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**October 22, 2012**

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve  
System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

Office of the Comptroller of the Currency  
250 E Street, SW  
Mail Stop 2-3  
Washington, D.C. 20219

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation,  
550 17th Street, N.W.  
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals (the "Proposals") that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Chartered in 1987 (formerly First Security Bank), Flagstar Bank, FSB ("Flagstar") is a full-service, federally chartered, savings bank headquartered in Troy, Michigan. Flagstar has over 3,500 employees, and operates 111 branches in Michigan, 31 home loan centers across 14 states, and a total of four commercial banking offices in Massachusetts, Connecticut, and Rhode Island. With total assets of \$14.4 billion at June 30, 2012, Flagstar is the largest financial institution headquartered in Michigan and the largest publicly held savings bank headquartered in the Midwest.

Flagstar is the 8<sup>th</sup> largest mortgage originator in the United States, with a national mortgage presence. Originating virtually all residential first mortgages for sale, Flagstar is also one of the ten largest sellers to Fannie Mae and one of the ten largest originators of FHA / VA mortgages. Flagstar also services approximately \$76 billion in mortgage loans for others, primarily Fannie Mae and Freddie Mac (collectively, the "GSEs"). Flagstar is dedicated to the communities it serves, through donations and major sponsorships of community events, in addition to employee volunteer hours. During 2011, over 500 Flagstar employees volunteered in excess of 7,000 hours in their communities.

Flagstar is majority owned by MP Thrift Investments LLC (“MP Thrift”), which controls approximately 64% of the outstanding common shares. MP Thrift made their initial investment in late 2009, and has invested over \$1 billion since that time. In addition, the U.S. Treasury currently holds an investment of \$267.7 million in preferred stock under the TARP program. Like many banks, Flagstar has limited access to the capital markets, and therefore capital management comes only from retained earnings or reducing the balance sheet.

We are generally in favor of strengthening both the quantity and quality of capital in the financial institution sector across the country. Our Bank currently holds capital levels commensurate with our risk profile, and well in excess of the required minimums. Since the beginning of 2010, our Tier 1 capital ratio (to adjusted assets) has averaged 9.3%, and our total risk-based capital ratio has averaged 17.8%. At the same time, we have increased our allowance for loan losses, as a percentage of non-performing loans from 46.8% at the beginning of 2010 to 66.5% at June 30, 2012, while our non-performing assets to total assets has improved from 9.8% to 3.8% over the same period.

While we support the common goal that the Proposals set to accomplish, we find several aspects of them to be very troubling, and believe they will result in unintended consequences such as stunting economic growth, slowing down the housing recovery, forcing layoffs, reducing the availability of credit and / or increasing costs to consumers, and shifting the mortgage servicing business to historically unregulated entities.

### **Deduction of Mortgage Servicing Rights (“MSRs”) from Tier 1 Capital**

Our first area of concern is the proposed treatment of MSRs in Tier 1 capital. As mentioned above, Flagstar services \$76 billion worth of loans, primarily for the GSEs. The loans we service were not purchased from other institutions but rather a result of servicing-retained mortgage sales, principally to the GSEs. We have demonstrated appropriate risk management practices with this asset, and have shown the ability to hedge against the volatility of market interest rates. The period from 2010 forward has seen at least a 100 basis point movement in the 10-year treasury rate in each calendar year. In 2010, the 10-year treasury rate experienced both a 100 basis point plus increase and decrease in that benchmark rate. Despite these tumultuous rate movements, we realized positive returns on our MSR asset (from both the underlying asset and our hedges) for each year. We have also invested tens of millions of dollars over the last few years to enhance our servicing operations, including employees, systems and implementing best practices in our operations.

The fair value of our MSRs was \$639 million at June 30, 2012. If the proposal is adopted as is, we stand to lose almost \$500 million in additional capital by the end of the phase-in period, which would need to be replaced by future earnings, other capital raising activities or balance sheet management. As a result, we have already begun to look at alternatives, including completely exiting the mortgage servicing business. If that happened, it would force us to layoff approximately 700 employees at Flagstar. We would also lose franchise value on our mortgage origination segment, and would no longer be able to offer our consumers a full suite of traditional banking products. Those consumers stand to potentially experience increased pricing in other products as a result.

