PHH CORP
Form 10-Q
August 05, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

For the transition period from to

Commission File Number: 1-7797

PHH CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	**52-0551284**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
3000 LEADENHALL ROAD MT. LAUREL, NEW JERSEY	**08054**
(Address of principal executive offices)	*(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 R 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 R No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. Large accelerated filer R Accelerated filer £ Non-accelerated filer £ (Do not check if a smaller reporting company) Smaller reporting company £

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

As of July 29, 2014, 57,439,206 shares of PHH common stock were outstanding.

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Except as expressly indicated or unless the context otherwise requires, the Company, PHH, we, our or us means PHH Corporation, a Maryl 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 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 mortgage business, executing our growth strategies, and executing our capital structure initiatives;

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

¡ our estimates related to the sale of the Fleet business, including the expected net proceeds and expected net gain on disposition;

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

¡ future origination volumes and loan margins in the mortgage industry;

¡ our belief that our mortgage servicing rights funding relationship will contribute positively to our cash flows;

¡ our belief that Fannie Mae and Freddie Mac are substantially complete with pre-2009 vintage mortgage loan repurchase and indemnification requests, as well as our expectations for future requests and associated reserves and provisions;

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

¡ our assessment of legal proceedings and associated reserves and provisions.

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 and those factors described below:

¡ our ability to successfully re-engineer our mortgage business, and implement changes to meet our operational and financial objectives;

¡ the impacts of actual amounts recognized in connection with the Fleet disposition, including post-closing purchase price adjustments and the final determination of income taxes;

¡ 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 Mortgage Servicing segment;

¡ 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 of any further declines in the volume of U.S. home sales and home prices, due to adverse economic changes or otherwise, on our Mortgage Production and Mortgage Servicing segments;

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¡ 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 any inquiries and investigations by attorneys general of certain states and the U.S. Department of Justice, the Bureau of Consumer Financial Protection, U.S. Department of Housing and Urban Development or other state or federal regulatory agencies 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, including service level agreements;

¡ the impact of the failure to maintain our credit ratings, including the impact on our cost of capital and ability to incur new indebtedness or refinance our existing indebtedness, as well as our current or potential customers assessment of our counterparty credit risk;

¡ the ability to obtain alternative funding sources for our mortgage servicing rights 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;

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

¡ 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; and

¡ the ability to attract and retain key employees.

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.

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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,	
	2014	2013	2014	2013
REVENUES				
Mortgage fees	$ 59	$ 82	$ 106	$ 161
Gain on mortgage loans, net	80	197	131	384
Mortgage interest income	12	19	20	39
Mortgage interest expense	(35)	(48)	(73)	(96)
Mortgage net finance expense	(23)	(29)	(53)	(57)
Loan servicing income	110	88	225	196
Change in fair value of mortgage servicing rights	(52)	75	(131)	80
Net derivative gain (loss) related to mortgage servicing rights	20	(1)	26	(17)
Valuation adjustments related to mortgage servicing rights, net	(32)	74	(105)	63
Net loan servicing income	78	162	120	259
Other income	2	3	3	4
Net revenues	196	415	307	751
EXPENSES				
Salaries and related expenses	112	140	216	276
Occupancy and other office expenses	12	13	25	25
Other depreciation and amortization	6	6	12	11
Other operating expenses	87	123	168	234
Total expenses	217	282	421	546
(Loss) income from continuing operations before income taxes	(21)	133	(114)	205
Income tax (benefit) expense	(12)	47	(45)	71
(Loss) income from continuing operations, net of tax	(9)	86	(69)	134
(Loss) income from discontinued operations, net of tax	(46)	16	(30)	32
Net (loss) income	(55)	102	(99)	166
Less: net income attributable to noncontrolling interest	4	12	2	24
Net (loss) income attributable to PHH Corporation	$ (59)	$ 90	$ (101)	$ 142
Basic (loss) earnings per share:				
From continuing operations	$ (0.23)	$ 1.30	$ (1.23)	$ 1.92
From discontinued operations	(0.79)	0.28	(0.52)	0.56
Total attributable to PHH Corporation	$ (1.02)	$ 1.58	$ (1.75)	$ 2.48
Diluted (loss) earnings per share:				
From continuing operations	$ (0.23)	$ 1.15	$ (1.23)	$ 1.68
From discontinued operations	(0.79)	0.25	(0.52)	0.50
Total attributable to PHH Corporation	$ (1.02)	$ 1.40	$ (1.75)	$ 2.18

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net (loss) income	$ (55)	$ 102	$ (99)	$ 166
Other comprehensive income (loss), net of tax:				
Currency translation adjustment	7	(6)		(11)
Change in unrealized gains on available-for-sale securities, net		(1)		(1)
Total other comprehensive income (loss), net of tax	7	(7)		(12)
Total comprehensive (loss) income	(48)	95	(99)	154
Less: comprehensive income attributable to noncontrolling interest	4	12	2	24
Comprehensive (loss) income attributable to PHH Corporation	$ (52)	$ 83	$ (101)	$ 130

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In millions, except share data)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 964	$ 1,126
Restricted cash	55	27
Mortgage loans held for sale	924	834
Accounts receivable, net	637	630
Mortgage servicing rights	1,187	1,279
Property and equipment, net	42	51
Other assets	435	450
Assets held for sale	4,694	4,456
Total assets (1)	$ 8,938	$ 8,853
LIABILITIES AND EQUITY		
Accounts payable and accrued expenses	$ 574	$ 583
Debt	2,167	2,024
Deferred taxes	699	687
Other liabilities	100	150
Liabilities held for sale	3,798	3,719
Total liabilities (1)	7,338	7,163
Commitments and contingencies (Note 12)		
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; 57,411,352 shares issued and outstanding at June 30, 2014; 57,265,517 shares issued and outstanding at December 31, 2013	1	1
Additional paid-in capital	1,151	1,142
Retained earnings	406	507
Accumulated other comprehensive income	16	16
Total PHH Corporation stockholders equity	1,574	1,666
Noncontrolling interest	26	24
Total equity	1,600	1,690
Total liabilities and equity	$ 8,938	$ 8,853

See accompanying Notes to Condensed Consolidated Financial Statements.

Continued.

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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, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 73	$ 94
Restricted cash	23	3
Mortgage loans held for sale	459	318
Accounts receivable, net	181	7
Property and equipment, net	1	2
Other assets	13	7
Assets held for sale (Note 2)	3,940	3,853
Total assets	$ 4,690	$ 4,284
LIABILITIES		
Accounts payable and accrued expenses	$ 18	$ 16
Debt	543	289
Other liabilities	14	12
Liabilities held for sale (Note 2)	3,529	3,471
Total liabilities	$ 4,104	$ 3,788

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)

(In millions, except share data)

	PHH Corporation Stockholders Equity						
	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
	Shares	Amount					
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**
Six Months Ended June 30, 2013							
Balance at December 31, 2012	**56,975,991**	**$ 1**	**$ 1,127**	**$ 372**	**$ 26**	**$ 36**	**$ 1,562**
Total comprehensive income (loss)				142	(12)	24	154
Distributions to noncontrolling interest						(35)	(35)
Stock compensation expense			4				4
Stock issued under share-based payment plans	129,660						
Recognition of deferred taxes related to Convertible notes			2				2
Balance at June 30, 2013	**57,105,651**	**$ 1**	**$ 1,133**	**$ 514**	**$ 14**	**$ 25**	**$ 1,687**

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In millions)

	Six Months Ended June 30,	
	2014	**2013**
Cash flows from operating activities:		
Net (loss) income	$ (99)	$ 166
Adjustments to reconcile Net (loss) income to net cash provided by operating activities:		
Capitalization of originated mortgage servicing rights	(46)	(145)
Net loss (gain) on mortgage servicing rights and related derivatives	105	(63)
Vehicle depreciation	596	607
Other depreciation and amortization	17	16
Origination of mortgage loans held for sale	(6,076)	(15,842)
Proceeds on sale of and payments from mortgage loans held for sale	6,100	16,611
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(95)	(379)
Deferred income tax expense	11	85
Other adjustments and changes in other assets and liabilities, net	13	193
Net cash provided by operating activities	526	1,249
Cash flows from investing activities:		
Investment in vehicles	(850)	(924)
Proceeds on sale of investment vehicles	201	154
Net cash received (paid) on derivatives related to mortgage servicing rights	19	(19)
Proceeds on sale of mortgage servicing rights	10	
Purchases of property and equipment	(8)	(17)
Increase in restricted cash	(87)	(48)
Purchases of restricted investments		(85)
Proceeds from sales and maturities of restricted investments		166
Other, net	6	2
Net cash used in investing activities	(709)	(771)
Cash flows from financing activities:		
Proceeds from secured borrowings	9,494	25,675
Principal payments on secured borrowings	(9,304)	(25,885)
Issuances of common stock	2	1
Cash paid for debt issuance costs	(12)	(11)
Distributions to noncontrolling interest		(35)
Other, net	(4)	(5)
Net cash provided by (used in) financing activities	176	(260)
Effect of changes in exchange rates on Cash and cash equivalents		(3)
Net (decrease) increase in Cash and cash equivalents	(7)	215
Cash and cash equivalents at beginning of period	1,245	829
Less: Cash balance of discontinued operations at end of period	(274)	(94)
Cash and cash equivalents at end of period	$ 964	$ 950

See accompanying Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

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 originated and purchased loans, and acts as a sub-servicer.

In the second quarter of 2014, the Company signed a definitive agreement to sell its Fleet Management Services business and related fleet entities (collectively the Fleet business). 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 assets and liabilities of the Fleet business are presented as Assets held for sale and Liabilities held for sale in the Condensed Consolidated Balance Sheets 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. The sale of the Fleet business was completed effective on July 1, 2014 as discussed in Note 17, Subsequent Events .

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 and its subsidiaries are consolidated within the Condensed Consolidated Financial Statements and Realogy Corporation s ownership interest is presented as a noncontrolling interest. Intercompany balances and transactions have been eliminated from the Condensed Consolidated 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 2013 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 mortgage loan repurchases and indemnifications and reinsurance losses, and the determination of certain income tax assets and liabilities and associated valuation allowances. Actual results could differ from those estimates.

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 Policies

Income Taxes. In July 2013, the FASB issued Accounting Standards Update (ASU) 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists . This update to the income tax guidance clarifies the diversity in practice in the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This update requires the unrecognized tax benefit to be presented in the financial statements as a reduction to

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

a deferred tax asset or as a liability to the extent the entity cannot or does not intend to use the deferred tax asset for such purpose. The Company adopted the new accounting guidance effective January 1, 2014 and applied the guidance prospectively to all unrecognized tax benefits that existed as of the effective date. The adoption of the guidance did not have a material impact on the Company s financial statements.

Recently Issued Accounting Pronouncements

Receivables. In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure . This update to the receivable guidance clarifies when a creditor is considered to have received physical possession of residential real estate resulting from an in substance repossession or foreclosure. In addition, the amendments require disclosure of both: (i) the amount of foreclosed residential real estate property held by the creditor; and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The update requires the Company to apply the guidance using either a modified retrospective transition method or a prospective transition method for interim and annual periods beginning after December 15, 2014, with early adoption permitted. The Company does not expect the adoption of the new guidance to have a material impact on its financial statements.

