new customer acquisition was the introduction in 2010 of lending products to the Retail Banking delivery channel. Previously, no lending products were offered directly by banking centers. In 2011, we reintroduced the home equity lines of credit for origination in its banking centers. In addition, we began to offer Flagstar-branded Visa credit cards for both personal and business customers. The ability to offer lending products to retail customers is essential to relationship profitability and customer retention. We now offer a wide range of lending products directly through banking centers, including mortgages, various consumer loans and business loans.

The banking operation plans to acquire high quality deposits through the following strategic initiatives:

Growing core deposits;

Pricing deposits in a disciplined manner;

Growing checking accounts to enhance both fee income and cross sell potential into other financial products;

Maintaining best in class customer service to enhance retention and increase word of mouth customer referrals;

Leveraging technology to enhance customer acquisition and retention:

Provide a comprehensive online banking platform (consumer and business) to improve retention;

Increase percentage of customers using online banking; and

Increase percentage of online banking customers using bill pay and direct deposit;

Utilize website analytics to understand customer web traffic and keep the website updated with fresh content; and

Establish improved mobile banking and social networking platforms to enhance customer acquisition and retention; and

Optimizing key internet banking ratios through website improvements, active site traffic monitoring and on line application usability. In addition to improving the effective use of our banking centers, we expect to opportunistically expand our banking centers network.

Our government banking strategy is focused on growing existing relationships through leveraging customer service levels and on expanding our customer base in Michigan and Georgia.

#### ***Home Lending Operation***

Our home lending operation originates, acquires, sells and services one-to-four family residential first mortgage loans. The origination or acquisition of residential first mortgage loans constitutes our most significant lending activity. At December 31, 2011, approximately 31.5 percent of interest-earning assets were held in residential first mortgage loans on single-family residences.

During 2011 and continuing into 2012, we were one of the country's leading mortgage loan originators. Three production channels were utilized to originate or acquire mortgage loans—Retail, Broker and Correspondent. Each production channel produces similar mortgage loan products and applies the same underwriting standards. We expect to continue to leverage technology to streamline the mortgage origination process and bring service and convenience to brokers and correspondents. Eight sales support offices were maintained that assist brokers and correspondents nationwide. We also continue to make increasing use of the Internet as a tool to facilitate the mortgage loan origination process through each of our production channels. Brokers, correspondents and retail home loan centers are able to register and lock loans, check the status of in-process inventory, deliver documents in electronic format, generate closing documents, and request funds through the Internet. Virtually all mortgage loans that closed in 2011 used the Internet in the completion of the mortgage origination or acquisition process.

Retail. In a retail transaction, loans are originated through a nationwide network of stand-alone home loan centers, as well as referrals from our retail banking centers and the national call center. When loans are originated on a retail basis, the origination documentation is completed inclusive of customer disclosures and other aspects of the lending process and funding of the transaction is completed

internally. At December 31, 2011, we maintained 27 loan origination centers. At the same time, our centralized loan processing gained efficiencies and allowed lending staff to focus on originations. For the year ended December 31, 2011, we closed \$1.8 billion of loans utilizing this origination channel, which equaled 6.7 percent of total originations, as compared to \$2.0 billion or 7.5 percent of total originations during 2010 and \$4.0 billion or 11.9 percent of total originations during 2009.

**Broker.** In a broker transaction, an unaffiliated bank or mortgage brokerage company completes the loan paperwork, but the loans are underwritten on a loan-level basis to our underwriting standards and we supply the funding for the loan at closing (also known as table funding ) thereby becoming the lender of record. Currently, we have active broker relationships with over 1,900 mortgage brokerage companies located in all 50 states. For the year ended December 31, 2011, we closed loans totaling \$7.9 billion utilizing this origination channel, which equaled 29.4 percent of total originations, as compared to \$9.1 billion or 34.2 percent during 2010 and to \$13.8 billion or 43.1 percent during 2009.

**Correspondent.** In a correspondent transaction, an unaffiliated mortgage company completes the loan paperwork and also supplies the funding for the loan at closing. After the mortgage company has funded the transaction, the loan is acquired, usually by us paying the mortgage company a market price for the loan. We do not acquire loans in bulk amounts from correspondents but rather we acquire each loan on a loan-level basis and each loan is required to be originated to our underwriting guidelines. We have active correspondent relationships with approximately 1,240 companies, including banks and mortgage companies, located in all 50 states. Over the years, we have developed a competitive advantage as a warehouse lender, wherein lines of credit to mortgage companies are provided to fund loans. We believe warehouse lending is not only a profitable, stand-alone business for us, but also provides valuable synergies within our correspondent channel. We believe that offering warehouse lines has provided a competitive advantage in the small to midsize correspondent channel and has helped grow and build the correspondent business in a profitable manner. For example, for the year ended December 31, 2011, warehouse lines funded over 70 percent of the loans in our correspondent channel. We plan to continue to leverage warehouse lending as a customer retention and acquisition tool throughout 2012. For the year ended December 31, 2011, we closed loans totaling \$16.9 billion utilizing the correspondent origination channel, which equaled 63.9 percent of total originations, compared to \$15.5 billion or 58.4 percent originated during 2010 and \$14.5 billion or 45.0 percent originated during 2009.

