PHH CORP
Form 10-Q
May 02, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from to

Commission File Number: 1-7797

PHH CORPORATION

(Exact name of registrant as specified in its charter)

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

856-917-1744

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

As of April 24, 2013, 57,098,148 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 impact of the adoption of recently issued accounting pronouncements on our financial statements;

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

- our expectations regarding improvements in our systems and processes, including our information technology infrastructure and systems;

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

- our belief that sources of liquidity will be adequate to fund operations;

- mortgage repurchase and indemnification requests and associated reserves and provisions; 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 I Item 1A. Risk Factors in our 2012 Form 10-K and those factors described below:

- 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 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;

- 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 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 effects of continued elevated volumes or increases in our actual and projected repurchases of, indemnification given in respect of, or related losses associated with, sold mortgage loans for which we have provided representations and warranties or other contractual recourse to purchasers and insurers of such loans, including increases in our loss severity and reserves associated with such loans;

- the effects of reinsurance claims in excess of projected levels and in excess of reinsurance premiums we are entitled to receive or amounts currently held in trust to pay such claims;

- 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 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 or other state or federal regulatory agencies related to foreclosure procedures or other 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 status as a government sponsored entity-approved seller and servicer, including the ability to continue to comply with the respective selling and servicing guides, including any changes caused by the Dodd-Frank Act;

- changes in laws and regulations, including changes in mortgage- and real estate-related laws and regulations (including changes caused by the Dodd-Frank Act) status of government sponsored-entities and state, federal and foreign tax laws and accounting standards;

- the effects of the insolvency of any of the counterparties to our significant customer contracts or financing arrangements or the inability or unwillingness of such counterparties 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 effects of competition in our existing and potential future lines of business, including the impact of consolidation within the industries in which we operate and competitors with greater financial resources and broader product lines;

- the ability to obtain financing (including refinancing and extending existing indebtedness) on acceptable terms, if at all, to finance our operations or growth strategy, to operate within the limitations imposed by our financing arrangements and to maintain the amount of cash required to service our indebtedness;

- the ability to maintain our relationships with our existing clients and to establish relationships with new clients;

- 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 law and our contractual obligations;

- the ability to attract and retain key employees;

- a deterioration in the performance of assets held as collateral for secured borrowings;

- any failure to comply with covenants under our financing arrangements; and

- 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.

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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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PHH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In millions, except per share data)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
REVENUES		
Mortgage fees	$ 79	$ 80
Fleet management fees	43	47
Net fee income	122	127
Fleet lease income	332	336
Gain on mortgage loans, net	187	230
Mortgage interest income	20	25
Mortgage interest expense	(48)	(55)
Mortgage net finance expense	(28)	(30)
Loan servicing income	108	121
Change in fair value of mortgage servicing rights	5	(21)
Net derivative loss related to mortgage servicing rights	(16)	(5)
Valuation adjustments related to mortgage servicing rights, net	(11)	(26)
Net loan servicing income	97	95
Other income	20	19
Net revenues	730	777
EXPENSES		
Salaries and related expenses	159	136
Occupancy and other office expenses	15	14
Depreciation on operating leases	302	301
Fleet interest expense	15	17
Other depreciation and amortization	7	6
Other operating expenses	136	179
Total expenses	634	653
Income before income taxes	96	124
Income tax expense	32	39
Net income	64	85
Less: net income attributable to noncontrolling interest	12	10
Net income attributable to PHH Corporation	$ 52	$ 75
Basic earnings per share attributable to PHH Corporation	$ 0.90	$ 1.32
Diluted earnings per share attributable to PHH Corporation	$ 0.79	$ 1.30

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In millions)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income	$ 64	$ 85
Other comprehensive (loss) income, net of tax:		
Currency translation adjustment	(5)	4
Change in unrealized gains on available-for-sale securities, net		(1)
Change in unfunded pension liability, net		1
Total other comprehensive (loss) income, net of tax	(5)	4
Total comprehensive income	59	89
Less: comprehensive income attributable to noncontrolling interest	12	10
Comprehensive income attributable to PHH Corporation	$ 47	$ 79