Presentation and Disclosure of Discontinued Operations. 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 operation 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. The update requires the Company to apply the amendments prospectively to all disposals and classifications as held for sale of components of an entity and to all businesses that, on acquisition, are classified as held for sale within interim and annual periods beginning on or after December 15, 2014. The Company did not elect to early adopt this guidance with respect to the disposal of the Fleet business. The Company will evaluate the impact of this standard related to the accounting for future disposal transactions.

Revenue Recognition. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The objective of the guidance is to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and IFRS. The Amendment supersedes most current revenue recognition guidance, including industry-specific guidance. The Amendment also enhances disclosure requirements around revenue recognition and the related cash flows. The guidance is to be applied retrospectively to all prior periods presented or through a cumulative adjustment in the year of adoption, for interim period and annual periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of adopting this new standard.

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. This guidance is effective for the first interim and annual periods beginning after December 15, 2014. Early adoption is not permitted. The amendments are to be applied retrospectively to all prior periods presented or through a cumulative adjustment in the year of

adoption. The Company is currently evaluating the impact of adopting this new standard on its financial statements.

Share-Based Payments. In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition, rather than being reflected in estimating the grant-date fair value of the award. The amendments are effective for interim and annual periods beginning after December 15, 2015, with early adoption permitted. Entities may apply the amendments in this update either

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

prospectively or retrospectively. The Company does not expect the adoption of this new standard to have an impact on its financial statements.

2. Discontinued Operations

On June 2, 2014, the Company entered into a definitive agreement with Element Financial Corporation in which Element agreed to purchase all of the issued and outstanding equity interests of the Fleet business for an aggregate purchase price of $1.4 billion. The sale was completed effective on July 1, 2014 as discussed further in Note 17, Subsequent Events .

The results of discontinued operations are summarized below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Net revenues	$ 415	$ 407	$ 820	$ 801
Total expenses	406	382	789	752
Income before income taxes	9	25	31	49
Income tax expense related to discontinued operations	55	9	61	17
(Loss) income from discontinued operations, net of tax	$ (46)	$ 16	$ (30)	$ 32

Income tax expense related to discontinued operations for the three and six months ended June 30, 2014 both include expense of $52 million 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 in the second quarter, the accumulated earnings are no longer deemed to be indefinitely invested and the Company must recognize expense related to the cumulative earnings of such Canadian subsidiaries.

Assets and liabilities classified as held for sale related to the Fleet business and consisted of the following:

	June 30, 2014	December 31, 2013
	(In millions)	
ASSETS		
Cash	$ 274	$ 119

Restricted cash		266		207
Accounts receivable, net		352		351
Net investment in fleet leases		3,678		3,653
Property and equipment, net		24		24
Goodwill		25		25
Other assets		75		77
Total assets held for sale(1)(2)	$	4,694	$	4,456
LIABILITIES				
Accounts payable and accrued expenses	$	251	$	223
Debt		3,534		3,481
Other liabilities		13		15
Total liabilities held for sale(1)	$	3,798	$	3,719

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Includes assets and liabilities of variable interest entities as follows:

Chesapeake and D.L. Peterson Trust:		
Total liabilities held for sale	2,945	2,868
FLRT and PHH Lease Receivables LP:		
Total liabilities held for sale	584	603

(2) As of June 30, 2014, includes Assets held as collateral related to vehicle asset-backed debt arrangements including Restricted cash of $261 million, Accounts receivable of $39 million and Net investment in fleet leases of $3,614 million

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.

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.

The computation also excludes shares related to the assumed issuance of the Convertible notes due 2014 and related purchased options as they are currently to be settled only in cash. Shares associated with anti-dilutive securities are outlined in the table below.

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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:

(Loss) income from continuing operations, net of tax	$ (9)	$ 86	$ (69)	$ 134
Net (loss) income from continuing operations attributable to PHH Corporation	(13)	74	(71)	110
Net (loss) income attributable to PHH Corporation	$ (59)	$ 90	$ (101)	$ 142
Weighted-average common shares outstanding basic	57,637,910	57,320,953	57,591,158	57,285,088
Share-based payment arrangements(1)		140,484		189,649
Weighted-average common shares outstanding diluted	57,637,910	64,822,174	57,591,158	65,301,491
Basic (loss) earnings per share:				
From discontinued operations	(0.79)	0.28	(0.52)	0.56
From continuing operations	$ (0.23)	$ 1.15	$ (1.23)	$ 1.68
Total attributable to PHH Corporation	$ (1.02)	$ 1.40	$ (1.75)	$ 2.18

(1) Represents incremental shares from restricted stock units and stock options.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Outstanding stock-based compensation awards(1)	2,119,350	1,109,118	2,119,350	650,818
Assumed conversion of debt securities	9,004,140		9,292,828	

(1) For both the three and six months ended June 30, 2014, excludes 771,206 shares that are contingently issuable for which the contingency has not been met.

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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 Ginnie Mae, or (ii) sales to private investors. The Company may have continuing involvement in mortgage loans sold by retaining one or more of the following: servicing rights and servicing obligations, recourse obligations and/or beneficial interests (such as interest-only strips, principal-only strips, or subordinated interests). See Note 11, 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 $225.9 billion and $226.8 billion, as of June 30, 2014 and December 31, 2013, 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 the Company will have continuing involvement as subservicer. During the six months ended June 30, 2014, sales with a fair value of $7 million were completed under the terms of these arrangements. As of June 30, 2014, the Company had commitments to sell servicing rights related to $762 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. Under these arrangements, the Company also had commitments to sell servicing rights related to $1.2 billion of unpaid principal balance of mortgage loans (fair value of $13 million) that were included in the capitalized servicing portfolio as of June 30, 2014.

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

	Six Months Ended June 30,			
	2014		2013	
	(In millions)			
Balance, beginning of period	$	129,145	$	140,381
Additions		4,428		13,438
Payoffs, sales and curtailments		(9,614)		(20,758)
Balance, end of period	$	123,959	$	133,061

The activity in capitalized MSRs consisted of:

Six Months Ended

	June 30,			
	2014		2013	
	(In millions)			
Balance, beginning of period	$	1,279	$	1,022
Additions		46		145
Sales		(7)		
Changes in fair value due to:				
Realization of expected cash flows		(74)		(157)
Changes in market inputs or assumptions used in the valuation model		(57)		237
Balance, end of period	$	1,187	$	1,247

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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:

Servicing fees from capitalized portfolio	$ 90	$ 99	$ 182	$ 199
Other ancillary servicing revenue	8	9	16	19

As of June 30, 2014 and December 31, 2013, the MSRs had a weighted-average life of 5.7 years and 6.5 years, respectively. See Note 14, 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:

Proceeds from new loan sales or securitizations	$ 4,578	$ 13,805
Purchases of delinquent or foreclosed loans (2)	(22)	(37)
Repayment of servicing advances (3)	1,017	569

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

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

(3) As of June 30, 2014 and December 31, 2013, outstanding servicing advance receivables of $558 million and $565 million, respectively, were included in Accounts receivable, net. The servicing advance cash flows above include advances and repayments related to the total loan servicing portfolio.

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 mortgage loans, net in the Condensed Consolidated Statements of Operations.

During the three and six months ended June 30, 2013, pre-tax gains of $186 million and $428 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on mortgage loans, net in the Condensed Consolidated Statements of Operations.

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
- **Convertible note-related agreements** Related to the issuance of the Convertible notes due in 2014

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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the gross notional amount of derivatives:

	June 30, 2014	December 31, 2013
	(In millions)	
Notional amounts:		
Interest rate lock commitments	$ 1,698	$ 1,378
Forward delivery commitments	5,318	4,527
Option contracts	180	190
MSR-related agreements	2,255	860
Convertible note-related agreements(1)		

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(1) The notional amount of derivative instruments underlying the Convertible-note related agreements is 9.6881 million shares of the Company s Common stock. These instruments relate to the issuance of the Convertible notes due 2014.

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

	June 30, 2014			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
		(In millions)		
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$ 11	$ (11)	$	$
MSR-related agreements	23		(17)	6
Derivative assets subject to netting	34	(11)	(17)	6
Not subject to master netting arrangements:				
Interest rate lock commitments	35			35
Forward delivery commitments	3			3
Convertible note-related agreements	1			1
Derivative assets not subject to netting	39			39
Total derivative assets	$ 73	$ (11)	$ (17)	$ 45

	Gross Liabilities	Offsetting Receivables	Cash Collateral Paid	Net Amount
		(In millions)		
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 25	$ (11)	$ (8)	$ 6

Not subject to master netting arrangements:								
Forward delivery commitments		4						4
Convertible note-related agreements		1						1
Derivative liabilities not subject to netting		5						5
Total derivative liabilities	$	30	$	(11)	$	(8)	$	11

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2013			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$ 22	$ (13)	$ (8)	$ 1
MSR-related agreements	4	(4)		
Derivative assets subject to netting	26	(17)	(8)	1
Not subject to master netting arrangements:				
Interest rate lock commitments	23			23
Forward delivery commitments	4			4
Option contracts	2			2
Convertible note-related agreements	16			16
Derivative assets not subject to netting	45			45
Total derivative assets	$ 71	$ (17)	$ (8)	$ 46

	Gross Liabilities	Offsetting Receivables	Cash Collateral Received	Net Amount
	(In millions)			
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 8	$ (13)	$ 5	$
MSR-related agreements		(4)	5	1
Derivative liabilities subject to netting	8	(17)	10	1
Not subject to master netting arrangements:				
Interest rate lock commitments	1			1
Forward delivery commitments	2			2
Convertible note-related agreements	16			16
Derivative liabilities not subject to netting	19			19
Total derivative liabilities	$ 27	$ (17)	$ 10	$ 20

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,	
	2014	2013	2014	2013
	(In millions)			
Gain on mortgage loans, net:				
Interest rate lock commitments	$ 95	$ 67	$ 169	$ 269
Forward delivery commitments	(39)	185	(59)	239
Option contracts	(2)	20	(3)	18
Net derivative gain (loss) related to mortgage servicing rights:				
MSR-related agreements	20	(1)	26	(17)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Other Assets

Other assets consisted of:

	June 30, 2014	December 31, 2013
	(In millions)	
Mortgage loans in foreclosure, net	$ 166	$ 172
Repurchase eligible loans(1)	77	94
Real estate owned, net	51	51
Derivatives	45	46
Equity method investments	35	37
Deferred financing costs	24	26
Other	37	24
Total	$ 435	$ 450

(1) Repurchase eligible loans represent 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. 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. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of:

	June 30, 2014	December 31, 2013
	(In millions)	
Subservicing advance liabilities	$ 324	$ 302
Accounts payable	88	98
Repurchase eligible loans	77	94
Accrued payroll and benefits	58	62
Accrued interest	25	26
Other	2	1

Total	$	574	$	583

8. Other Liabilities

Other liabilities consisted of:

		June 30, 2014		December 31, 2013
		(In millions)		
Loan repurchase and indemnification liability	$	70	$	100
Derivatives		11		20
Pension and other post employment benefits liability		6		7
Capital lease obligation		3		7
Other		10		16
Total	$	100	$	150

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. Debt and Borrowing Arrangements

The following table summarizes the components of Debt:

	June 30, 2014		December 31, 2013	
	Balance	Wt. Avg- Interest Rate(1)	Balance	Wt. Avg- Interest Rate(1)
	(In millions)			
Committed warehouse facilities	$ 783	2.1%	$ 709	2.1%
Uncommitted warehouse facilities		%		%
Servicing advance facility	126	2.7%	66	2.7%
Mortgage Asset-Backed Debt	909		775	
Term notes	795	7.3%	795	7.3%
Convertible notes(2)	463	5.0%	454	5.0%
Unsecured credit facilities		%		%
Unsecured Debt	1,258		1,249	
Total	$ 2,167		$ 2,024	

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(1) Represents the weighted-average stated interest rate of outstanding debt as of the respective date, which may be different from the effective rate due to the amortization of premiums, discounts and issuance costs. Facilities are variable-rate, except for the Unsecured Term notes and Convertible notes which are fixed-rate.