**Underwriting.** In past years, we originated a wide variety of residential mortgage loans, both for sale and for our own portfolio.

During the year ended December 31, 2011, we primarily originated residential first mortgage loans for sale that conformed to the respective underwriting guidelines established by Fannie Mae, Freddie Mac and Ginnie Mae (each an Agency or collectively the Agencies ). The increase in the held-for-investment loan portfolio was driven by our jumbo loan program offering in the third quarter 2011. The program has credit parameters, including maximum loan-to-value ( LTV ) of 80 percent and a minimum FICO of 700, with a maximum loan limit of \$2.0 million.

*Residential First Mortgage Loans.* At December 31, 2011, most of our held-for-investment residential first mortgage loans represented loans that were originated in 2008 or prior years with underwriting criteria that varied by product and with the standards in place at the time of origination.

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Set forth below is a table describing the characteristics of the residential first mortgage loans in our held-for-investment portfolio at December 31, 2011, by year of origination (also referred to as the vintage year, or vintage).

Year of Origination	2008 and Prior	2009	2010	2011	Total
	(Dollars in thousands)				
Unpaid principal balance(1)	\$ 3,409,935	\$ 67,572	\$ 21,000	\$ 227,623	\$ 3,726,130
Average note rate	4.52%	5.21%	4.99%	4.09%	4.51%
Average original FICO score	715	699	717	766	717
Average original loan-to-value ratio	75.3%	84.5%	78.9%	66.6%	74.9%
Housing Price Index LTV, as recalculated(2)	93.3%	91.9%	83.8%	65.6%	91.5%
Underwritten with low or stated income documentation	38.0%	2.0%	%	%	35.0%

(1) Unpaid principal balance does not include premiums or discounts.

(2) The housing price index (HPI) LTV is updated from the original LTV based on Metropolitan Statistical Area-level Office of Federal Housing Enterprise Oversight (OFHEO) data as of September 30, 2011.

Residential first mortgage loans are underwritten on a loan-by-loan basis rather than on a pool basis. Generally, residential first mortgage loans produced through our production channels in held-for-investment loan portfolio are reviewed by one of our in-house loan underwriters or by a contract underwriter. In all cases, loans must be underwritten to our underwriting standards.

Our criteria for underwriting generally includes, but are not limited to, full documentation of borrower income and other relevant financial information, fully indexed rate consideration for variable loans, and for agency loans, the specific agency's eligible loan-to-value ratios with full appraisals when required. Variances from any of these standards are permitted only to the extent allowable under the specific program requirements. These included the ability to originate loans with less than full documentation and variable rate loans with an initial interest rate less than the fully indexed rate. Mortgage loans are collateralized by a first or second mortgage on a one-to-four family residential property.

In general, for loans in the portfolio originated in years 2008 and prior, loan balances under \$1,000,000 required a valid agency automated underwriting system (AUS) response for approval consideration. Documentation and ratio guidelines are driven by the AUS response. A FICO credit score for the borrower is required and a full appraisal of the underlying property that would serve as collateral is obtained.

For loan balances over \$1,000,000, traditional manual underwriting documentation and ratio requirements are required as are two years plus year to date of income documentation and two months of bank statements. Income documentation based solely on a borrower's statement is an available underwriting option for each loan category. Even so, in these cases employment of the borrower is verified under the vast majority of loan programs, and income levels are usually checked against third party sources to confirm validity.

We believe that our underwriting process, which relies on the electronic submission of data and images and is based on an award-winning imaging workflow process, allows for underwriting at a higher level of accuracy and with more timeliness than exists with processes which rely on paper submissions. We also provide our underwriters with integrated quality control tools, such as automated valuation models (AVMs), multiple fraud detection engines and the ability to electronically submit IRS Form 4506s to ensure underwriters have the information that they need to make informed decisions. The process begins with the submission of an electronic application and an initial determination of eligibility. The application and required documents are then uploaded to our corporate underwriting department and all documents are identified by optical character recognition or our underwriting staff. The underwriter is responsible for checking the data integrity and reviewing credit. The file is then reviewed in accordance with the applicable guidelines established by us for the particular product. Quality

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control checks are performed by the underwriting department using the tools outlined above, as necessary, and a decision is then made and communicated to the prospective borrower.

The following table identifies our held-for-investment mortgages by major category, at December 31, 2011. Loans categorized as subprime were initially originated for sale and comprised only 0.1 percent of the portfolio of first liens.

	Unpaid Principal Balance(1)	Average Note Rate	Average Original FICO Score (Dollars in thousands)	Average Original Loan-to- Value Ratio	Weighted Average Maturity	Housing Price Index LTV, as Recalculated(2)
<b>First mortgage loans:</b>						
Amortizing:						
3/1 ARM	\$ 155,902	3.38%	685	73.4%	270	86.3%
5/1 ARM	515,230	3.78%	728	65.7%	299	75.2%
7/1 ARM	48,582	4.64%	742	67.9%	319	77.1%
Other ARM	66,831	3.42%	671	72.2%	267	84.9%
Other amortizing	1,187,667	5.21%	709	75.0%	284	94.1%
Interest only:						
3/1 ARM	219,463	3.55%	723	74.0%	276	90.9%
5/1 ARM	961,630	3.91%	724	73.5%	287	91.2%
7/1 ARM	88,347					