PHH CORP
Form 10-Q
August 06, 2015
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

o 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: 1-7797

PHH CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	52-0551284 (I.R.S. Employer Identification Number)
3000 LEADENHALL ROAD MT. LAUREL, NEW JERSEY (Address of principal executive offices)	08054 (Zip Code)

856-917-1744
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 þ No o

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. Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

As of July 30, 2015, 59,807,113 shares of PHH Common stock were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

Except as expressly indicated or unless the context otherwise requires, the “Company,” “PHH,” “we,” “our” or “us” means PHH Corporation, a Maryland corporation, and its subsidiaries.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may also be made in other documents filed or furnished with the SEC or may be made orally to analysts, investors, representatives of the media and others.

Generally, forward-looking statements are not based on historical facts but instead represent only our current beliefs regarding future events. All forward-looking statements are, by their nature, subject to risks, uncertainties and other factors. Investors are cautioned not to place undue reliance on these forward-looking statements. Such statements may be identified by words such as “expects,” “anticipates,” “intends,” “projects,” “estimates,” “plans,” “may increase,” “may fluctuate” and similar expressions or future or conditional verbs such as “will,” “should,” “would,” “may” and “could.” Forward-looking statements contained in this Form 10-Q include, but are not limited to, statements concerning the following:

the execution of our strategic priorities, including re-engineering our business, executing our growth strategies, executing our capital structure initiatives and our expectations regarding future operating benefits from the achievement of those priorities;

other potential acquisitions, dispositions, partnerships, joint ventures and changes in product offerings to achieve disciplined growth in our franchise platforms and to optimize our business;

our expectations of the impacts of regulatory changes on our businesses;

future origination volumes and loan margins in the mortgage industry;

our expectations regarding the impacts of the shift in our volume to a greater mix of subserviced loans, including the impacts on our earnings and potential benefits to our capital structure;

our expectations around future losses from representation and warranty claims, and associated reserves and provisions;

the impact of the adoption of recently issued accounting pronouncements on our financial statements; and

our assessment of legal and regulatory proceedings and the associated impact on our financial statements.

Actual results, performance or achievements may differ materially from those expressed or implied in forward-looking statements due to a variety of factors, including but not limited to the factors listed and discussed in “Part II—Item 1A. Risk Factors” in this Form 10-Q, “Part I—Item 1A. Risk Factors” in our 2014 Form 10-K and those factors described below:

our ability to successfully re-engineer our mortgage business, re-negotiate our private label agreements, and implement changes to meet our operational and financial objectives;

the effects of market volatility or macroeconomic changes on the availability and cost of our financing arrangements and the value of our assets;

the effects of changes in current interest rates on our business and our financing costs;

our decisions regarding the use of derivatives related to mortgage servicing rights, if any, and the resulting potential volatility of the results of operations of our business;

the impact of changes in the U.S. financial condition and fiscal and monetary policies, or any actions taken or to be taken by the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System on the credit markets and the U.S. economy;

the effects on our business of any further declines in the volume of U.S. home sales and home prices, due to adverse economic changes or otherwise;

the effects of any significant adverse changes in the underwriting criteria or existence or programs of government-sponsored entities, including Fannie Mae and Freddie Mac, including any changes caused by the Dodd-Frank Wall Street Reform and Consumer Protection Act or other actions of the federal government;

the ability to maintain our status as a government sponsored entity-approved seller and servicer, including the ability to continue to comply with the respective selling and servicing guides;

the effects of changes in, or our failure to comply with, laws and regulations, including mortgage- and real estate-related laws and regulations, changes in the status of government sponsored-entities and changes in state, federal and foreign tax laws and accounting standards;

the effects of the outcome or resolutions of any inquiries, investigations or appeals related to our mortgage origination or servicing activities, any litigation related to our mortgage origination or servicing activities, or any related fines, penalties and increased costs;

the ability to maintain our relationships with our existing clients, including our efforts to amend the terms of certain of our private label client agreements, and to establish relationships with new clients;

the effects of competition in our business, including the impact of consolidation within the industry in which we operate and competitors with greater financial resources and broader product lines;

the inability or unwillingness of any of the counterparties to our significant customer contracts or financing arrangements to perform their respective obligations under, or to renew on terms favorable to us, such contracts, or our ability to continue to comply with the terms of our significant customer contracts;

the impacts of our current credit ratings, including the impact on our cost of capital and ability to access the debt markets, as well as on our current or potential customers' assessment of our long-term stability;

the ability to obtain alternative funding sources for our mortgage servicing rights or servicing advances, or to obtain financing (including refinancing and extending existing indebtedness) on acceptable terms, if at all, to finance our operations or growth strategies, to operate within the limitations imposed by our financing arrangements and to maintain the amount of cash required to service our indebtedness and operate our business;

any failure to comply with covenants or asset eligibility requirements under our financing arrangements; and

the effects of any failure in or breach of our technology infrastructure, or those of our outsource providers, or any failure to implement changes to our information systems in a manner sufficient to comply with applicable laws, regulations and our contractual obligations.

Forward-looking statements speak only as of the date on which they are made. Factors and assumptions discussed above, and other factors not identified above, may have an impact on the continued accuracy of any forward-looking statements that we make. Except for our ongoing obligations to disclose material information under the federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements. For any forward-looking statements contained in any document, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Table of Contents

PART I — FINANCIAL INFORMATION
Item 1. Financial Statements

PHH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In millions, except per share data)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
REVENUES								
Origination and other loan fees	$87		$59		$145		$106	
Gain on loans held for sale, net	86		80		168		131	
Net loan servicing income:								
Loan servicing income	100		110		204		225	
Change in fair value of mortgage servicing rights	18		(52	)	(8	)	(131	)
Net derivative (loss) gain related to mortgage servicing rights	(49	)	20		4		26	
Net loan servicing income	69		78		200		120	
Net interest expense:								
Interest income	13		12		22		20	
Secured interest expense	(9	)	(9	)	(18	)	(18	)
Unsecured interest expense	(16	)	(26	)	(33	)	(55	)
Net interest expense	(12	)	(23	)	(29	)	(53	)
Other income	7		2		14		3	
Net revenues	237		196		498		307	
EXPENSES								
Salaries and related expenses	85		91		172		180	
Commissions	27		21		46		36	
Loan origination expenses	25		23		49		42	
Foreclosure and repossession expenses	15		14		30		28	
Professional and third-party service fees	45		28		87		56	
Technology equipment and software expenses	9		9		19		17	
Occupancy and other office expenses	12		12		24		25	
Depreciation and amortization	4		6		9		12	
Other operating expenses	89		13		105		25	
Total expenses	311		217		541		421	
Loss from continuing operations before income taxes	(74	)	(21	)	(43	)	(114	)
Income tax benefit	(18	)	(12	)	(10	)	(45	)
Loss from continuing operations, net of tax	(56	)	(9	)	(33	)	(69	)
Loss from discontinued operations, net of tax	—		(46	)	—		(30	)
Net loss	(56	)	(55	)	(33	)	(99	)
Less: net income attributable to noncontrolling interest	6		4		8		2	
Net loss attributable to PHH Corporation	$(62	)	$(59	)	$(41	)	$(101	)
Basic loss per share:								
From continuing operations	$(1.20	)	$(0.23	)	$(0.80	)	$(1.23	)
From discontinued operations	—		(0.79	)	—		(0.52	)
Total attributable to PHH Corporation	$(1.20	)	$(1.02	)	$(0.80	)	$(1.75	)
Diluted loss per share:								

From continuing operations	$(1.20)	$(0.23)	$(0.80)	$(1.23)
From discontinued operations	—	(0.79)	—	(0.52)
Total attributable to PHH Corporation	$(1.20)	$(1.02)	$(0.80)	$(1.75)

See accompanying Notes to Condensed Consolidated Financial Statements.