(2) Balance is net of unamortized discounts of $37 million and $46 million as of June 30, 2014 and December 31, 2013, respectively. The effective interest rate of the Convertible notes is 13.1%, which includes 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, 2014 consisted of:

	Warehouse Facilities	Servicing Advance Facility
	(In millions)	
Restricted cash	$ 6	$ 19

Accounts receivable				165
Mortgage loans held for sale (unpaid principal balance)		813		
Total	$	819	$	184

The following table provides the contractual debt maturities as of June 30, 2014:

		Mortgage Asset-Backed Debt		Unsecured Debt(1) (In millions)		Total
Within one year	$	877	$	250	$	1,127
Between one and two years		25		170		195
Between two and three years		7		250		257
Between three and four years						
Between four and five years						
Thereafter				625		625
	$	909	$	1,295	$	2,204

(1) Maturities of convertible notes have been reflected based on the contractual maturity date. Under certain circumstances prior to the contractual maturity date, the convertible notes may be converted. If this happens, the principal portion of the notes would be due in cash and the conversion premium, if any, may be settled in cash.

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Capacity under all borrowing agreements is dependent upon maintaining compliance with, or obtaining waivers of, the terms, conditions and covenants of the respective agreements. Available capacity under asset-backed funding arrangements may be further limited by asset eligibility requirements. Available capacity under committed borrowing arrangements as of June 30, 2014 consisted of:

	Maximum Capacity	Utilized Capacity (In millions)	Maximum Available Capacity
Mortgage Asset-Backed Debt:			
Committed warehouse facilities	2,089	783	1,306
Servicing advance facility	155	126	29
Unsecured credit facilities(1)	305		305

(1) On July 7, 2014, in order to facilitate the sale of the Fleet business, the Company voluntarily terminated the revolving credit facility which provided $300 million of aggregate commitments.

Capacity for Mortgage asset-backed debt shown above excludes $2.8 billion not drawn under uncommitted facilities. See Note 14, Fair Value Measurements, for the measurement of the fair value of Debt.

Mortgage Asset-Backed Debt

On February 4, 2014, the committed mortgage repurchase facility with Wells Fargo Bank was extended to February 3, 2015, and the total committed capacity was reduced from $450 million to $350 million.

In the first quarter of 2014, PHH Servicer Advance Receivables Trust (PSART), a special purpose bankruptcy remote trust was formed for the purpose of issuing asset-backed notes secured by servicing advance receivables. PSART was consolidated as a result of the determination that the Company is the primary beneficiary of the variable interest entity, as discussed in Note 15, Variable Interest Entities . On March 10, 2014, PSART issued variable funding notes with an aggregate maximum principal amount of $130 million. Upon closing, a portion of the proceeds were used to repay the outstanding balance of the Fannie Mae Servicing advance facility. The notes have a revolving period through March 9, 2015 and the final maturity of the notes is March 15, 2017. On May 29, 2014, the PSART facility was increased by $25 million to provide a total aggregate maximum principal borrowing capacity of $155 million.

On June 20, 2014, the committed variable-rate mortgage repurchase facilities with Credit Suisse First Boston Mortgage Capital LLC were reduced by $100 million to $575 million and renewed for an additional year. The expiration of the facility is based on a 364-day rolling term and may continue, at CSFB s option, until the stated expiration of June 17, 2016.

On June 20, 2014, the Company extended the term of the $250 million of committed and $250 million of uncommitted capacity with The Royal Bank of Scotland plc to June 19, 2015.

Unsecured Debt

Convertible Notes

As of June 30, 2014, Convertible notes included: (i) $250 million of 4.0% Convertible notes with a maturity date of September 1, 2014; and (ii) $250 million of 6.0% Convertible notes with a maturity date of June 15, 2017.

Holders of the Convertible notes due 2014 may convert all or any portion at any time through the third business day immediately preceding their maturity on September 1, 2014. As of June 30, 2014, no note holders have converted. As of June 30, 2014, the ending share price did not reach the conversion price. The 2014 notes currently may only be settled in cash upon conversion because the Company has not sought shareholder approval, as required by the New York Stock Exchange, to allow for the issuance of shares of common stock or securities convertible into common stock that will, or will upon issuance, equal or exceed 20% of outstanding shares.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Holders of the Convertible notes due 2017 may convert all or any portion of the notes, at their option, prior to December 15, 2016 only upon the occurrence of certain triggering events related to (i) the price of the notes, (ii) the price of the Company s Common stock, or (iii) upon the occurrence of specified corporate events. Holders of the Convertible notes due 2017 may also convert all or any portion of the notes at any time, at their option from December 15, 2016 through the third scheduled trading day immediately preceding the maturity date. Upon conversion, the principal amount of the converted notes is payable in cash and the Company will pay or deliver (at its election): (i) cash; (ii) shares of the Company s Common stock; or (iii) a combination of cash and shares of the Company s Common stock; to settle amounts due if the conversion value exceeds the principal of the converted notes. As of June 30, 2014, the if-converted value exceeded the principal amount of the notes by $199 million, and the notes met the requirements for conversion.

Term Notes

On July 7, 2014, the Company gave notice to the trustee of its intent to redeem the $170 million Senior Notes due 2016 as further described in Note 17, Subsequent Events .

Credit Facilities

On July 7, 2014, the Amended and Restated Credit Agreement which provided the Company with $300 million of aggregate commitments was voluntarily terminated as further described in Note 17, Subsequent Events .

Debt Covenants

Certain debt arrangements require the maintenance of certain financial ratios and contain other affirmative and negative covenants, termination events, and other restrictions, including, but not limited to, covenants relating to material adverse changes, consolidated net worth, liquidity, profitability, and available borrowing capacity maintenance, restrictions on indebtedness of the Company and its material subsidiaries, mergers, liens, liquidations, and restrictions on certain types of payments, including dividends and stock repurchases. Certain other debt arrangements, including the Fannie Mae committed facility, contain provisions that permit the Company or our counterparty to terminate the arrangement upon the occurrence of certain events.

As of June 30, 2014, the Company was in compliance with all financial covenants related to its debt arrangements.

In June and July 2014, all of the mortgage warehouse facilities were amended in order to facilitate the sale of the Fleet business as discussed in Note 2, Discontinued Operations . Upon the completion of the disposal of the Fleet business, among other covenants, certain mortgage repurchase facilities require that the Company maintain: (i) on the last day of each fiscal quarter, net worth of at least $1.0 billion; (ii) a ratio of indebtedness to tangible net worth no greater than 5.75 to 1; and (iii) a minimum of $1.0 billion in committed mortgage warehouse financing capacity excluding any mortgage warehouse capacity provided by GSEs and certain mortgage gestation facilities. These covenants represent the most restrictive net worth, liquidity, and debt to equity covenants; however, certain other outstanding debt agreements contain liquidity and debt to equity covenants that are less restrictive.

Under certain of the Company s financing, servicing, hedging and related agreements and instruments, the lenders or trustees have the right to notify the Company if they believe it has breached a covenant under the operative documents and may declare an event of default. If one or more notices of default were to be given, the Company believes it would have various periods in which to cure certain of such events of default. If the Company does not cure the events of default or obtain necessary waivers within the required time periods, the maturity of certain debt agreements could be accelerated and the ability to incur additional indebtedness could be restricted. In addition, an event of default or acceleration under certain agreements and instruments would trigger cross-default provisions under certain of the Company s other agreements and instruments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

10. Income Taxes

Interim income tax expense or benefit from continuing operations is recorded by applying a projected full-year effective income tax rate to the quarterly Income or loss before income taxes for results that are deemed to be reliably estimable. Certain results dependent on fair value adjustments of the Mortgage Production and Mortgage Servicing segments 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,	
	2014	2013	2014	2013
	(In millions)			
State and local income taxes, net of federal tax benefits	$ (2)	$ 6	$ (5)	$ 9
Noncontrolling interest	(2)	(4)	(1)	(9)

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, 2014 was consistent with 2013.

Noncontrolling interest. Represents the impact to the effective tax rate from Realogy Corporation 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.

11. 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.

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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, 2014	December 31, 2013
	(In millions)	
Loan Servicing Portfolio Composition		
Owned	$ 125,181	$ 130,494
Subserviced	100,721	96,343
Total	$ 225,902	$ 226,837
Conventional loans	$ 192,998	$ 191,916
Government loans	28,450	29,200
Home equity lines of credit	4,454	5,721
Total	$ 225,902	$ 226,837
Weighted-average interest rate	4.0%	4.0%

	June 30, 2014		December 31, 2013	
	Number of Loans	Unpaid Balance	Number of Loans	Unpaid Balance
Portfolio Delinquency(1)				
30 days	2.36%	1.74%	2.43%	1.82%
60 days	0.74	0.56	0.83	0.62
90 or more days	0.97	0.76	1.08	0.90
Total	4.07%	3.06%	4.34%	3.34%
Foreclosure/real estate owned(2)	2.34%	2.19%	2.46%	2.36%

(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, 2014 and December 31, 2013, the total servicing portfolio included 22,759 and 24,892 of loans in foreclosure with an unpaid principal balance of $4.3 billion and $4.7 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. In the event of a breach of these representations and warranties, the Company may be required to repurchase the mortgage loan or indemnify the investor against loss. If there is no breach of a representation and warranty provision, there is no obligation to repurchase the loan or indemnify the investor against loss. 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In millions)	
Balance, beginning of period	$ 142	$ 191
Realized losses	(34)	(37)
Increase (decrease) in reserves due to:		
Changes in assumptions	(1)	26
New loan sales	3	11
Balance, end of period	$ 110	$ 191

Repurchase and foreclosure-related reserves consist of the following:

Loan Repurchases and Indemnifications

The maximum exposure to representation and warranty provisions exceeds the amount of loans in the capitalized portfolio of $124.0 billion; however, 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, 2014, $205 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; 14% of which were at least 90 days delinquent (calculated based upon the unpaid principal balance of the loans).

As of June 30, 2014 and December 31, 2013, liabilities for probable losses related to repurchase and indemnification obligations of $70 million and $100 million, respectively, are included in Other liabilities in the Condensed Consolidated Balance Sheets. The liability for loan repurchases and indemnifications represents management s estimate of probable losses based on the best information available and requires the application of a significant level of judgment and the use of a number of assumptions. These assumptions include the estimated amount and timing of repurchase and indemnification requests, the expected success rate in defending against requests, estimated insurance claim proceeds and denials and estimated loss severities on repurchases and indemnifications. The liability for loan repurchases and indemnifications does not reflect losses from litigation or governmental and regulatory examinations, investigations or inquiries. While the Company uses the best information available in estimating the liability, actual experience can vary significantly from the assumptions as the estimation process is inherently uncertain.