We believe the severely capital intensive nature of the Proposals regarding MSR's would ultimately cause financial institutions to cease servicing mortgages, causing a shift in the business to historically unregulated entities. By allowing this to happen, the mortgage servicing industry will become fragmented and will no longer be customer centric. Consumers will be unable to readily obtain loan modifications, refinances or other essential banking services directly through their servicer, as these entities are not typically equipped to offer such products and services. We do not believe the results which would transpire are what the Proposals were intended to accomplish.

### **Increase in Risk Weighting on Residential Mortgages**

Our second area of concern relates to the proposed rules on residential mortgages. Flagstar has over \$5.5 billion in residential mortgage loans on its balance sheet as of June 30, 2012. The proposed rules intend to significantly increase the risk weighting on these loans based the type of loan (adjustable vs. fixed) and loan-to-value ("LTV"), and ignore the impact of any credit enhancements, such as private mortgage insurance or employment history. In addition, loan modifications are treated as Category 2 under Basel III unless they were modified under HAMP. As a result, it will be extremely burdensome for us to examine all of our old underwriting files to determine appropriate categories for mortgages. In addition, given the substantial increase in capital we would be required to hold against Category 2 mortgages, we may be forced to reduce lending, increase pricing on mortgage loans, and limit the types of products we are able to offer. This would potentially deny, or drastically limit, the ability of some consumers to obtain financing to own a home.

### **Elimination of Trust Preferred Securities from Capital**

Our third area of concern is the proposed rule to phase out entirely the amount of trust preferred securities included in capital, which is wholly inconsistent with the Collins amendment. We have approximately \$240 million in trust preferred securities, or 18.5% of our Tier 1 capital, which we have held for between 5 and 10 years. These securities represent a cost effective funding source, which has allowed us to continue to grow and offer our customers mortgages and other loans. By eliminating this source of capital, we will be forced to shrink our balance sheet by approximately \$2.6 billion over time to maintain our current capital ratios. This will significantly reduce the number of loans we are able to provide, or potentially force layoffs or asset sales. When you take into consideration the amount of trust preferred across the country, you can readily ascertain the detrimental impact it could have on economic growth and housing prices.

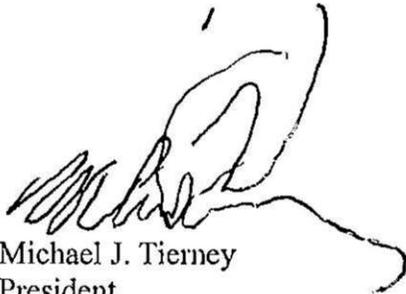
### **Increase in Risk Weighting on Delinquent Loans**

Our fourth area of concern is the proposed rule to increase the risk weighting on delinquent loans. We are already reserving for delinquent loans through our allowance for loan loss process, which is already highly regulated. We believe that requiring additional capital against these loans is redundant. Forcing both additional capital and reserves to be set aside for delinquent loans would drastically reduce the flexibility we have in working with struggling

borrowers. If the rule is adopted, banks will more aggressively move delinquent loans off the balance sheet, leaving more consumers at risk of foreclosure.

In conclusion, the limitation of financial institutions to recognize reasonably sufficient returns has made it almost impossible raise additional capital. Without a functioning capital market, the Proposals will undoubtedly force financial institutions to decrease lending, sell assets, layoff employees and increase pricing. There will be a significant impact on consumers across the country, which will come at a time where loan economic growth is already constrained.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Michael J. Tierney', with a long, sweeping underline.

Michael J. Tierney  
President  
Flagstar Bank, FSB and  
Flagstar Bancorp, Inc.

cc: Senator Carl Levin  
Senator Debbie Stabenow  
Representative Bill Huizenga  
Representative Gary Peters