3

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net loss	$(56)	$(55)	$(33)	$(99)
Other comprehensive income, net of tax:				
Change in unfunded pension liability, net	—	—	1	—
Currency translation adjustment	—	7	—	—
Total other comprehensive income, net of tax	—	7	1	—
Total comprehensive loss	(56)	(48)	(32)	(99)
Less: comprehensive income attributable to noncontrolling interest	6	4	8	2
Comprehensive loss attributable to PHH Corporation	$(62)	$(52)	$(40)	$(101)

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In millions, except share data)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and cash equivalents	$958	$1,259
Restricted cash	43	56
Mortgage loans held for sale	1,364	915
Accounts receivable, net	103	123
Servicing advances, net	671	694
Mortgage servicing rights	1,020	1,005
Property and equipment, net	41	36
Other assets	294	208
Total assets (1)	$4,494	$4,296
LIABILITIES AND EQUITY		
Accounts payable and accrued expenses	$281	$244
Subservicing advance liabilities	361	347
Debt	1,912	1,739
Deferred taxes	250	262
Loan repurchase and indemnification liability	63	63
Other liabilities	100	70
Total liabilities (1)	2,967	2,725
Commitments and contingencies (Note 11)	—	—
EQUITY		
Preferred stock, $0.01 par value; 1,090,000 shares authorized; none issued or outstanding	—	—
Common stock, $0.01 par value; 273,910,000 shares authorized; 59,805,817 shares issued and outstanding at June 30, 2015; 51,143,723 shares issued and outstanding at December 31, 2014	1	1
Additional paid-in capital	986	989
Retained earnings	520	566
Accumulated other comprehensive loss(2)	(10)	(11)
Total PHH Corporation stockholders’ equity	1,497	1,545
Noncontrolling interest	30	26
Total equity	1,527	1,571
Total liabilities and equity	$4,494	$4,296

See accompanying Notes to Condensed Consolidated Financial Statements.

Continued.

Table of Contents

CONDENSED CONSOLIDATED BALANCE SHEETS-(Continued)
(Unaudited)
(In millions)

[1] The Condensed Consolidated Balance Sheets include assets of variable interest entities which can be used only to settle the obligations and liabilities of variable interest entities which creditors or beneficial interest holders do not have recourse to PHH Corporation and subsidiaries as follows:

	June 30, 2015	December 31, 2014
ASSETS		
Cash and cash equivalents	$78	$85
Restricted cash	12	23
Mortgage loans held for sale	682	378
Accounts receivable, net	15	8
Servicing advances, net	136	155
Property and equipment, net	1	1
Other assets	9	8
Total assets	$933	$658
LIABILITIES		
Accounts payable and accrued expenses	$22	$16
Debt	714	443
Other liabilities	10	11
Total liabilities	$746	$470

[2] Includes amounts recorded related to the Company’s defined benefit pension plan, net of income tax benefits of $6 million as of both June 30, 2015 and December 31, 2014. During both the three and six months ended June 30, 2015 and 2014, there were no amounts reclassified out of Accumulated other comprehensive loss.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited)
(In millions, except share data)

	PHH Corporation Stockholders' Equity						
	Common Stock						
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Six Months Ended June 30, 2015							
Balance at December 31, 2014	51,143,723	$1	$ 989	$566	$(11)	$ 26	$1,571
Total comprehensive (loss) income	—	—	—	(41)	1	8	(32)
Distributions to noncontrolling interest	—	—	—	—	—	(4)	(4)
Stock compensation expense	—	—	4	—	—	—	4
Stock issued under share-based payment plans	160,693	—	2	—	—	—	2
Repurchase of Common stock	(1,574,252)	(1)	5	(5)	—	—	(1)
Conversion of Convertible Notes	10,075,653	1	(16)	—	—	—	(15)
Recognition of deferred taxes related to Convertible notes	—	—	2	—	—	—	2
Balance at June 30, 2015	59,805,817	$1	$ 986	$520	$(10)	$ 30	$1,527
Six Months Ended June 30, 2014							
Balance at December 31, 2013	57,265,517	$1	$ 1,142	$507	$16	$ 24	$1,690
Total comprehensive (loss) income	—	—	—	(101)	—	2	(99)
Stock compensation expense	—	—	5	—	—	—	5
Stock issued under share-based payment plans	145,835	—	2	—	—	—	2
Recognition of deferred taxes related to Convertible notes	—	—	2	—	—	—	2
Balance at June 30, 2014	57,411,352	$1	$ 1,151	$406	$16	$ 26	$1,600

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In millions)

	Six Months Ended June 30, 2015	2014
Cash flows from operating activities:		
Net loss	$(33)	$(99)
Adjustments to reconcile Net loss to net cash (used in) provided by operating activities:		
Capitalization of originated mortgage servicing rights	(48)	(46)
Net loss on mortgage servicing rights and related derivatives	4	105
Vehicle depreciation	—	596
Other depreciation and amortization	9	17
Loss on early extinguishment of debt	30	—
Origination of mortgage loans held for sale	(7,262)	(6,076)
Proceeds on sale of and payments from mortgage loans held for sale	6,938	6,100
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(151)	(95)
Deferred income tax (benefit) expense	(2)	11
Other adjustments and changes in other assets and liabilities, net	66	13
Net cash (used in) provided by operating activities	(449)	526
Cash flows from investing activities:		
Net cash received on derivatives related to mortgage servicing rights	5	19
Proceeds on sale of mortgage servicing rights	36	10
Purchases of property and equipment	(16)	(8)
Decrease (increase) in restricted cash	13	(87)
Investment in vehicles	—	(850)
Proceeds on sale of investment vehicles	—	201
Other, net	3	6
Net cash provided by (used in) investing activities	41	(709)
Cash flows from financing activities:		
Proceeds from secured borrowings	9,199	9,494
Principal payments on secured borrowings	(8,812)	(9,304)
Principal payments on unsecured borrowings	(243)	—
Cash tender premiums for convertible debt	(30)	—
Issuances of Common stock	2	2
Cash paid for debt issuance costs	(4)	(12)
Distributions to noncontrolling interest	(4)	—
Other, net	(1)	(4)
Net cash provided by financing activities	107	176
Net decrease in Cash and cash equivalents	(301)	(7)
Cash and cash equivalents at beginning of period	1,259	1,245
Less: Cash balance of discontinued operations at end of period	—	(274)
Cash and cash equivalents at end of period	$958	$964

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization

PHH Corporation and subsidiaries (collectively, “PHH” or the “Company”) is a leading provider of end to end mortgage solutions. The Company operates in two business segments, Mortgage Production, which provides mortgage loan origination services and sells mortgage loans, and Mortgage Servicing, which performs servicing activities for loans originated by PHH Mortgage and mortgage servicing rights purchased from others, and acts as a subservicer for certain clients that own the underlying mortgage servicing rights.