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, 2014, the estimated amount of reasonably possible losses in excess of the recorded liability was $25 million which relates to our 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 our expectation of future defaults and the historical defect rate for government insured loans. The Company s estimate of reasonably

possible losses does not represent probable losses 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 our underwriting procedures; (iii) borrower delinquency and default patterns; and (iv) general economic conditions.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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, 2014		December 31, 2013	
	(In millions)			
Mortgage loans in foreclosure(1)	$	185	$	192
Allowance for probable foreclosure losses		(19)		(20)
Mortgage loans in foreclosure, net	$	166	$	172
Real estate owned	$	72	$	73
Adjustment to value for real estate owned		(21)		(22)
Real estate owned, net	$	51	$	51

(1) Includes $121 million and $118 million of recoverable advances as of June 30, 2014 and December 31, 2013, respectively.

Mortgage Reinsurance

The Company no longer has exposure to consumer credit risk through reinsurance activities since the remaining contractual reinsurance agreement was terminated in the second quarter of 2013. During the three and six months ended June 30, 2013, the termination resulted in a pre-tax loss of $21 million which was recorded in Loan servicing income in the Condensed Consolidated Statements of Operations.

12. Commitments and Contingencies

Legal 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. Alternately, 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 loss cannot be estimated for all matters. For matters where the Company can estimate the range of losses, the aggregate estimated amount of reasonably possible losses in excess of the recorded liability was $20 million as of June 30, 2014.

As of June 30, 2014, the Company s recorded reserves associated with legal and regulatory contingencies were not material. However, 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Contingencies Involving Mortgage Origination and Servicing Practices

PHH Mortgage Corporation, a wholly-owned subsidiary of the Company, is the defendant in a lawsuit initiated in 2012 in the Superior Court of California, Yuba County, by a borrower with a loan that has been serviced by the Company. The lawsuit includes allegations of breach of contract, negligence and intentional misrepresentation. In July 2014, the jury issued a verdict in favor of the borrower, awarding compensatory damages of approximately $0.5 million and punitive damages of $15.7 million, resulting in an exposure of $16.2 million. The Company will seek further judicial review of the verdict, including filing a motion for judgment notwithstanding the verdict and a motion for a new trial. The recorded liability for probable losses related to this matter as of June 30, 2014 was not significant.

The Company has received inquiries and requests for information from, and is subject to investigations by, regulators and attorneys general of certain states, the U.S. Department of Housing and Urban Development, the U.S. Attorney s Offices for the Southern and Eastern Districts of New York, the Committee on Oversight and Government Reform of the U.S. House of Representatives and the U.S. Senate Judiciary Committee, requesting information as to the Company s mortgage origination and servicing practices, including its foreclosure processes and procedures.

The Company has received document subpoenas from the Office of Inspector General of the U.S. Department of Housing and Urban Development (HUD) and the U.S. Attorney s Offices for the Southern and Eastern Districts of New York. The HUD subpoenas request production of certain documents related to, among other things, our origination and underwriting process for loans insured by the Federal Housing Administration (FHA). The U.S. Attorney s Offices 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. The Company has also undergone a regulatory examination by a multistate coalition of certain mortgage banking regulators and such regulators have alleged various violations of federal and state laws related to the Company s mortgage servicing practices prior to July 2011.

The Company believes it has meritorious defenses to these various allegations. However, there can be no assurance that claims or litigation will not arise from these inquiries, or similar inquiries by other governmental authorities, or that fines, penalties or increased legal costs will not be incurred in connection with these matters.

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.

CFPB Investigation

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. The Company did not provide reinsurance on loans originated after 2009.

The Company believes that it has complied with RESPA and other laws applicable to its former mortgage reinsurance activities, and is continuing to vigorously defend against the CFPB s allegations. Given the nature of this investigation and the related allegations, the Company cannot estimate the amount of loss or a range of possible losses, if any, 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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. Alternately, the Company may engage in settlement discussions in order to avoid the additional costs of engaging in litigation. 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.

13. Accumulated Other Comprehensive Income

The after-tax components of Accumulated other comprehensive income (loss) were as follows:

	June 30, 2014	December 31, 2013
	(In millions)	
Currency translation adjustment(1)	$ 22	$ 22
Pension adjustment, net of income tax benefit of $(4) and $(4)	(6)	(6)
Total	$ 16	$ 16

(1) Currency translation adjustment relates to the operations of the Fleet business in Canada. For the three and six months ended June 30, 2014, the tax impact for the reversal of the indefinitely invested undistributed earnings of foreign subsidiaries has been recorded in income tax expense related to discontinued operations . For the three and six months ended June 30, 2014, tax expense for currency translation adjustments related to current period other comprehensive income was not significant. See Note 2, Discontinued Operations for more information.

There were no amounts of Accumulated other comprehensive income (loss) attributable to noncontrolling interests as of June 30, 2014 and December 31, 2013, or during the respective periods.

There were no amounts reclassified out of Accumulated other comprehensive income (loss) during both the three and six months ended June 30, 2014. In 2013, amounts reclassified out of Accumulated other comprehensive income (loss) related to realized gains and losses from the sale of available-for-sale securities were recorded within Other income in the Condensed Consolidated Statements of Operations. During both the three and six months ended June 30, 2013, $1 million of realized gains and $1 million of realized losses from the sale of available-for-sale securities

were recorded.

14. 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. For assets and liabilities measured at fair value, there has been no change in the valuation methodologies and classification pursuant to the valuation hierarchy during the six months ended June 30, 2014. 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, 2014 or December 31, 2013. Significant inputs to the measurement of fair value and further information on the assets and liabilities measured at fair value are as follows:

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	June 30, 2014		December 31, 2013	
	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	$ 924	$ 12	$ 834	$ 12
Aggregate unpaid principal balance	920	17	837	17
Difference	$ 4	$ (5)	$ (3)	$ (5)

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

	June 30, 2014	December 31, 2013
	(In millions)	
First mortgages:		
Conforming	$ 778	$ 737
Non-conforming	88	48
Total first mortgages	866	785
Second lien	5	5
Scratch and Dent	52	44
Other	1	
Total	$ 924	$ 834

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

	Six Months Ended June 30,	
	2014	2013
Initial capitalization rate of additions to MSRs	1.04 %	1.08 %

	June 30, 2014	December 31, 2013
Capitalization servicing rate	0.96 %	0.99 %
Capitalization servicing multiple	3.3	3.4
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, 2014	December 31, 2013
Weighted-average prepayment speed (CPR)	11.4 %	9.0 %
Option adjusted spread, in basis points (OAS)	776	1,056
Weighted-average delinquency rate	5.6 %	5.8 %

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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, 2014		
	Weighted-Average Prepayment Speed	Option Adjusted Spread	Weighted-Average Delinquency Rate
	(In millions)		
Impact on fair value of 10% adverse change	$ (58)	$ (51)	$ (27)
Impact on fair value of 20% adverse change	(112)	(97)	(54)

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. The average pullthrough percentage used in measuring the fair value of Interest rate lock commitment s (IRLCs) as of June 30, 2014 and December 31, 2013 was 72% and 77%, 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Assets and liabilities measured at fair value on a recurring basis were included in the Condensed Consolidated Balance Sheets as follows:

	June 30, 2014				
	Level One	Level Two	Level Three (In millions)	Cash Collateral and Netting	Total
ASSETS					
Mortgage loans held for sale	$	$ 867	$ 57	$	$ 924
Mortgage servicing rights			1,187		1,187
Other assets Derivative assets:					
Interest rate lock commitments			35		35
Forward delivery commitments		14		(11)	3
MSR-related agreements		23		(17)	6
Convertible note-related agreements			1		1
LIABILITIES					
Other liabilities Derivative liabilities:					
Forward delivery commitments	$	$ 29	$	$ (19)	$ 10
Convertible note-related agreements			1		1

	December 31, 2013				
	Level One	Level Two	Level Three (In millions)	Cash Collateral and Netting	Total
ASSETS					
Mortgage loans held for sale	$	$ 785	$ 49	$	$ 834
Mortgage servicing rights			1,279		1,279
Other assets Derivative assets:					
Interest rate lock commitments			23		23
Forward delivery commitments		26		(21)	5
Option contracts		2			2
MSR-related agreements		4		(4)	
Convertible note-related agreements			16		16
LIABILITIES					
Other liabilities Derivative liabilities:					
Interest rate lock commitments	$	$	$ 1	$	$ 1
Forward delivery commitments		10		(8)	2
MSR-related agreements				1	1
Convertible note-related agreements			16		16

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended June 30, 2014			Three Months Ended June 30, 2013		
	MLHS	MSRs	IRLCs, net	MLHS	MSRs	IRLCs, net
	(In millions)					
Balance, beginning of period	$ 49	$ 1,224	$ 20	$ 56	$ 1,101	$ 113
Realized and unrealized (losses) gains		(52)	95	(6)	75	67
Purchases	14			31		
Issuances	1	21			71	
Settlements	(5)	(6)	(80)	(26)		(191)
Transfers into Level Three	8			11		
Transfers out of Level Three	(10)			(11)		
Balance, end of period	$ 57	$ 1,187	$ 35	$ 55	$ 1,247	$ (11)

	Six Months Ended June 30, 2014			Six Months Ended June 30, 2013		
	MLHS	MSRs	IRLCs, net	MLHS	MSRs	IRLCs, net
	(In millions)					
Balance, beginning of period	$ 49	$ 1,279	$ 22	$ 64	$ 1,022	$ 139
Realized and unrealized (losses) gains	(3)	(131)	169	(12)	80	269
Purchases	30			56		
Issuances	2	46			145	
Settlements	(18)	(7)	(156)	(56)		(419)
Transfers into Level Three	14			25		
Transfers out of Level Three	(17)			(22)		
Balance, end of period	$ 57	$ 1,187	$ 35	$ 55	$ 1,247	$ (11)

Transfers into Level Three generally represent mortgage loans held for sale with performance issues, origination flaws, or other characteristics that impact their salability in active secondary market transactions. Transfers out of Level Three represent Scratch and Dent loans that were foreclosed upon and loans that have been cured.

Realized and unrealized gains (losses) related to assets and liabilities classified within Level Three of the valuation hierarchy were included in the Condensed Consolidated Statements of Operations as follows:

Three Months Ended	Six Months Ended

	June 30,		June 30,	
	2014	2013	2014	2013
	(In millions)			
Gain on mortgage loans, net:				
Mortgage loans held for sale	$ (1)	$ (7)	$ (5)	$ (15)
Interest rate lock commitments	95	67	169	269
Change in fair value of mortgage servicing rights:				
Mortgage servicing rights	(52)	75	(131)	80
Mortgage interest income:				
Mortgage loans held for sale	1	1	2	3

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unrealized gains (losses) included in the Condensed Consolidated Statement of Operations related to assets and liabilities classified within Level Three of the valuation hierarchy that are included in the Condensed Consolidated Balance Sheets were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Gain on mortgage loans, net	$ 29	$ (23)	$ 25	$ (22)
Change in fair value of mortgage servicing rights	(12)	155	(57)	237

Fair Value of Other Financial Instruments

As of June 30, 2014 and December 31, 2013, all financial instruments were either recorded at fair value or the carrying value approximated fair value, with the exception of Debt and derivative instruments included in Total PHH Corporation stockholders equity. For financial instruments that were not recorded at fair value, such as Cash and cash equivalents and Restricted cash, the carrying value approximates fair value due to the short-term nature of such instruments. These financial instruments are classified within Level One of the valuation hierarchy.