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In millions, except share data)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	$ 927	$ 829
Restricted cash, cash equivalents and investments (including $114 and $121 of available-for-sale securities at fair value)	402	425
Mortgage loans held for sale	1,732	2,174
Accounts receivable, net	742	797
Net investment in fleet leases	3,678	3,636
Mortgage servicing rights	1,101	1,022
Property, plant and equipment, net	79	79
Goodwill	25	25
Other assets	570	616
Total assets (1)	$ 9,256	$ 9,603
LIABILITIES AND EQUITY		
Accounts payable and accrued expenses	$ 502	$ 562
Debt	6,209	6,554
Deferred taxes	650	622
Other liabilities	287	303
Total liabilities (1)	7,648	8,041
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; 57,089,341 shares issued and outstanding at March 31, 2013; 56,975,991 shares issued and outstanding at December 31, 2012	1	1
Additional paid-in capital	1,129	1,127
Retained earnings	424	372
Accumulated other comprehensive income	21	26
Total PHH Corporation stockholders equity	1,575	1,526
Noncontrolling interest	33	36
Total equity	1,608	1,562
Total liabilities and equity	$ 9,256	$ 9,603

See accompanying Notes to Condensed Consolidated Financial Statements.

Continued.

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CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

(Unaudited)
(In millions)

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

	March 31, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	$ 98	$ 66
Restricted cash, cash equivalents and investments	238	249
Mortgage loans held for sale	552	730
Accounts receivable, net	79	90
Net investment in fleet leases	3,578	3,531
Property, plant and equipment, net	2	2
Other assets	42	39
Total assets	$ 4,589	$ 4,707
LIABILITIES		
Accounts payable and accrued expenses	$ 35	$ 36
Debt	3,952	4,074
Other liabilities	15	13
Total liabilities	$ 4,002	$ 4,123

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 Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Three Months Ended March 31, 2013							
Balance at December 31, 2012	**56,975,991**	**$ 1**	**$ 1,127**	**$ 372**	**$ 26**	**$ 36**	**$ 1,562**
Total comprehensive income (loss)				52	(5)	12	59
Distributions to noncontrolling interest						(15)	(15)
Stock compensation expense			2				2
Stock issued under share-based payment plans	113,350		(1)				(1)
Recognition of deferred taxes related to Convertible notes			1				1
Balance at March 31, 2013	**57,089,341**	**$ 1**	**$ 1,129**	**$ 424**	**$ 21**	**$ 33**	**$ 1,608**
Three Months Ended March 31, 2012							
Balance at December 31, 2011	**56,361,155**	**$ 1**	**$ 1,082**	**$ 338**	**$ 21**	**$ 19**	**$ 1,461**
Total comprehensive income				75	4	10	89
Distributions to noncontrolling interest						(14)	(14)
Stock compensation expense			1				1
Stock issued under share-based payment plans	284,578		(2)				(2)
Conversion option related to Convertible note issuance, net			33				33
Recognition of deferred taxes related to Convertible notes			1				1
Balance at March 31, 2012	**56,645,733**	**$ 1**	**$ 1,115**	**$ 413**	**$ 25**	**$ 15**	**$ 1,569**