The Condensed Consolidated Financial Statements include the accounts and transactions of PHH and its subsidiaries, as well as entities in which the Company directly or indirectly has a controlling interest and variable interest entities of which the Company is the primary beneficiary. PHH Home Loans, LLC (“PHH Home Loans”) and its subsidiaries are consolidated within the Condensed Consolidated Financial Statements and Realogy Group LLC’s ownership interest is presented as a noncontrolling interest. Intercompany balances and transactions have been eliminated from the Condensed Consolidated Financial Statements.

Preparation of Financial Statements

The Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”), for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. In management’s opinion, the unaudited Condensed Consolidated Financial Statements contain all adjustments, which include normal and recurring adjustments, necessary for a fair presentation of the financial position and results of operations for the interim periods presented. The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Company’s 2014 Form 10-K.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions include, but are not limited to, those related to the valuation of mortgage servicing rights, mortgage loans held for sale and other financial instruments, the estimation of liabilities for commitments and contingencies, mortgage loan repurchases and indemnifications and the determination of certain income tax assets and liabilities and associated valuation allowances. Actual results could differ from those estimates.

Effective on July 1, 2014, the Company sold its Fleet Management Services business and related fleet entities (collectively, the “Fleet business”) to certain wholly-owned subsidiaries of Element Financial Corporation. The results of the Fleet business are presented as discontinued operations in the Condensed Consolidated Statements of Operations, and have been excluded from continuing operations and segment results for all periods presented. The cash flows and comprehensive income related to the Fleet business have not been segregated and are included in the Condensed Consolidated Statements of Cash Flows and Condensed Consolidated Statements of Comprehensive Income, respectively, for all periods presented. Amounts related to the Fleet business are excluded from the Notes to Condensed Consolidated Financial Statements unless otherwise noted. See Note 2, 'Discontinued Operations' for additional information.

Unless otherwise noted and except for share and per share data, dollar amounts presented within these Notes to Condensed Consolidated Financial Statements are in millions.

Changes in Accounting Pronouncements

Presentation of Financial Statements. In April 2014, the FASB issued ASU 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” Under the new guidance, only disposals of a component of an entity that represent a major strategic shift on an entity’s operations and financial results shall be reported in discontinued operations. The guidance also requires the presentation as discontinued operations for an entity that, on acquisition, meets the criteria to be classified as held for sale. In addition, the update expands disclosures for discontinued operations, requires new disclosures regarding disposals of an individually significant component of an entity that does not qualify for discontinued operations presentation and expands disclosures about an entity’s significant continuing involvement with a discontinued operation. Due to the change in

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

requirements for reporting discontinued operations described above, presentation and disclosures of future disposal transactions after adoption may be different than under current standards. The Company adopted this guidance as of January 1, 2015, and there was no impact to the Company's financial statements or disclosures.

Transfers of Financial Assets. In June 2014, the FASB issued limited amendments to ASC 860, "Transfers and Servicing" through the issuance of ASU 2014-11, "Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The update requires entities to account for repurchase-to-maturity transactions as secured borrowings, and eliminates the accounting guidance on linked repurchase financing transactions. In addition, the update expands disclosure requirements related to certain transfers of financial assets accounted for as financings and accounted for as sales. The Company adopted this guidance as of January 1, 2015 and there was no impact to the Company's financial statements.

Recently Issued Accounting Pronouncements

Consolidation. In February 2015, the FASB issued ASU 2015-02, "Amendments to the Consolidation Analysis." The update impacts an entity's consolidation analysis of its variable interest entities, particularly those that have fee arrangements and related party relationships. The update eliminates certain conditions for evaluating whether a fee paid to a decision maker or a service provider represents a variable interest, and places more emphasis in the evaluation of variable interests other than fee arrangements. Additionally, the amendments reduce the extent to which related party arrangements cause an entity to be considered a primary beneficiary. The amendments in this update are effective for the first interim and annual periods beginning after December 15, 2015 with early adoption permitted. A reporting entity may apply this update retrospectively or by using a modified retrospective approach. The Company is currently evaluating the impact of adopting this new standard.

Interest. In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs" which requires that debt issuance costs related to a recognized debt liability be presented in the Balance Sheets as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. The amendments in this update are to be applied retrospectively, and are effective for the first interim and annual periods beginning after December 15, 2015, with early adoption permitted. The adoption will impact the Company's balance sheet presentation, but will not impact the Company's results of operations or cash flows. The Company is currently evaluating the impact of adopting this new standard.

Intangibles—Goodwill and Other—Internal-Use Software. In April 2015, the FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." This update clarifies whether a cloud computing arrangement should be accounted for as a software license or as a service contract by the customer, depending on the terms of the arrangement. In addition, the guidance requires all software licenses within the scope of the internal use software subtopic to be accounted for consistent with other licenses of intangible assets. The amendments in this update are effective for the first interim and annual periods beginning after December 15, 2015, with early adoption permitted. An entity can elect to adopt this update either: (i) prospectively to all arrangements entered into or materially modified after the effective date; or (ii) retrospectively. The Company is currently evaluating the impact of adopting this new standard.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Discontinued Operations

During the second quarter of 2014, the Company entered into a definitive agreement to sell its Fleet business and the sale was completed effective on July 1, 2014.

The results of discontinued operations are summarized below:

	June 30, 2014 Three Months Ended	Six Months Ended
	(In millions)	
Net revenues[1]	$415	$820
Total expenses[1]	391	774
Income before income taxes[1]	24	46
Income tax expense	10	16
Loss from sale of discontinued operations, net of tax	(60)	(60)
Loss from discontinued operations, net of tax	$(46)	$(30)

[1] Represents the results of the Fleet business.

The Loss from sale of discontinued operations, net of tax for the three and six months ended June 30, 2014 both include $52 million of income tax expense associated with the earnings of Canadian subsidiaries that were previously considered to be indefinitely invested. Upon the classification of these entities as held for sale during the second quarter of 2014, the accumulated earnings were no longer deemed to be indefinitely invested and the Company recognized expense related to the cumulative earnings of such Canadian subsidiaries.

3. Earnings Per Share

Basic earnings or loss per share attributable to PHH Corporation was computed by dividing Net income or loss attributable to PHH Corporation for the period by the weighted-average number of shares outstanding during the period. Diluted earnings or loss per share attributable to PHH Corporation was computed by dividing Net income or loss attributable to PHH Corporation for the period by the weighted-average number of shares outstanding during the period, assuming all potentially dilutive common shares were issued.

During 2014, the Company entered into two separate Accelerated Share Repurchase agreements to repurchase an aggregate of $200 million of PHH’s Common stock. The final delivery of shares occurred in March 2015 and resulted in a 1,574,252 reduction of the outstanding shares used to calculate the weighted-average common shares outstanding for basic and diluted earnings or loss per share.

In June 2015, the Company completed the offer to exchange its 6.0% Convertible notes due in 2017. The principal amount of the notes was settled in cash and the amount by which the conversion value exceeded the principal of the converted notes was settled in shares, resulting in the issuance of 10,075,653 shares. The shares were settled on June 18, 2015 and increased the outstanding shares used to calculate the weighted-average common shares outstanding for basic and diluted earnings or loss per share. See Note 8, 'Debt and Borrowing Arrangements' for further discussion.

The weighted-average computation of the dilutive effect of potentially issuable shares of Common stock under the treasury stock method excludes the effect of any contingently issuable securities where the contingency has not been met and the effect of securities that would be anti-dilutive. Anti-dilutive securities may include:

outstanding stock-based compensation awards representing shares from restricted stock units and stock options;
stock assumed to be issued related to convertible notes; and
sold warrants related to the Company's Convertible notes due 2014.