Debt. As of June 30, 2014 and December 31, 2013, the total fair value of Debt was $2.5 billion and $2.4 billion, respectively, and substantially all of the debt is measured using Level Two inputs. As of June 30, 2014, the fair value of Level Two Debt was estimated using the following valuation techniques: (i) $1.6 billion was measured using a market based approach, considering the current market pricing of recent trades for similar instruments or the current expected ask price for the Company s debt instruments; and (ii) $0.9 billion was measured using observable spreads and terms for recent pricing of similar instruments.

15. Variable Interest Entities

Servicing Advance Receivables Trust

In the first quarter of 2014, PHH Servicer Advance Receivables Trust (PSART) and PHH Servicer Advance Funding Depositor, LLC (the Depositor) (collectively the Servicing Advance Receivables Trust) were formed. PSART is a special purpose bankruptcy remote trust and was formed for the purpose of issuing asset-backed notes secured by servicing advance receivables. The Company, the Depositor and PSART entered into a Receivables Purchase and Contribution Agreement under which the Company has conveyed (and may in the future convey) to the

Depositor the contractual right to reimbursement of certain mortgage loan servicing advances made by the Company related to its servicing activities. The Depositor in turn sells the servicing advances to PSART. Upon the initial funding of the entity, the Company determined that PSART and the Depositor are variable interest entities based on their nature and purpose, and that the Company is the primary beneficiary.

In the first quarter of 2014, PSART entered into an agreement to issue asset-backed notes as further discussed in Note 9, Debt and Borrowing Arrangements. Certain capital transactions are executed between the Company and the Depositor whereby subsidiaries of the Company contribute receivables to the Depositor and receive distributions upon the issuance of notes or leveraging of note series. During the six months ended June 30, 2014, the Company and its subsidiaries contributed Accounts receivable of $397 million to the Depositor, and received distributions of $336 million.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Assets and liabilities of significant consolidated variable interest entities are included in the Condensed Consolidated Balance Sheets as follows:

	June 30, 2014		December 31, 2013
	PHH Home Loans	Servicing Advance Receivables Trust	PHH Home Loans
		(In millions)	
ASSETS			
Cash	$ 69	$	$ 91
Restricted cash	4	19	3
Mortgage loans held for sale	459		308
Accounts receivable, net	16	165	7
Property and equipment, net	1		2
Other assets	11	2	7
Total assets	$ 560	$ 186	$ 418
Assets held as collateral(1)	$ 437	$ 184	$ 300
LIABILITIES			
Accounts payable and accrued expenses	$ 17	$ 1	$ 15
Debt	417	126	280
Other liabilities	13		11
Total liabilities(2)	$ 447	$ 127	$ 306

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(1) Represents amounts not available to pay the Company s general obligations. See Note 9, Debt and Borrowing Arrangements for further information.

(2) Excludes intercompany payables.

16. Segment Information

Operations are conducted through the following two reportable segments:

¡ **Mortgage Production** provides mortgage loan origination services and sells mortgage loans.

¡ **Mortgage Servicing** performs servicing activities for originated and purchased loans.

In the second quarter of 2014, the Company signed a definitive agreement to sell its Fleet business; therefore Fleet Management Services is no longer a reportable segment and is presented as discontinued operations. The results of the Fleet business have been excluded from continuing operations and segment results for all periods presented. See Note 2, Discontinued Operations for additional information.

The heading Other includes certain income and expenses that are not allocated back to the two reportable segments and certain general corporate overhead expenses that were previously allocated to the Fleet business. The Company s continuing operations are located in the U.S.

Management evaluates the operating results of each of the reportable segments based upon Net revenues and Segment profit or loss, which is presented as the Income or loss from continuing operations before income tax expense or benefit and after Net income or loss attributable to noncontrolling interest. The Mortgage Production segment profit or loss excludes Realogy Corporation s noncontrolling interest in the profit or loss of PHH Home Loans.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Segment results were as follows:

	Total Assets	
	June 30, 2014	December 31, 2013
	(In millions)	
Mortgage Production segment	$ 1,231	$ 1,127
Mortgage Servicing segment	2,112	2,219
Assets related to discontinued operations	4,694	4,456
Other	901	1,051
Total	$ 8,938	$ 8,853

	Net Revenues			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Mortgage Production segment	$ 129	$ 265	$ 211	$ 517
Mortgage Servicing segment	67	150	96	234
Total	$ 196	$ 415	$ 307	$ 751

	Segment Profit (Loss)(1)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Mortgage Production segment	$ (27)	$ 44	$ (87)	$ 89
Mortgage Servicing segment	10	81	(19)	98
Other	(8)	(4)	(10)	(6)
Total	$ (25)	$ 121	$ (116)	$ 181

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(1) The following is a reconciliation of Income or loss from continuing operations before income taxes to Segment profit or loss:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
(Loss) income from continuing operations before income taxes	$ (21)	$ 133	$ (114)	$ 205
Less: net income attributable to noncontrolling interest	4	12	2	24
Segment (loss) profit	$ (25)	$ 121	$ (116)	$ 181

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

17. Subsequent Events

Completed Disposition of Business

Effective on July 1, 2014, the Company completed the sale of the Fleet business to certain wholly owned subsidiaries of Element Financial Corporation, as discussed in Note 2, Discontinued Operations . The Company sold all of the issued and outstanding equity interests of the Fleet Business to Element for an aggregate purchase price of $1.4 billion which may be increased or decreased based upon certain post-closing adjustments set forth in the Stock Purchase Agreement.

Termination of Credit Facility

On July 7, 2014, in order to facilitate the closing of the sale of the Fleet Business described above, the unsecured revolving credit facility, which provided the Company with $300 million of aggregate commitments, was voluntarily terminated.

Early Retirement of Debt

On July 7, 2014, the Company gave notice to the trustee of our intent to redeem the $170 million total aggregate principal outstanding of the Senior Notes due 2016. The applicable redemption date of the notes is August 7, 2014.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Cautionary Note Regarding Forward-Looking Statements , Part II Item 1A. Risk Factors and our Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Part I Item 1. Business , Part II Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements included in our 2013 Form 10-K.

Our Management s Discussion and Analysis of Financial Condition and Results of Operations is presented in sections as follows:

§ Overview

§ Results of Operations

§ Risk Management

§ Liquidity and Capital Resources

§ Critical Accounting Policies and Estimates

§ Recently Issued Accounting Pronouncements

OVERVIEW

We are a leading outsource provider of mortgage services. We conduct our business through two reportable segments: Mortgage Production and Mortgage Servicing. Our Mortgage Production segment originates, purchases and sells mortgage loans through PHH Mortgage. Our Mortgage Servicing segment services mortgage loans originated by PHH Mortgage and acts as a subservicer for certain clients that own the underlying servicing rights.

Our Mortgage Production and Mortgage Servicing segments have experienced, and may continue to experience, high degrees of earnings volatility due to significant exposure to interest rates and the real estate markets, which impacts our loan origination volumes, valuation of our mortgage servicing rights and repurchase and foreclosure-related charges. See Risk Management in this Form 10-Q for additional information regarding our interest rate and market risks.

As a result of our definitive agreement to sell our Fleet business, which closed effective on July 1, 2014, Fleet Management Services is no longer a reportable segment, and the results and operations of the Fleet business and transaction-related amounts are included within (Loss) income from discontinued operations, net of tax and Assets and Liabilities held for sale for all periods presented. See further discussion in Results of Operations Discontinued Operations .

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Executive Summary

Financial Performance

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions, except per share data)			
Net revenues	$ 196	$ 415	$ 307	$ 751
Total expenses	217	282	421	546
(Loss) income from continuing operations, net of tax	(9)	86	(69)	134
(Loss) earnings per share from continuing operations:				
Basic	$ (0.23)	$ 1.30	$ (1.23)	$ 1.92
Diluted	(0.23)	1.15	(1.23)	1.68

Our financial results from continuing operations for the second quarter of 2014 reflect the challenging mortgage industry environment, including declines in industry origination volumes, margin compression, increased competition and a higher regulatory focus.

Net revenues of our Mortgage Production segment declined $136 million (51%) from the second quarter of 2013, reflecting a 35% decline in applications, a 62% decline in IRLCs and a 75 bps (22%) decrease in total loan margins. Total closings also declined by 37% compared to the second quarter of 2013, primarily driven by a 62% decline in refinance closings, consistent with the relative interest rate environments and industry demand. Our actions taken in the second half of 2013 and first quarter of 2014 to reduce staffing levels in our Mortgage Production segment in response to expected client and industry demand have resulted in salary expense reductions in production and overhead functions. Despite the cost reduction efforts, the results of our Mortgage Production segment still reflected the industry-wide reductions in mortgage loan originations. As a result, the Mortgage Production segment recorded a $27 million Segment loss in the second quarter of 2014, compared to Segment profit of $44 million in the second quarter of 2013.

As discussed further below under Mortgage Re-Engineering we are working towards further adjustments to our direct operating expense and staffing levels to match expected mortgage volumes and to re-engineer our support infrastructure to operate as a stand-alone mortgage business. We expect a highly challenging mortgage industry environment to continue throughout 2014. If the current mortgage market conditions and interest rate levels persist, our Mortgage Production segment will likely continue to be unprofitable and cash consumptive for the second half of 2014.

We are continuing to experience favorable trends in mortgage loan repurchase and indemnification requests. During the second quarter of 2014, repurchase requests for pre-2009 origination years were minimal as the Agencies substantially completed their file reviews for these originations years by the end of 2013. We also experienced a continued downward trend in new repurchase requests for more recent origination years (2009 to 2012) in the second quarter of 2014. As a result, we recorded a $1 million benefit for repurchase and foreclosure-related charges in the second quarter of 2014, compared to $11 million of charges for the second quarter of 2013. See Risk Management for additional information regarding our loan repurchase obligations and potential exposure.

Net revenues of our Servicing segment declined $83 million (55%) from the second quarter of 2013, reflecting the change in mortgage interest rates that led to market-related changes in value of our mortgage servicing rights. During the second quarter of 2014, we recorded $12 million of unfavorable market-related changes in value of our mortgage servicing rights from a 29 basis point decrease in the primary rate used to value our MSR asset, compared to favorable changes of $155 million for the second quarter of 2013 from a 76 bps increase in rate.

Operating and Capital Strategy

We completed the sale of the Fleet business effective on July 1, 2014 for cash consideration of $1.4 billion, and expect to realize net proceeds of $821 million (estimated, and subject to certain post closing purchase price adjustments and the final determination of income taxes). The net proceeds from the sale have increased our excess cash above key cash requirements and we intend to utilize excess cash after the completion of the sale by returning

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capital to shareholders, reducing our unsecured debt, re-engineering the company as a stand-alone mortgage business, and growing the business. See *Liquidity and Capital Resources* for further discussion outlining our unrestricted cash, cash requirements and excess cash amounts.

Return of Capital to Shareholders

Our Board of Directors has authorized up to $450 million in share repurchases. In the third quarter of 2014, we expect to commence a $200 million accelerated stock repurchase (ASR) program. We further expect that the ASR will be followed by up to $250 million in open market purchases in the twelve months following the ASR, subject to market conditions and satisfaction of the other requirements of the program.