Shares associated with anti-dilutive securities are outlined in the table below.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the calculations of basic and diluted earnings or loss per share attributable to PHH Corporation for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In millions, except share and per share data)			
Loss from continuing operations, net of tax	$(56)	$(9)	$(33)	$(69)
Less: net income attributable to noncontrolling interest	6	4	8	2
Net loss from continuing operations attributable to PHH Corporation	(62)	(13)	(41)	(71)
Loss from discontinued operations, net of tax	—	(46)	—	(30)
Net loss attributable to PHH Corporation	$(62)	$(59)	$(41)	$(101)
Weighted-average common shares outstanding—basic & diluted[(1)]	51,135,313	57,637,910	51,154,163	57,591,158
Basic loss per share:				
From continuing operations	$(1.20)	$(0.23)	$(0.80)	$(1.23)
From discontinued operations	—	(0.79)	—	(0.52)
Total attributable to PHH Corporation	$(1.20)	$(1.02)	$(0.80)	$(1.75)
Diluted loss per share:				
From continuing operations	$(1.20)	$(0.23)	$(0.80)	$(1.23)
From discontinued operations	—	(0.79)	—	(0.52)
Total attributable to PHH Corporation	$(1.20)	$(1.02)	$(0.80)	$(1.75)

____

(1) For the three and six months ended June 30, 2015 and 2014, the Company had a net loss from continuing operations attributable to PHH Corporation and, as a result, there were no potentially dilutive securities included in the denominator for computing dilutive earnings per share.

The following table summarizes anti-dilutive securities excluded from the computation of dilutive shares:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Outstanding stock-based compensation awards[(1)]	1,836,791	2,119,350	1,836,791	2,119,350
Assumed conversion of debt securities	8,482,846	9,004,140	8,751,067	9,292,828

____

(1) For the three and six months ended June 30, 2015, excludes 283,648 shares that are contingently issuable for which the contingency has not been met.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Transfers and Servicing of Mortgage Loans

Residential mortgage loans are sold through one of the following methods: (i) sales to or pursuant to programs sponsored by Fannie Mae, Freddie Mac and the Government National Mortgage Association (collectively, the “Agencies”) or (ii) sales to private investors. The Company may have continuing involvement in mortgage loans sold by retaining one or more of the following: mortgage servicing rights and servicing obligations, recourse obligations and/or beneficial interests (such as interest-only strips, principal-only strips, or subordinated interests). During the six months ended June 30, 2015, the Company did not retain any interest from sales or securitizations other than mortgage servicing rights. See Note 10, 'Credit Risk' for a further description of recourse obligations.

The total servicing portfolio consists of loans associated with capitalized mortgage servicing rights, loans held for sale, and the portfolio associated with loans subserviced for others. The total servicing portfolio was $225.2 billion and $227.3 billion, as of June 30, 2015 and December 31, 2014, respectively. Mortgage servicing rights (“MSRs”) recorded in the Condensed Consolidated Balance Sheets are related to the capitalized servicing portfolio and are created either through the direct purchase of servicing from a third party or through the sale of an originated loan.

The Company has agreements to sell a portion of its newly-created mortgage servicing rights to third parties, and will have continuing involvement as subservicer. As of June 30, 2015, the Company had commitments to sell mortgage servicing rights related to $152 million of the unpaid principal balance of mortgage loans held for sale and interest rate lock commitments that are expected to result in closed loans and $875 million of the unpaid principal balance of loans in the capitalized servicing portfolio. As of June 30, 2015, the fair value of the MSRs subject to sale commitments and associated with the loans in the capitalized portfolio was $12 million.

The activity in the loan servicing portfolio associated with capitalized mortgage servicing rights consisted of:

	Six Months Ended June 30,	
	2015	2014
	(In millions)	
Balance, beginning of period	$112,686	$129,145
Additions	4,323	4,428
Payoffs and curtailments	(9,966)	(8,936)
Sales	(2,338)	(678)
Balance, end of period	$104,705	$123,959

The activity in capitalized MSRs consisted of:

	Six Months Ended June 30,	
	2015	2014
	(In millions)	
Balance, beginning of period	$1,005	$1,279
Additions	48	46
Sales	(25)	(7)
Changes in fair value due to:		
Realization of expected cash flows	(89)	(74)
Changes in market inputs or assumptions used in the valuation model	81	(57)

Balance, end of period	$1,020	$1,187

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The value of MSRs is driven by the net positive cash flows associated with servicing activities. These cash flows include contractually specified servicing fees, late fees and other ancillary servicing revenue and were recorded within Loan servicing income as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In millions)			
Servicing fees from capitalized portfolio	$77	$90	$156	$182
Late fees	3	3	7	8
Other ancillary servicing revenue	8	8	15	16

As of June 30, 2015 and December 31, 2014, the MSRs had a weighted-average life of 6.7 years and 5.7 years, respectively. See Note 12, 'Fair Value Measurements' for additional information regarding the valuation of MSRs.

The following table sets forth information regarding cash flows relating to loan sales in which the Company has continuing involvement:

	Six Months Ended June 30,	
	2015	2014
	(In millions)	
Proceeds from new loan sales or securitizations	$4,439	$4,578
Servicing fees from capitalized portfolio[1]	156	182
Purchases of delinquent or foreclosed loans [2]	(6)	(22)
Servicing advances [3]	(1,018)	(1,013)
Repayment of servicing advances [3]	1,041	1,017

(1) Excludes late fees and other ancillary servicing revenue.

(2) Excludes indemnification payments to investors and insurers of the related mortgage loans.

(3) Outstanding servicing advance receivables are presented in Servicing advances, net in the Condensed Consolidated Balance Sheets, except for advances related to loans in foreclosure or real estate owned, which are included in Other assets.

During the three and six months ended June 30, 2015, pre-tax gains of $86 million and $149 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on loans held for sale, net in the Condensed Consolidated Statements of Operations.

During the three and six months ended June 30, 2014, pre-tax gains of $73 million and $145 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on loans held for sale, net in the Condensed Consolidated Statements of Operations.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Derivatives

Derivative instruments and the risks they manage are as follows:

Forward delivery commitments—Related to interest rate and price risk for mortgage loans held for sale and interest rate lock commitments

Option contracts—Related to interest rate and price risk for mortgage loans held for sale and interest rate lock commitments

MSR-related agreements—Related to interest rate risk for mortgage servicing rights

Derivative instruments are recorded in Other assets and Other liabilities in the Condensed Consolidated Balance Sheets. The Company does not have any derivative instruments designated as hedging instruments.