Accelerate Reduction of Unsecured Debt

Our strategic vision for PHH is a more capital-light, fee-based business with greater scale, operational efficiency and capital efficiency. On July 7 2014, we gave notice to the trustee of our intention to redeem the outstanding principal of the Senior Notes due 2016 on August 7, 2014. We anticipate this transaction will require approximately $200 million in cash.

We will be further reducing our unsecured debt upon the retirement of our 2014 Convertible notes at maturity in September 2014. These actions are consistent with our objectives for unsecured debt for a stand-alone mortgage business, namely:

§ Lowering our debt to our target levels of $750 million to $1.0 billion;

§ Reducing our cost of debt; and

§ Extending the maturity ladder of our unsecured debt.

After completing the repayment of the Senior Notes due 2016 and the 2014 Convertible Notes, our next unsecured debt maturity will not be until 2017.

Mortgage Re-Engineering

We intend to deploy up to $200 million to re-engineer our operations and support infrastructure for a stand-alone mortgage business in a lower volume, home purchase driven mortgage market. While we have reduced our Total expenses by $125 million, or 23%, in the six months ended June 30, 2014 as compared to the same period of the prior year, mortgage industry origination volume for the full year is projected to be down 41% from 2013 levels according to Fannie Mae s July 2014 *Economic and Housing Outlook*.

We are targeting our direct operating expense and staffing levels to match expected mortgage origination volumes. Additionally, we will be focusing on consolidating our support infrastructure to operate as a stand-alone mortgage business, and restructuring our private label business model to meet our operational and financial objectives and those of our clients. We expect the benefits of our re-engineering efforts to be phased in during the first half of 2015 and be fully realized on an annualized basis by mid-to-late 2015.

In our discussions thus far with respect to the private label agreements, we have not been able to achieve all of the pricing adjustments necessary to meet our financial objectives. However, both we and our Private Label clients have an interest in updating these contracts prior to their renewal dates to ensure these programs support our respective business objectives. We remain cautiously optimistic that these contracts can be restructured or renewed on mutually beneficial terms. The timing to complete this process, however, remains uncertain due to the complexity of these contracts and our desire to build a differentiated model that has the flexibility to adapt to future market changes. We believe the end result of these negotiations should be a stronger business model with better economics and an improved value proposition for our PLS clients. For more information, see Part II Item 1A. Risk Factors Risks Related to our Company *The profitability of our Mortgage Production segment has been adversely affected by the increased mix of fee-based closings originated under our existing private label client contracts. We are currently evaluating a number of alternatives to restructure these contracts to improve the economics of the underlying contractual relationships; however, there can be no assurances that we will be successful in these efforts.* in this Form 10-Q.

Growth Initiatives

We intend to invest up to $150 million in growth initiatives to enhance scale and profitability and diversify our revenue streams across Mortgage Production and Servicing. We will be focused on expanding our target market within the existing private label client base and growing our origination volume through outsourcing

opportunities with regional and community banks and credit unions. We believe that we can grow our share in the home purchase market through improved capture rates and additional investments in the Real Estate channel. We will also be focused on increasing our servicing portfolio in connection with growing our origination volume. We will evaluate selective inorganic growth investments to leverage our fixed-cost infrastructure to expand our retail mortgage market presence and grow our servicing portfolio.

For more information, see Part II Item 1A. Risk Factors Risks Related to our Company *We may not be able to fully or successfully execute or implement our business strategies or achieve our objectives, including our initiatives to re-engineer and grow our mortgage business.* in this Form 10-Q.

Legal and Regulatory Environment

Consistent with other companies in the mortgage industry, we have experienced inquiries, examinations and requests for information from regulators and attorneys general of certain states as well as various government agencies. In addition, we are working diligently in assessing and understanding the implications of the developments in the regulatory environment, and we are devoting substantial resources towards implementing all of the new rules and responding to inquiries, examinations, and proceedings, while meeting the needs and expectations of our clients. We expect the higher legislative and regulatory focus on mortgage origination and servicing practices to continue to result in higher legal, compliance, and servicing related costs, potential regulatory fines and penalties, and we could experience an increase in mortgage origination or servicing related litigation in the future. Although our probable losses, payments and costs related to these matters have not been material to date, the ultimate resolution of any particular matter could be material to our results of operations or cash flows for the period in which such matter is resolved. For more information, see Part II Item 1A. Risk Factors Risks Related to Our Company *Our Mortgage businesses are complex and heavily regulated, and the full impact of regulatory developments to our businesses remains uncertain. In addition, we are subject to litigation, regulatory investigations, inquiries and proceedings and we may incur fines, penalties, and increased costs that could negatively impact our future results of operations, liquidity and cash flows or damage our reputation.* in this Form 10-Q and Note 12, Commitments and Contingencies in the accompanying Notes to Condensed Consolidated Financial Statements.

In January 2014, the CFPB initiated an administrative proceeding alleging that our reinsurance activities have violated certain provisions of the Real Estate Settlement Procedures Act. We believe that we have complied with the Real Estate Settlement Procedures Act and other laws applicable to our former mortgage reinsurance activities, and are continuing to vigorously defend against the CFPB s allegations. We 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, fines or penalties which could be material to our results of operations, cash flows or financial position.

We are monitoring increases in litigation and settlements among our peers in the mortgage industry around servicing practices for lender-placed insurance, also called forced-placed insurance . We are currently subject to pending litigation alleging that our servicing practices around lender-placed insurance were not in compliance with applicable laws. Through our mortgage servicing subsidiary, we did have certain outsourcing arrangements for the purchase of lender-placed hazard insurance for borrowers whose coverage had lapsed. We believe we have meritorious defenses to these allegations; however, the resolution of such matter may result in adverse judgments, other relief against us, as well as monetary payments or other agreements and obligations, any of which may be material to our results of operations, cash flows or financial position.

In connection with the sale of the Fleet business, which became effective on July 1, 2014, we have indemnified Element against certain liabilities that may arise in connection with the transaction and business activities prior to the completion of the transaction. The term of these

indemnifications, which generally pertain to breaches by us of our representations and warranties or our covenants under the purchase agreement, is generally through March 31, 2016, except that the term of our indemnifications for breaches of certain fundamental representations and warranties or its covenants or excluded liabilities is generally through the expiration of the applicable statute of limitations or, with respect to covenants to be performed after closing, the date performance is fulfilled or completed. Due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss, and no specific recourse provisions exist.

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RESULTS OF OPERATIONS

Continuing Operations

The following tables present our consolidated results of operations from continuing operations and segment profit or loss for our reportable segments:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In millions, except per share data)			
Mortgage fees	$ 59	$ 82	$ 106	$ 161
Gain on mortgage loans, net	80	197	131	384
Mortgage net finance expense	(23)	(29)	(53)	(57)
Loan servicing income	110	88	225	196
Valuation adjustments related to mortgage servicing rights, net	(32)	74	(105)	63
Other income	2	3	3	4
Net revenues	196	415	307	751
Total expenses	217	282	421	546
(Loss) income from continuing operations before income taxes	(21)	133	(114)	205
Income tax (benefit) expense	(12)	47	(45)	71
(Loss) income from continuing operations, net of tax	(9)	86	(69)	134
Less: net income attributable to noncontrolling interest	4	12	2	24
Net (loss) income from continuing operations attributable to PHH Corporation	$ (13)	$ 74	$ (71)	$ 110
(Loss) earnings per share from continuing operations:				
Basic	$ (0.23)	$ 1.30	$ (1.23)	$ 1.92
Diluted	$ (0.23)	$ 1.15	$ (1.23)	$ 1.68

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In millions)			
Segment (Loss) Profit:(1)				
Mortgage Production segment	$ (27)	$ 44	$ (87)	$ 89
Mortgage Servicing segment	10	81	(19)	98
Other(2)	(8)	(4)	(10)	(6)

(1) Segment profit (loss) is described in Note 16, Segment Information , in the accompanying Notes to Condensed Consolidated Financial Statements.

(2) Includes certain income and expenses that are not allocated back to our reportable segments and certain general corporate overhead expenses that were previously allocated to the Fleet business. See Other for more information.

The results of operations for reportable segments are reported on a pre-tax basis and are discussed in more detail in the following sections. We record our interim tax provision or benefit from continuing operations by applying a projected full-year effective income tax rate to our quarterly pre-tax income or loss for results that we deem to be reliably estimable. Certain results dependent on fair value adjustments are considered to not be reliably estimable, and therefore we record discrete year-to-date income tax provisions on those results. Our effective income tax rate for the six months ended June 30, 2014 and 2013 was (39.3)% and 34.6%, respectively. See Note 10, Income Taxes in the accompanying Notes to Condensed Consolidated Financial Statements for further information.

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Discontinued Operations

On June 2, 2014, we entered into a Stock Purchase Agreement to sell all of the issued and outstanding equity interests of our Fleet Management Services business (Fleet business). The Fleet business was focused on providing commercial fleet management services to corporate clients and government agencies throughout the U.S. and Canada which included vehicle maintenance, accident management, driver safety training and fuel card programs.

The transaction closed effective on July 1, 2014, and we estimate a net gain on the disposition of $243 million will be recognized, which includes both transaction-related costs and related income taxes. The estimated gain of $243 million is based on March 31, 2014 Balance sheets, and is subject to post-closing adjustments and final determination of income taxes. Income tax expense related to discontinued operations for the second quarter and six months ended June 30, 2014 includes approximately $52 million of discrete items (as described below) included in the estimate of net gain on disposition. The remaining gain on disposition will be recognized in the third quarter of 2014 as the net proceeds received less the net assets disposed of and related tax amounts.

As a result of the sale of the Fleet business, Fleet Management Services is no longer a reportable segment, and the results of the Fleet business and transaction-related amounts are included within (Loss) income from discontinued operations, net of tax in the Condensed Consolidated Statements of Operations and have been excluded from continuing operations and segment results for all periods presented. Assets and liabilities to be disposed of with the Fleet business are presented as Assets held for sale and Liabilities held for sale in the Condensed Consolidated Balance Sheets as of each period presented.

The following table summarizes (Loss) income from discontinued operations, net of tax which includes the results of the Fleet business and transaction-related amounts:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions, except per share data)			
Net revenues	$ 415	$ 407	$ 820	$ 801
Total expenses	406	382	789	752
Income before income taxes	9	25	31	49
Income tax expense related to discontinued operations	55	9	61	17
(Loss) income from discontinued operations, net of tax	$ (46)	$ 16	$ (30)	$ 32
(Loss) earnings per share from discontinued operations:				
Basic	$ (0.79)	$ 0.28	$ (0.52)	$ 0.56
Diluted	$ (0.79)	$ 0.25	$ (0.52)	$ 0.50

Total expenses related to discontinued operations includes transaction-related costs associated with the sale which were $15 million and $16 million during the second quarter and six months ended June 30, 2014, respectively.

Income tax expense related to discontinued operations for the second quarter and six months ended June 30, 2014 includes provisions for earnings of our Canadian subsidiaries included in the Fleet business that were previously considered to be indefinitely invested. Upon the classification of the Fleet business as held for sale, the accumulated earnings are no longer deemed to indefinitely invested and we recognized the tax expense related to the cumulative earnings of such Canadian subsidiaries. See Note 2, Discontinued Operations in the accompanying Condensed Consolidated Financial Statements for additional information.