The following table summarizes the gross notional amount of derivatives:

	June 30, 2015	December 31, 2014
	(In millions)	
Interest rate lock commitments	$1,947	$1,185
Forward delivery commitments	5,493	3,893
Option contracts	120	213
MSR-related agreements	2,825	4,013

The following tables present the balances of outstanding derivative instruments on a gross basis and the application of counterparty and collateral netting:

	June 30, 2015			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$13	$(12)	$—	$1
MSR-related agreements	31	—	(21)	10
Derivative assets subject to netting	44	(12)	(21)	11
Not subject to master netting arrangements:				
Interest rate lock commitments	23	—	—	23
Forward delivery commitments	5	—	—	5
Derivative assets not subject to netting	28	—	—	28
Total derivative assets	$72	$(12)	$(21)	$39

	Gross Liabilities	Offsetting Receivables	Cash Collateral Received	Net Amount
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$5	$(12)	$9	$2
Not subject to master netting arrangements:				

Interest rate lock commitments	1	—	—	1
Forward delivery commitments	4	—	—	4
Derivative liabilities not subject to netting	5	—	—	5
Total derivative liabilities	$ 10	$(12)	$9	$7

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2014			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$2	$(2)	$—	$—
MSR-related agreements	66	(2)	(56)	8
Derivative assets subject to netting	68	(4)	(56)	8
Not subject to master netting arrangements:				
Interest rate lock commitments	22	—	—	22
Forward delivery commitments	3	—	—	3
Derivative assets not subject to netting	25	—	—	25
Total derivative assets	$93	$(4)	$(56)	$33

	Gross Liabilities	Offsetting Receivables	Cash Collateral Paid	Net Amount
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 9	$(4)	$(3)	$2
Not subject to master netting arrangements:				
Forward delivery commitments	5	—	—	5
Total derivative liabilities	$ 14	$(4)	$(3)	$7

The following table summarizes the gains (losses) recorded in the Condensed Consolidated Statements of Operations for derivative instruments:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In millions)			
Gain on loans held for sale, net:				
Interest rate lock commitments	$54	$95	$135	$169
Forward delivery commitments	28	(39)	11	(59)
Option contracts	(1)	(2)	(1)	(3)
Net derivative (loss) gain related to mortgage servicing rights:				
MSR-related agreements	(49)	20	4	26

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Other Assets

Other assets consisted of:

	June 30, 2015	December 31, 2014
	(In millions)	
Repurchase eligible loans[1]	$102	$53
Derivatives	39	33
Income taxes receivable	38	2
Equity method investments	33	34
Mortgage loans in foreclosure, net	28	32
Real estate owned, net	20	21
Deferred financing costs	16	19
Other	18	14
Total	$294	$208

(1) Repurchase eligible loans represent certain mortgage loans sold pursuant to Government National Mortgage Association programs where the Company, as servicer, has the unilateral option to repurchase the loan if certain criteria are met, including if a loan is greater than 90 days delinquent and where it has been determined that there is more than a trivial benefit from exercising the repurchase option. Regardless of whether the repurchase option has been exercised, the Company must recognize eligible loans within Other assets and a corresponding repurchase liability within Accounts payable and accrued expenses in the Condensed Consolidated Balance Sheets.

7. Other Liabilities

Other liabilities consisted of:

	June 30, 2015	December 31, 2014
	(In millions)	
Litigation and regulatory reserves (Note 11)	$62	$29
Pension and other post employment benefits liability	11	11
Liability for income tax contingencies	8	9
Derivatives	7	7
Other	12	14
Total	$100	$70

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. Debt and Borrowing Arrangements

The following table summarizes the components of Debt:

	June 30, 2015				December 31, 2014
	Balance	Interest Rate[(1)]		Available Capacity[(2)]	Balance
	(In millions)				
Committed warehouse facilities	$1,207	2.1	%	$718	$ 800
Uncommitted warehouse facilities	—	—		2,500	—
Servicing advance facility	88	2.2	%	67	108
Convertible notes due in 2017[(3)]	2	6.0	%	n/a	216
Term notes due in 2019	275	7.375	%	n/a	275
Term notes due in 2021	340	6.375	%	n/a	340
Unsecured debt	617				831
Total	$1,912				$ 1,739

____

(1) Interest rate shown represents the stated interest rate of outstanding borrowings, which may differ from the effective rate due to the amortization of premiums, discounts and issuance costs. Warehouse facilities and the servicing advance facility are variable-rate. Rate shown for warehouse facilities represents the weighted-average rate of current outstanding borrowings.

(2) Capacity is dependent upon maintaining compliance with, or obtaining waivers of, the terms, conditions and covenants of the respective agreements, including asset-eligibility requirements.

(3) Amount is net of unamortized discount of $29 million as of December 31, 2014. The effective interest rate of the Convertible notes due in 2017 is 13%, including the accretion of the discount and issuance costs.

Assets held as collateral that are not available to pay the Company’s general obligations as of June 30, 2015 consisted of:

	Warehouse Facilities	Servicing Advance Facility
	(In millions)	
Restricted cash	$7	$8
Servicing advances	—	136
Mortgage loans held for sale (unpaid principal balance)	1,256	—
Total	$1,263	$144

The following table provides the contractual debt maturities as of June 30, 2015:

	Warehouse Facilities	Servicing Advance Facility[(1)]	Unsecured Debt	Total
	(In millions)			
Within one year	$1,207	$88	$—	$1,295
Between one and two years	—	—	2	2
Between two and three years	—	—	—	—

Between three and four years	—	—	—	—
Between four and five years	—	—	275	275
Thereafter	—	—	340	340
	$1,207	$88	$617	$1,912

(1) Maturities of the servicing advance facility represent estimated payments based on the expected cash inflows of the receivables.

See Note 12, 'Fair Value Measurements' for the measurement of the fair value of Debt.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Mortgage Warehouse Facilities

In the first quarter of 2015, the committed mortgage repurchase facility with Wells Fargo Bank was extended to April 1, 2016, and the committed capacity was increased by $100 million to $450 million. On April 7, 2015, the $150 million committed mortgage repurchase facility with The Royal Bank of Scotland plc was terminated by mutual agreement of the parties.

Servicing Advance Facility

On June 11, 2015, PHH Servicer Advance Receivables Trust 2013-1 ("PSART"), an indirect, wholly-owned subsidiary of the Company, entered into a Note Purchase Agreement with Wells Fargo and issued the Series 2015-1 variable funding notes with an aggregate maximum principal amount of $155 million. The proceeds from the Series 2015-1 Notes were used to pay in full all amounts owed under the Series 2013-1 Notes previously issued to The Royal Bank of Scotland plc. The Series 2015-1 Notes have a revolving period through June 15, 2016 and a final maturity of June 15, 2017. The notes bear interest, payable monthly, based on LIBOR plus an agreed-upon margin.

Unsecured Debt

Convertible Notes due in 2017. In June 2015, the Company completed an exchange of $243 million aggregate principal of its 6.0% Convertible notes due in 2017 for cash and, for the conversion value in excess of principal, shares of the Company's Common stock. The exchange offer included cash consideration of $1,125 and 41.4611 shares of Common stock for each $1,000 principal amount of the notes, plus accrued and unpaid interest. The Company retired the notes in exchange for $274 million of cash, plus 10.076 million shares of Common stock.

The total value of the consideration of the exchange offer was allocated between the liability and equity components of the original instrument. The portion allocated to the extinguishment of the liability component was equal to the fair value of that component immediately prior to extinguishment, with the difference between this allocation and the net carrying amount of the debt recognized as a loss on early extinguishment of debt. The remaining settlement consideration was allocated to the reacquisition of the equity component and was recognized as a reduction of additional paid-in capital. In connection with the exchange offer, the Company recognized a loss of $30 million during the three and six months ended June 30, 2015 in Other operating expenses in the Condensed Consolidated Statements of Operations.

In July 2015, the Company retired substantially all the 6.0% Convertible notes due in 2017 remaining after the exchange offer for $4 million of cash, including an exchange premium and accrued and unpaid interest.

Debt Covenants

There were no significant amendments to the terms of debt covenants during the six months ended June 30, 2015. As of June 30, 2015, the Company was in compliance with all financial covenants related to its debt arrangements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. Income Taxes

Interim income tax expense was recorded by applying a projected full-year effective income tax rate to the quarterly income or loss from continuing operations before income taxes for results that are deemed to be reliably estimable. Certain results dependent on fair value adjustments of the Company are considered not to be reliably estimable, and therefore, discrete year-to-date income tax provisions are recorded on those results. See Note 2, 'Discontinued Operations' for a discussion of the income tax provision related to the income or loss from discontinued operations.

The following table and discussion summarizes items that significantly impacted Income tax expense or benefit from continuing operations and increased (decreased) the effective tax rate:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In millions)			
State and local income taxes, net of federal tax benefits	$(2)	$(2)	$(1)	$(5)
Changes in valuation allowance	4	(2)	3	(1)
Nondeductible expenses	6	—	6	—
Noncontrolling interest	(2)	(2)	(3)	(1)

State and local income taxes, net of federal tax benefits. Represents the impact to the effective tax rate from the pre-tax income or loss as well as the mix of income or loss from the operations by entity and state income tax jurisdiction. The effective state tax rate for the six months ended June 30, 2015 was higher compared to the six months ended June 30, 2014.

Changes in valuation allowance. Represents the impact to the effective tax rate from state loss carryforwards generated during the year and certain cumulative non net operating loss deferred tax assets for which the Company believes it is more likely than not that the amounts will not be realized. For the three and six months ended June 30, 2015, the amount was primarily driven by state tax losses generated and an increase in the non net operating loss deferred tax assets for which a valuation allowance is warranted.

Nondeductible expenses. Represents the impact to the effective tax rate from nondeductible expenses primarily related to legal and regulatory matters, premiums paid to exchange the Convertible notes due in 2017 and certain amounts of officer's compensation.

Noncontrolling interest. Represents the impact to the effective tax rate from Realogy Group LLC’s portion of income taxes related to the income or loss attributable to PHH Home Loans. The impact is driven by PHH Home Loans’ election to report as a partnership for federal and state income tax purposes, whereby, the tax expense is reported by the individual LLC members. Accordingly, the Company’s income tax expense or benefit includes only its proportionate share of the income tax related to the income or loss generated by PHH Home Loans.

10. Credit Risk

The Company is subject to the following forms of credit risk:

Consumer credit risk—through mortgage banking activities as a result of originating and servicing residential mortgage loans

Counterparty credit risk—through derivative transactions, sales agreements and various mortgage loan origination and servicing agreements

Consumer Credit Risk

The Company is not subject to the majority of the risks inherent in maintaining a mortgage loan portfolio because loans are not held for investment purposes and are generally sold to investors within 30 days of origination. The majority of mortgage loan sales are on a non-recourse basis; however, the Company has exposure in certain circumstances in its capacity as a loan originator and servicer to loan repurchases and indemnifications through representation and warranty provisions and government servicing contracts.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following tables summarize certain information regarding the total loan servicing portfolio, which includes loans associated with the capitalized mortgage servicing rights as well as loans subserviced for others:

	June 30, 2015	December 31, 2014
	(In millions)	
Loan Servicing Portfolio Composition		
Owned	$106,200	$113,849
Subserviced	119,027	113,423
Total	$225,227	$227,272
Conventional loans	$196,860	$195,184
Government loans	24,098	27,720
Home equity lines of credit	4,269	4,368
Total	$225,227	$227,272
Weighted-average interest rate	3.8 %	3.9 %

	June 30, 2015		December 31, 2014	
	Number of Loans	Unpaid Balance	Number of Loans	Unpaid Balance
Portfolio Delinquency[(1)]				
30 days	2.15 %	1.55 %	2.43 %	1.75 %
60 days	0.37	0.26	0.58	0.41
90 or more days	0.89	0.66	1.13	0.85
Total	3.41 %	2.47 %	4.14 %	3.01 %
Foreclosure/real estate owned[(2)]	2.03 %	1.82 %	2.22 %	2.04 %

---

(1) Represents portfolio delinquencies as a percentage of the total number of loans and the total unpaid balance of the portfolio.

(2) As of June 30, 2015 and December 31, 2014, the total servicing portfolio included 18,730 and 21,456 of loans in foreclosure with an unpaid principal balance of $3.6 billion and $4.1 billion, respectively.

Repurchase and Foreclosure-Related Reserves

Representations and warranties are provided to investors and insurers on a significant portion of loans sold, and are also assumed on purchased mortgage servicing rights for loans that are owned by the Agencies or included in Agency-guaranteed securities. In limited circumstances, the full risk of loss on loans sold is retained to the extent the liquidation of the underlying collateral is insufficient. In some instances where the Company has purchased loans from third parties, it may have the ability to recover the loss from the third party originator. Repurchase and foreclosure-related reserves are maintained for probable losses related to repurchase and indemnification obligations and for on-balance sheet loans in foreclosure and real estate owned.

A summary of the activity in repurchase and foreclosure-related reserves is as follows:

Six Months Ended
June 30,

	2015	2014
	(In millions)	
Balance, beginning of period	$93	$142
Realized losses	(13)	(34)
Increase (decrease) in reserves due to:		
Changes in assumptions	6	(1)
New loan sales	6	3
Balance, end of period	$92	$110

21

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Repurchase and foreclosure-related reserves consist of the following:

Loan Repurchases and Indemnifications

The maximum amount of losses cannot be estimated because the Company does not service all of the loans for which it has provided representations or warranties. As of June 30, 2015, $177 million of loans have been identified in which the Company has full risk of loss or has identified a breach of representation and warranty provisions; 11% of which were at least 90 days delinquent (calculated based upon the unpaid principal balance of the loans).

Liabilities for probable losses related to repurchase and indemnification obligations of $63 million, as of both June 30, 2015 and December 31, 2014, are presented in the Condensed Consolidated Balance Sheets.

Given the inherent uncertainties involved in estimating losses associated with future repurchase and indemnification requests, there is a reasonable possibility that future losses may be in excess of the recorded liability. As of June 30, 2015, the estimated amount of reasonably possible losses in excess of the recorded liability was $25 million which primarily relates to the Company's estimate of repurchase and foreclosure-related charges that may not be reimbursed pursuant to government mortgage insurance programs in the event we do not file insurance claims. The estimate is based on an expectation of future defaults and the historical defect rate for government insured loans and is based upon significant judgments and assumptions which can be influenced by many factors, including: (i) home prices and the levels of home equity; (ii) the quality of underwriting procedures; (iii) borrower delinquency and default patterns; and (iv) general economic conditions. The Company's estimate of reasonably possible losses does not represent probable losses and does not include an estimate for any losses related to loans from origination years where the Agencies have substantially completed or resolved their file reviews or related to loans with defects that were excluded from the resolution agreement entered into with Fannie Mae during the fourth quarter of 2014. Excluded defects include, but are not limited to, loans with certain title defects or with violations of law.

Mortgage Loans in Foreclosure and Real Estate Owned

The carrying values of the mortgage loans in foreclosure and real estate owned were recorded within Other assets in the Condensed Consolidated Balance Sheets as follows:

	June 30, 2015	December 31, 2014
	(In millions)	
Mortgage loans in foreclosure and related advances	$42	$46
Allowance for probable foreclosure losses	(14)	(14)
Mortgage loans in foreclosure, net	$28	$32
Real estate owned and related advances	$35	$37
Adjustment to value for real estate owned	(15)	(16)
Real estate owned, net	$20	$21

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

11. Commitments and Contingencies

The Company and its subsidiaries are defendants in various legal proceedings, which include private and civil litigation as well as government and regulatory examinations, investigations and inquiries or other requests for information. These matters are at varying procedural stages and primarily relate to contractual disputes and other commercial, employment and tax claims. The resolution of these various matters may result in adverse judgments, fines, penalties, injunctions and other relief against the Company as well as monetary payments or other agreements and obligations. Alternatively, the Company may engage in settlement discussions on certain matters in order to avoid the additional costs of engaging in litigation.