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Mortgage Production Segment

The current interest rate environment has continued to negatively affect loan margins and origination volumes. A variety of other factors have also continued to affect the industry, including an increasingly complex regulatory compliance environment and changes to mortgage backed security programs, including increases in guarantee fees. Future conforming origination volumes and loan margins may be negatively impacted by higher interest rates and increases in guarantee fees.

During the first half of 2014, the origination environment has continued to trend towards a lower volume, home purchase driven mortgage market. According to Fannie Mae s July 2014 *Economic and Housing Outlook*, the industry experienced a 50% decline in total loan originations during the six months ended June 30, 2014 compared to the prior year driven largely by a 68% decrease in refinancing activity. On a full year basis, Fannie Mae is forecasting industry loan originations for 2014 to decline to $1.1 trillion compared to $1.9 trillion during 2013, consisting of a 64% decline in refinancing originations and a 5% decrease in purchase closings.

Our refinance closings were down 62% during the six months ended June 30, 2014 compared to the prior year which was driven by lower overall consumer demand from relatively higher interest rates and a 72% decline in HARP closings. During the second quarter of 2014, interest rates retreated back from the recent elevated levels; however, we did not see a corresponding increase in our refinance application activity as the decline in rates did not generate refinance incentive to the borrowers. While Fannie Mae is projecting purchase closings to be down 10% during the six months of June 30, 2014 compared to the six months of June 30, 2013, our purchase closings increased by 10% during the same period. Despite our increase in purchase closings (based on unpaid principal balance), our results of operations were negatively impacted by a 6% decline in the number of purchase closing units.

During 2013, we observed a shift in the mix of our originations to a greater percentage of fee-based closings which has continued into the first half of 2014. Fee-based closings generally consist of higher average loan amounts than saleable closings and are impacted by the mortgage product and loan programs our PLS clients market to their customers, as well as the amount of mortgage loans our clients want to retain on their balance sheets. Fee-based closings represented 65% and 44% of our total origination volume during the six months ended June 30, 2014 and 2013, respectively. See Part II Item 1A. Risk Factors Risks Related to Our Company *The profitability of our Mortgage Production segment has been adversely affected by the increased mix of fee-based closings originated under our existing private label client contracts. We are currently evaluating a number of alternatives to restructure these contracts to improve the economics of the underlying contractual relationships; however, there can be no assurances that we will be successful in these efforts.* in this Form 10-Q for more information.

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Segment Metrics:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	($ In millions)			
Loans closed to be sold	$ 3,292	$ 7,897	$ 5,901	$ 15,744
Fee-based closings	6,002	6,874	10,777	12,346
Total closings	$ 9,294	$ 14,771	$ 16,678	$ 28,090
Purchase closings	$ 5,732	$ 5,344	$ 9,322	$ 8,483
Refinance closings	3,562	9,427	7,356	19,607
Total closings	$ 9,294	$ 14,771	$ 16,678	$ 28,090
Retail closings - PLS	$ 6,587	$ 9,503	$ 12,007	$ 18,013
Retail closings - Real Estate	2,397	3,877	3,953	6,908
Total retail closings	8,984	13,380	15,960	24,921
Wholesale/correspondent closings	310	1,391	718	3,169
Total closings	$ 9,294	$ 14,771	$ 16,678	$ 28,090
Retail - PLS (in units)	13,598	24,976	25,620	48,902
Retail - Real Estate (in units)	9,520	15,703	16,272	27,979
Total retail	23,118	40,679	41,892	76,881
Wholesale/correspondent (in units)	1,455	6,131	3,118	14,082
Total closings (in units)	24,573	46,810	45,010	90,963
Loans sold	$ 3,053	$ 7,989	$ 5,976	$ 16,222
Applications	$ 12,846	$ 19,704	$ 23,215	$ 35,869
IRLCs expected to close	$ 2,060	$ 5,386	$ 3,810	$ 10,341
Total loan margin (in basis points)	273	348	281	359

Segment Results:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In millions)			
Mortgage fees	$ 59	$ 82	$ 106	$ 161
Gain on mortgage loans, net	80	197	131	384
Mortgage interest income	11	16	18	35
Mortgage interest expense	(23)	(33)	(47)	(67)
Mortgage net finance expense	(12)	(17)	(29)	(32)
Other income	2	3	3	4
Net revenues	129	265	211	517
Salaries and related expenses	80	113	157	223
Occupancy and other office expenses	7	9	15	17
Other depreciation and amortization	3	3	6	6
Other operating expenses	62	84	118	158
Total expenses	152	209	296	404
(Loss) income before income taxes	(23)	56	(85)	113
Less: net income attributable to noncontrolling interest	4	12	2	24
Segment (loss) profit	$ (27)	$ 44	$ (87)	$ 89

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Quarterly Comparison: Mortgage Production segment loss was $27 million during 2014, compared to a segment profit of $44 million during the prior year quarter. Net revenues decreased to $129 million, down $136 million, or 51%, compared with the second quarter of 2013 driven by lower refinance activity, an increased mix of fee-based closings and lower loan margins and economic hedge results. Total expenses decreased to $152 million, down $57 million, or 27%, compared with the prior year quarter primarily driven by a decline in origination volumes which resulted in lower salaries and related expenses and production direct expenses. Total expenses compared to the second quarter of 2013 also included a decrease in operating costs related to customer service and outsourcing fees.

Net revenues. Mortgage fees decreased to $59 million, down $23 million, or 28%, from the prior year quarter. A 43% decline in total retail closing units from lower refinance closings contributed to a $14 million decrease in application fees, appraisal income and other underwriting income. In addition, we experienced a $7 million decrease in origination assistance fees from our PLS channel resulting from a 46% decline in PLS closing units compared to the prior year quarter. Gain on mortgage loans, net was $117 million lower compared to the prior year quarter driven by a $98 million decline in gain on loans related to a 62% decrease in IRLCs expected to close and a 75 basis points decline in average total loan margins, coupled with a $27 million decrease in economic hedge results. Consistent with our expectations, the decrease in IRLCs expected to close and average total loan margins was attributable to lower consumer demand for refinancing activity and an increased mix of fee-based production (where we do not enter into an IRLC). The decline in economic hedge results compared to the second quarter of 2013 was primarily attributable to a lower impact from pullthrough assumptions associated with a decrease in the average outstanding balance of IRLCs expected to close and lower execution gains on mortgage loans sold.

Total expenses. During the second half of 2013, we announced actions to reduce headcount in response to projected declines in industry origination volumes which primarily drove a $14 million, or 20%, decline in Salaries, benefits and incentives compared to the prior year quarter. Commissions were down $13 million, or 38%, compared to the second quarter of 2013 primarily driven by a 38% decrease in real estate channel closings. The lower overall closing and application volumes in 2014 also resulted in a decrease in contract labor and overtime and production-related direct expenses. Other expenses decreased to $16 million, down $8 million, or 33%, compared to the second quarter of 2013. We continued to improve our operating execution and benefited from a combined $3 million decline in customer service related expenses and outsourcing fees compared to the prior year quarter. The remaining $5 million decrease in Other expenses primarily related to nonrecurring professional fees incurred in 2013 for risk management costs and the realization of other corporate cost reduction initiatives.

See Other for a discussion of the corporate overhead allocation.

Year-to-Date Comparison: Mortgage Production segment loss was $87 million during 2014, compared to a segment profit of $89 million during the prior year. Net revenues decreased to $211 million, down $306 million, or 59%, compared with the six months ended June 30, 2013 driven by lower refinance activity, an increased mix of fee-based closings and lower loan margins and economic hedge results. Total expenses decreased to $296 million, down $108 million, or 27%, compared with the prior year primarily driven by a decline in origination volumes which resulted in lower salaries and related expenses and production direct expenses. Total expenses compared to the six months ended June 30, 2013 also included a decrease in operating costs related to customer service, professional and outsourcing fees.

Net revenues. Mortgage fees decreased to $106 million, down $55 million, or 34%, from the prior year. A 46% decline in total retail closing units from lower refinance closings contributed to a $31 million decrease in application fees, appraisal income and other underwriting income. In addition, we experienced a $20 million decrease in origination assistance fees from our PLS channel resulting from a 48% decline in PLS closing units compared to the prior year. Gain on mortgage loans, net was $253 million lower compared to the prior year driven by a $203 million decline in gain on loans related to a 63% decrease in IRLCs expected to close and a 78 basis points decline in average total loan margins, coupled with a $61 million decrease in economic hedge results. The decline in economic hedge results compared to the six months ended June 30, 2013 was primarily attributable to a lower impact from pullthrough assumptions associated with a decrease in the average outstanding balance of IRLCs expected to close and lower execution gains on mortgage loans sold.

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Total expenses. The headcount reductions described above primarily drove a $27 million, or 19%, decline in Salaries, benefits and incentives compared to the prior year. Commissions were down $26 million, or 42%, compared to 2013 driven by a 43% decrease in real estate channel closings. The lower overall closing and application volumes in 2014 also resulted in a decrease in contract labor and overtime and production-related direct expenses. Other expenses decreased to $30 million, down $18 million, or 38%, compared to the six months ended June 30, 2013 which consisted of a combined $9 million decline in customer service related expenses and outsourcing fees and $9 million related to nonrecurring professional fees incurred in 2013 for risk management costs and the realization of other corporate cost reduction initiatives.

See Other for a discussion of the corporate overhead allocation.

Selected Income Statement Data:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
		(In millions)		
Gain on mortgage loans, net:				
Gain on loans	$ 68	$ 166	$ 116	$ 319
Change in fair value of Scratch and Dent and certain non-conforming mortgage loans	(2)	(10)	(9)	(20)
Economic hedge results	14	41	24	85
Total change in fair value of mortgage loans and related derivatives	12	31	15	65
Total	$ 80	$ 197	$ 131	$ 384
Salaries and related expenses:				
Salaries, benefits and incentives	$ 57	$ 71	$ 118	$ 145
Commissions	21	34	36	62
Contract labor and overtime	2	8	3	16
Total	$ 80	$ 113	$ 157	$ 223
Other operating expenses:				
Corporate overhead allocation	$ 23	$ 26	$ 46	48
Production-related direct expenses	23	34	42	62
Other expenses	16	24	30	48
Total	$ 62	$ 84	$ 118	158

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Following are descriptions of the contents and drivers of the financial results of the Mortgage Production segment:

Mortgage fees consist of fee income earned on all loan originations, including loans closed to be sold and fee-based closings. Retail closings and fee-based closings are key drivers of Mortgage fees. Fee income consists of amounts earned related to application and underwriting fees and fees on cancelled loans. Fee income also consists of amounts earned from financial institutions related to brokered loan fees and origination assistance fees resulting from our private-label mortgage outsourcing activities.

Gain on mortgage loans, net includes realized and unrealized gains and losses on our mortgage loans, as well as the changes in fair value of our IRLCs and loan-related derivatives. The fair value of our IRLCs is based upon the estimated fair value of the underlying mortgage loan, adjusted for: (i) the estimated costs to complete and originate the loan and (ii) the estimated percentage of IRLCs that will result in a closed mortgage loan.