Reserves are established for pending or threatened litigation, claims or assessments when it is probable that a loss has been incurred and the amount of such loss can be reasonably estimated. In light of the inherent uncertainties involved in litigation and other legal proceedings, it is not always possible to determine a reasonable estimate of the amount of a probable loss, and the Company may estimate a range of possible loss for consideration in its estimates. The estimates are based upon currently available information and involve significant judgment taking into account the varying stages and inherent uncertainties of such matters. Accordingly, the Company's estimates may change from time to time and such changes may be material to the consolidated financial results. Given the inherent uncertainties and status of the Company's outstanding legal proceedings, the range of reasonably possible losses cannot be estimated for all matters. For matters where the Company can estimate the range, the aggregate estimated amount of reasonably possible losses in excess of the recorded liability was not significant as of June 30, 2015.

As of June 30, 2015, the Company's recorded reserves associated with legal and regulatory contingencies were $62 million and are presented in Other liabilities in the Condensed Consolidated Balance Sheets. There can be no assurance that the ultimate resolution of the Company's pending or threatened litigation, claims or assessments will not result in losses in excess of the Company's recorded reserves. As a result, the ultimate resolution of any particular legal matter, or matters, could be material to the Company's results of operations or cash flows for the period in which such matter is resolved.

The following are descriptions of the Company's significant legal and regulatory matters, which may involve loss contingencies.

CFPB Enforcement Action. In January 2014, the Bureau of Consumer Financial Protection (the "CFPB") initiated an administrative proceeding alleging that the Company's reinsurance activities, including its mortgage insurance premium ceding practices, have violated certain provisions of the Real Estate Settlement Procedures Act ("RESPA") and other laws enforced by the CFPB. Through its reinsurance subsidiaries, the Company assumed risk in exchange for premiums ceded from primary mortgage insurance companies.

In November 2014, the Company received a recommended decision from the administrative law judge for the payment of $6.4 million to the CFPB. Both the Company and the CFPB's enforcement counsel subsequently appealed the recommended decision to the Director of the CFPB. In June 2015, the Director of the CFPB issued a final order upholding in part, and reversing in part, the recommended decision. The final order requires the Company to pay $109 million, which is based upon the gross reinsurance premiums the Company received on or after July 21, 2008. The Company continues to believe that it has complied with RESPA and other laws applicable to its former mortgage reinsurance activities, and has filed an appeal to the United States Court of Appeals. The Company continues to vigorously defend against the CFPB's allegations and the Director's judgment through the appellate process, although there can be no assurances as to the final outcome of any such appeal.

As of June 30, 2015, the Company's recorded estimate for probable losses in connection with this matter is not material, and is substantially less than the amount reflected in the final order. Based on currently available information, the Company cannot determine an amount of reasonably possible losses in excess of the recorded liability, if any, and there is no estimate of reasonably possible losses in excess of the recorded reserve for this matter included in the amount above. There can be no assurance that the ultimate resolution of this matter will not result in losses in excess of the Company's recorded reserves, and any such losses could be material to the Company's results of operations, cash flows or financial position.

MMC and NYDFS Examinations. The Company has undergone a regulatory examination by a multistate coalition of certain mortgage banking regulators (the "MMC") and such regulators have alleged various violations of federal and state laws related to the Company's legacy mortgage servicing practices. In July 2015, the Company received a settlement proposal from the MMC, proposing payments to certain borrowers nationwide where foreclosure proceedings were either referred or completed during 2009 through 2012, as well as other consumer relief and administrative penalties. In addition, the proposal would require that the Company comply with national servicing standards, submit its servicing activities to monitoring for compliance, and other injunctive relief. The Company believes it has meritorious explanations and defenses to the findings and has provided or is in the process

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

of providing responses to these findings. As of June 30, 2015, the Company included an estimate of probable losses in connection with this matter in the recorded reserve.

In the second quarter of 2015, the New York Department of Financial Services ("NYDFS") clarified that it intends to propose that the Company enter into a consent order to close out pending examination report findings, including New York findings stemming from the MMC examination. While the Company believes it has meritorious explanations and defenses to the findings and has provided or is in the process of providing responses to these findings, the settlement agreement and/or consent order may include fines and penalties, as well as other consumer relief or injunctive relief. Given the uncertainties about the nature of any demands or claims against the Company that may result from this examination, and the current status of the matter, we cannot estimate an amount of probable loss, a range of the reasonably possible loss or the maximum amount of possible losses in connection with this matter. There can be no assurance that the ultimate resolution of this matter will not result in losses which could be material to the Company’s results of operations, cash flows or financial position.

HUD Subpoenas. The Company has received document subpoenas from the Office of Inspector General of the U.S. Department of Housing and Urban Development (“HUD”) requesting production of certain documents related to, among other things, the Company’s origination and underwriting process for loans insured by the Federal Housing Administration (“FHA”). The Company has been cooperating in this investigation since its receipt of the subpoenas in 2013, and certain current and former employees of the Company have been deposed in connection with this matter. Several large mortgage originators that participate in FHA lending programs have been subject to similar investigations, which have resulted in the payment of substantial fines and penalties. However, the range of losses varied significantly for each originator as there were different facts and circumstances underlying each investigation.

Given the current status and nature of this investigation, uncertainties about the nature of any demands or claims against the Company that may result, and the diversity of prior settlements, we cannot estimate an amount of probable loss, a range of the reasonably possible loss or the maximum amount of possible losses in connection with this matter. There can be no assurance that the ultimate resolution of this matter will not result in losses which could be material to the Company’s results of operations, cash flows and financial position.

Lender-Placed Insurance. The Company is currently subject to pending litigation alleging that its servicing practices around lender-placed insurance were not in compliance with applicable laws. Through its mortgage subsidiary, the Company did have certain outsourcing arrangements for the purchase of lender-placed hazard insurance for borrowers whose coverage had lapsed. The Company believes that it has meritorious defenses to these allegations; however, the resolution of such matter may result in adverse judgments, other relief against the Company, as well as monetary payments or other agreements and obligations. Given the nature of this matter and the related allegations, the Company cannot estimate the amount of loss or a range of possible losses, if any, associated with this matter and there can be no assurance that the ultimate resolution of this matter will not result in losses which could be material to the Company’s results of operations, cash flows or financial position.

Other Subpoenas and Investigations. The Company has received document subpoenas from the U.S. Attorney’s Offices for the Southern and Eastern Districts of New York. The subpoenas requested production of certain documents related to, among other things, foreclosure expenses that we incurred in connection with the foreclosure of loans insured or guaranteed by FHA, Fannie Mae or Freddie Mac and loans sold pursuant to programs sponsored by Fannie Mae, Freddie Mac or Ginnie Mae. There can be no assurance that claims or litigation will not arise from this inquiry, or that fines, penalties or increased legal costs will not be incurred in connection with any of these matters.