Gain on loans is primarily driven by the volume of IRLCs expected to close, total loan margins and the mix of wholesale/correspondent closing volume. For wholesale/correspondent closings and certain retail closings from our private label clients, the cost to acquire the loan reduces the gain from selling the loan into the secondary market. Change in fair value of Scratch and Dent and certain non-conforming mortgage loans is primarily driven by additions, sales and changes in value of Scratch and Dent loans, which represent loans with origination flaws or performance issues. Economic hedge results represent the change in value of mortgage loans, interest rate lock commitments and related derivatives, including the impact of changes in actual pullthrough as compared to our initial assumptions.

Salaries and related expenses consist of salaries, payroll taxes, benefits and incentives paid to employees in our mortgage production operations and commissions paid to employees involved in the loan origination process. Commissions for employees involved in the loan origination process are primarily driven by the volume of retail closings. Closings from our real estate channel have higher commission rates than private label closings.

Other operating expenses consist of production-related direct expenses, allocations for corporate overhead and other production related expenses. Production-related direct expenses represent variable costs directly related to the volume of loan originations and consist of appraisal, underwriting and other direct loan origination expenses and are primarily driven by the volume of applications.

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Mortgage Servicing Segment

In recent periods, our servicing operations have been negatively impacted by conditions in the housing market and general economic factors, including higher unemployment rates, which have led to elevated levels of delinquencies, increases in repurchase and indemnification requests and high loss severities on defaulted loans. These factors, plus the increased regulatory focus on servicing activities, have increased, and will likely continue to increase, servicing costs across the industry.

Although we believe the Agencies have substantially completed their reviews of loan files from pre-2009 vintages, repurchase and indemnification requests from all investors and insurers have been volatile in recent periods. There continues to be inherent uncertainty around recent repurchase and indemnification request trends, as well as uncertainty around the full impact of the new representation and warranty framework for conventional loans sold or delivered after January 1, 2013. See Risk Management for additional information regarding loan repurchase and indemnification trends and our related reserves.

Segment Metrics:

	As of June 30, 2014	As of June 30, 2013
	($ In millions)	
Total loan servicing portfolio	$ 225,902	$ 228,637
Number of loans in owned portfolio	778,108	851,506
Number of subserviced loans	402,291	408,191
Total number of loans serviced	1,180,399	1,259,697
Capitalized loan servicing portfolio	$ 123,959	$ 133,061
Capitalized servicing rate	0.96 %	0.94 %
Capitalized servicing multiple	3.3	3.2
Weighted-average servicing fee (in basis points)	29	29

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Average total loan servicing portfolio	$ 225,905	$ 204,961	$ 226,138	$ 195,595
Average capitalized loan servicing portfolio	125,513	134,962	126,837	136,813
Payoffs, sales and principal curtailments of capitalized portfolio	5,361	10,246	9,614	20,758

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Segment Results:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In millions)			
Mortgage interest income	$ 1	$ 3	$ 2	$ 4
Mortgage interest expense	(12)	(15)	(26)	(29)
Mortgage net finance expense	(11)	(12)	(24)	(25)
Loan servicing income	110	88	225	196
Change in fair value of mortgage servicing rights	(52)	75	(131)	80
Net derivative gain (loss) related to mortgage servicing rights	20	(1)	26	(17)
Valuation adjustments related to mortgage servicing rights, net	(32)	74	(105)	63
Net loan servicing income	78	162	120	259
Net revenues	67	150	96	234
Salaries and related expenses	14	14	29	25
Occupancy and other office expenses	5	3	9	6
Other depreciation and amortization		1	1	1
Other operating expenses	38	51	76	104
Total expenses	57	69	115	136
Segment profit (loss)	$ 10	$ 81	$ (19)	$ 98

Quarterly Comparison: Mortgage Servicing segment profit was $10 million during 2014, a decrease of $71 million, or 88%, from the prior year quarter. Net revenues decreased to $67 million, down $83 million, or 55%, compared with the second quarter of 2013 driven by unfavorable MSR market-related fair value adjustments that were partially offset by lower prepayment activity, net gains on MSR derivatives and a loss recorded in 2013 related to the termination of an inactive reinsurance contract. Total expenses decreased to $57 million, down $12 million, or 17%, compared with the prior year quarter primarily driven by lower repurchase and foreclosure-related charges.

Net revenues. Servicing fees from our capitalized portfolio decreased by $9 million, or 9%, compared to the prior year quarter driven by a 7% decrease in the average capitalized loan servicing portfolio and a decline in the weighted average servicing fee. Lower refinancing activity in 2014 resulted in a 61% decrease in payoffs in our capitalized loan servicing portfolio, which drove a $9 million, or 69%, decrease in curtailment interest paid to investors and a $40 million decrease in MSR valuation changes from actual prepayments of the underlying mortgage loans.

During the second quarter of 2014, market-related fair value adjustments decreased the value of our MSRs by $12 million. We observed a 29 basis point decline in the mortgage rate used to value our MSR asset during the second quarter of 2014; however prepayments in our capitalized portfolio declined by 61% compared to the prior year quarter as the refinance incentive decreased and prepayments became less sensitive to changes in interest rates. During the second quarter of 2013, market-related fair value adjustments increased the value of our MSRs by $155 million primarily due to a 76 basis points increase in the mortgage rate used to value our MSR asset that was partially offset by higher expected prepayment activity from HARP refinances and a decrease in projected servicing cash flows for delinquent and foreclosed loans. Changes in interest rates and the composition of our MSR derivative portfolio during each period drove a net gain on MSR derivatives of $20 million during 2014, compared to a net loss of $1 million during the second quarter of 2013.

Loan servicing income for 2014 includes the full impact from the assumption of a subservicing portfolio with an unpaid principal balance of $47 billion in the second quarter of 2013. Subservicing fees were $13 million during the second quarter of 2014, an increase of $4 million from the prior year quarter resulting from an increase in the average number of loans in our subserviced portfolio and the subservicing fee earned per loan. We expect the trends in subservicing to continue in 2014, consistent with our strategy to position the mortgage business to be less capital intensive, and have more fee-based revenue streams. Net reinsurance loss for 2013 included a nonrecurring $21 million pre-tax loss related to the termination of our remaining reinsurance contract.

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Total expenses. The Agencies substantially completed their repurchase and indemnification requests for pre-2009 vintage years by the end of 2013. During the second quarter of 2014, we observed a continued downward trend in new repurchase requests for more recent originations years (2009 to 2012) which resulted in a decline in our actual and projected number of repurchase and indemnification requests that was offset by an increase in our expected loss severities. As a result, we recorded a $1 million benefit for repurchase and foreclosure-related charges during 2014. The $11 million of repurchase and foreclosure-related charges during the second quarter of 2013 reflected the impact of additional clarity from the Agencies on the total number of loan file reviews expected to be completed for pre-2009 origination years and reduced government insurance claims proceeds.

Other expenses decreased by $2 million in 2014, or 6%, primarily due to a $5 million decrease in unreimbursed servicing and interest costs from delinquent and foreclosed government loans that was partially offset by a $3 million increase in costs associated with managing a larger subservicing portfolio, various regulatory proceedings and Agency compensatory fees related to foreclosures.

See Other for a discussion of the corporate overhead allocation.

Year-to-Date Comparison: Mortgage Servicing segment loss was $19 million during 2014, compared to a segment profit of $98 million during the prior year. Net revenues decreased to $96 million, down $138 million, or 59%, compared with the six months ended June 30, 2013 driven by unfavorable MSR market-related fair value adjustments that were partially offset by lower prepayment activity, net gains on MSR derivatives and a loss recorded in 2013 related to the termination of an inactive reinsurance contract. Total expenses decreased to $115 million, down $21 million, or 15%, compared with the prior year primarily driven by lower repurchase and foreclosure-related charges and direct foreclosure and REO expenses that were partially offset by higher salaries and related expenses associated with the increased subservicing portfolio and an increase in corporate overhead allocations.

Net revenues. Servicing fees from our capitalized portfolio decreased by $17 million, or 9%, compared to the prior year driven by a 7% decrease in the average capitalized loan servicing portfolio and a decline in the weighted average servicing fee. Lower refinancing activity in 2014 resulted in a 66% decrease in payoffs in our capitalized loan servicing portfolio, which drove a $19 million, or 73%, decrease in curtailment interest paid to investors and an $85 million decrease in MSR valuation changes from actual prepayments of the underlying mortgage loans.

During the six months ended June 30, 2014, market-related fair value adjustments decreased the value of our MSRs by $57 million. We observed a 42 basis point decline in the mortgage rate used to value our MSR asset during the six months ended June 30, 2014; however prepayments in our capitalized portfolio declined by 66% compared to the prior year as the refinance incentive decreased and prepayments became less sensitive to changes in interest rates. During the six months ended June 30, 2013, market-related fair value adjustments increased the value of our MSRs by $237 million primarily due to a 107 basis points increase in the mortgage rate used to value our MSR asset that was partially offset by higher expected prepayment activity from HARP refinances and a decrease in projected servicing cash flows for delinquent and foreclosed loans. Changes in interest rates during each period drove a net gain on MSR derivatives of $26 million during 2014, compared to a net loss of $17 million during the prior year.

Subservicing fees were $26 million during the six months ended June 30, 2014, an increase of $12 million from the prior year resulting from an increase in the average number of loans in our subserviced portfolio related to the assumption of a subservicing portfolio in the second quarter of 2013 and an increase in the subservicing fee earned per loan. Net reinsurance loss for 2013 included a nonrecurring $21 million pre-tax loss related to the termination of our remaining reinsurance contract.

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Total expenses. During the six months ended June 30, 2014, we observed a continued downward trend in new repurchase requests for more recent originations years (2009 to 2012) which resulted in a decline in our actual and projected number of repurchase and indemnification requests that was offset by an increase in our expected loss severities. As a result, we recorded a $1 million benefit for repurchase and foreclosure-related charges during 2014. The $26 million of repurchase and foreclosure-related charges during the six months ended June 30, 2013 reflected the impact of additional clarity from the Agencies on the total number of loan file reviews expected to be completed for pre-2009 origination years, a continued elevated level of total requests and reduced government insurance claims proceeds.

Salaries and related expenses increased by $4 million compared to the prior year which was primarily driven by an increase in the average number of permanent employees from the transfer of certain employees into our servicing operations when we commenced subservicing activities on the portfolio that was assumed in the second quarter of 2013.

Other expenses decreased by $5 million in 2014, or 7%, which consisted of a $7 million decrease in unreimbursed servicing and interest costs from delinquent and foreclosed government loans and a $3 million decrease in tax service fee expenses related to lower closing volumes that were partially offset by a $4 million increase in costs associated with managing a larger subservicing portfolio and various regulatory proceedings.

See Other for a discussion of the corporate overhead allocation.

Selected Income Statement Data:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In millions)			
Loan servicing income:				
Servicing fees from capitalized portfolio	$ 90	$ 99	$ 182	$ 199
Subservicing fees	13	9	26	14
Late fees and other ancillary servicing revenue	11	13	24	28
Curtailment interest paid to investors	(4)	(13)	(7)	(26)
Net reinsurance loss		(20)		(19)
Total	$ 110	$ 88	$ 225	$ 196
Changes in fair value of Mortgage Servicing Rights:				
Actual prepayments of the underlying mortgage loans	$ (29)	$ (69)	$ (51)	$ (136)
Actual receipts of recurring cash flows	(11)	(11)	(23)	(21)
Market-related fair value adjustments	(12)	155	(57)	237
Total	$ (52)	$ 75	$ (131)	$ 80