In addition, in October 2014 the Company received a document subpoena from the Office of the Inspector General of the Federal Housing Financing Agency (the "FHFA") requesting production of certain documents related to, among other things, our origination, underwriting and quality control processes for loans sold to Fannie Mae and Freddie Mac. While the FHFA, as regulatory and conservator for Fannie Mae and Freddie Mac, does not have regulatory authority over the Company or its subsidiaries, there can be no assurance that Fannie Mae and/or Freddie Mac will not assert additional claims as a result of this inquiry.

In addition to the increased regulatory focus on origination and servicing practices described above, Fannie Mae and Freddie Mac have also had a continued focus on foreclosure practices. They have assessed compensatory fees against the Company for failing to meet certain foreclosure timelines specified in their respective servicing guides. Although such compensatory fees have not been material to date, there can be no assurance that the assessment of any such compensatory fees will not be material to the Company's results in the future.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

12. Fair Value Measurements

The Company updates the valuation of each instrument recorded at fair value on a quarterly basis, evaluating all available observable information, which may include current market prices or bids, recent trade activity, changes in the levels of market activity and benchmarking of industry data. The assessment also includes consideration of identifying the valuation approach that would be used currently by market participants. If it is determined that a change in valuation technique or its application is appropriate, or if there are other changes in availability of observable data or market activity, the current methodology will be analyzed to determine if a transfer between levels of the valuation hierarchy is appropriate. Such reclassifications are reported as transfers into or out of a level as of the beginning of the quarter that the change occurs.

The incorporation of counterparty credit risk did not have a significant impact on the valuation of assets and liabilities recorded at fair value as of June 30, 2015 or December 31, 2014.

Recurring Fair Value Measurements

The following summarizes the fair value hierarchy for instruments measured at fair value on a recurring basis:

	June 30, 2015				
	Level One	Level Two	Level Three	Cash Collateral and Netting	Total
	(In millions)				
ASSETS					
Mortgage loans held for sale	$—	$1,316	$48	$—	$1,364
Mortgage servicing rights	—	—	1,020	—	1,020
Other assets—Derivative assets:					
Interest rate lock commitments	—	—	23	—	23
Forward delivery commitments	—	18	—	(12)	6
MSR-related agreements	—	31	—	(21)	10
LIABILITIES					
Other liabilities—Derivative liabilities:					
Interest rate lock commitments	$—	$—	$1	$—	$1
Forward delivery commitments	—	9	—	(3)	6

	December 31, 2014				
	Level One	Level Two	Level Three	Cash Collateral and Netting	Total
	(In millions)				
ASSETS					
Mortgage loans held for sale	$—	$873	$42	$—	$915
Mortgage servicing rights	—	—	1,005	—	1,005
Other assets—Derivative assets:					
Interest rate lock commitments	—	—	22	—	22
Forward delivery commitments	—	5	—	(2)	3

MSR-related agreements	—	66	—	(58	) 8
LIABILITIES					
Other liabilities—Derivative liabilities:					
Forward delivery commitments	$—	$14	$—	$(7	) $7

25

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Significant inputs to the measurement of fair value and further information on the assets and liabilities measured at fair value are as follows:

Mortgage Loans Held for Sale ("MLHS"). The following table reflects the difference between the carrying amounts of MLHS measured at fair value, and the aggregate unpaid principal amount that the Company is contractually entitled to receive at maturity:

	June 30, 2015		December 31, 2014	
	Total	Loans 90 days or more past due and on non-accrual status	Total	Loans 90 days or more past due and on non-accrual status
	(In millions)			
Carrying amount	$1,364	$ 16	$915	$ 13
Aggregate unpaid principal balance	1,352	19	903	17
Difference	$12	$ (3)	$12	$ (4)

The following table summarizes the components of mortgage loans held for sale:

	June 30, 2015	December 31, 2014
	(In millions)	
First mortgages:		
Conforming	$1,170	$761
Non-conforming	145	111
Total first mortgages	1,315	872
Second lien	5	5
Scratch and Dent	43	37
Other	1	1
Total	$1,364	$915

Mortgage Servicing Rights. The following tables summarize certain information regarding the initial and ending capitalization rate of MSRs:

	Six Months Ended June 30,	
	2015	2014
Initial capitalization rate of additions to MSRs	1.11 %	1.04 %

	June 30, 2015	December 31, 2014
Capitalization servicing rate	0.97 %	0.89 %
Capitalization servicing multiple	3.4	3.1
Weighted-average servicing fee (in basis points)	29	29

The significant assumptions used in estimating the fair value of MSRs were as follows (in annual rates):

	June 30, 2015	December 31, 2014
Weighted-average prepayment speed (CPR)	8.3 %	11.5 %

Option adjusted spread, in basis points (OAS)	921	865
Weighted-average delinquency rate	4.3 %	5.0 %

In the first quarter of 2015, the Company integrated an updated prepayment model used in the valuation of MSRs which is more closely aligned with the slower actual prepayment speeds of the capitalized servicing portfolio and made further updates to the cash flow model based on a market data calibration. During the six months ended June 30, 2015, these updates to the valuation model resulted in a $46 million positive change in fair value of MSRs.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the estimated change in the fair value of MSRs from adverse changes in the significant assumptions:

	June 30, 2015		
	Weighted-Average Prepayment Speed	Option Adjusted Spread	Weighted-Average Delinquency Rate
	(In millions)		
Impact on fair value of 10% adverse change	$(36)	$(50)	$(24)
Impact on fair value of 20% adverse change	(69)	(95)	(48)

These sensitivities are hypothetical and presented for illustrative purposes only. Changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, this analysis does not assume any impact resulting from management's intervention to mitigate these variations.

The effect of a variation in a particular assumption is calculated without changing any other assumption and the assumptions used in valuing the MSRs are independently aggregated. Although there are certain inter-relationships among the various key assumptions noted above, changes in one of the significant assumptions would not independently drive changes in the others. The modeled prepayment speed assumptions are highly dependent upon interest rates, which drive borrowers' propensity to refinance; however, there are other factors that can influence borrower refinance activity. These factors include housing prices, the levels of home equity, underwriting standards and loan product characteristics. The OAS is a component of the discount rate used to present value the cash flows of the MSR asset and represents the spread over a base interest rate that equates the present value of cash flows of an asset to the market price of that asset. The weighted average delinquency rate is based on the current and projected credit characteristics of the capitalized servicing portfolio and is dependent on economic conditions, home equity and delinquency and default patterns.

Derivative Instruments. Derivative instruments are classified within Level Two and Level Three of the valuation hierarchy. The average pullthrough percentage used in measuring the fair value of interest rate lock commitments (IRLCs) as of June 30, 2015 and December 31, 2014 was 75% and 74%, respectively. The pullthrough percentage is considered a significant unobservable input and is estimated based on changes in pricing and actual borrower behavior using a historical analysis of loan closing and fallout data. Actual loan pullthrough is compared to the modeled estimates in order to evaluate this assumption each period based on current trends. Generally, a change in interest rates is accompanied by a directionally opposite change in the assumption used for the pullthrough percentage, and the impact to fair value of a change in pullthrough would be partially offset by the related change in price.

Level Three Measurements

Activity of assets and liabilities classified within Level Three of the valuation hierarchy consisted of:

	Three Months Ended June 30, 2015			Three Months Ended June 30, 2014		
	MLHS	MSRs	IRLCs, net	MLHS	MSRs	IRLCs, net
	(In millions)					
Balance, beginning of period	$41	$986				