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In millions)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cash flows from operating activities:		
Net income	$ 64	$ 85
Adjustments to reconcile Net income to net cash provided by operating activities:		
Capitalization of originated mortgage servicing rights	(74)	(108)
Net loss on mortgage servicing rights and related derivatives	11	26
Vehicle depreciation	302	301
Other depreciation and amortization	7	6
Origination of mortgage loans held for sale	(7,845)	(10,784)
Proceeds on sale of and payments from mortgage loans held for sale	8,506	12,012
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(194)	(264)
Deferred income tax expense	29	36
Other adjustments and changes in other assets and liabilities, net	27	133
Net cash provided by operating activities	833	1,443
Cash flows from investing activities:		
Investment in vehicles	(447)	(481)
Proceeds on sale of investment vehicles	77	92
Net cash paid on derivatives related to mortgage servicing rights	(21)	(5)
Purchases of property, plant and equipment	(11)	(6)
Purchases of restricted investments	(51)	(49)
Proceeds from sales and maturities of restricted investments	58	70
Decrease in restricted cash and cash equivalents	15	39
Other, net	1	19
Net cash used in investing activities	(379)	(321)
Cash flows from financing activities:		
Proceeds from secured borrowings	12,755	17,663
Principal payments on secured borrowings	(13,093)	(18,495)
Proceeds from unsecured borrowings		243
Principal payments on unsecured borrowings		(51)
Cash paid for debt issuance costs	(2)	(7)
Other, net	(16)	(14)
Net cash used in financing activities	(356)	(661)
Effect of changes in exchange rates on Cash and cash equivalents		
Net increase in Cash and cash equivalents	98	461
Cash and cash equivalents at beginning of period	829	414
Cash and cash equivalents at end of period	$ 927	$ 875

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 outsource provider of mortgage and fleet management services operating in the following business segments:

- **Mortgage Production** provides mortgage loan origination services and sells mortgage loans.
- **Mortgage Servicing** performs servicing activities for originated and purchased loans.
- **Fleet Management Services** provides commercial fleet management services.

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, which is commonly referred to as 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 2012 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

Comprehensive Income. In February 2013, the FASB issued ASU 2013-2, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income . This update to the comprehensive income guidance requires additional disclosure about the amounts reclassified out of Accumulated other comprehensive income, including disclosing the amounts that impact each line item in the Statement of Operations within a reporting period. This update enhances the disclosure requirements for amounts reclassified out of Accumulated other comprehensive income but will not impact the Company s financial position, results of operations or cash flows. The Company adopted the new accounting guidance prospectively effective January 1, 2013. The updated disclosures are included in Note 13. Accumulated Other Comprehensive Income .

Intangibles. In July 2012, the FASB issued ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment . This update amends the current guidance on testing indefinite-lived intangibles for impairment and allows for the option to first assess qualitative factors to determine whether the existence of events and

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

circumstances indicates that it is more likely than not that the indefinite-lived intangibles are impaired. If it is more likely than not that the indefinite-lived intangibles are impaired, the entity is required to determine the fair value of the indefinite-lived intangibles and perform the quantitative impairment test by comparing the fair value with the carrying amount. The Company adopted the new accounting guidance effective January 1, 2013 and the guidance will be incorporated prospectively when performing impairment tests for intangible assets.

Offsetting Assets and Liabilities. In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities . This update requires disclosure of both gross and net information about instruments and transactions in the scope of these pronouncements. Subsequently in January 2013, the FASB issued ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities which limited the disclosures to derivatives including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in accordance with current derivative and netting guidance, or subject to a master netting arrangement or similar agreement. The Company adopted the new accounting guidance retrospectively effective January 1, 2013. The updated disclosures are included in Note 5, Derivatives .

2. Earnings Per Share

Basic earnings per share attributable to PHH Corporation was computed by dividing Net income attributable to PHH Corporation for the period by the weighted-average number of shares outstanding during the period. Diluted earnings per share attributable to PHH Corporation was computed by dividing Net income 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 per share attributable to PHH Corporation for the periods indicated:

	Three Months Ended March 31, 2013	2012
	(In millions, except share and per share data)	
Net income attributable to PHH Corporation	$ 52	$ 75
Weighted-average common shares outstanding basic	57,248,825	56,657,040
Effect of potentially dilutive securities:		
Share-based payment arrangements(1)	239,361	224,084
Conversion of debt securities	8,297,949	841,111
Weighted-average common shares outstanding diluted	65,786,135	57,722,235
Basic earnings per share attributable to PHH Corporation	$ 0.90	$ 1.32
Diluted earnings per share attributable to PHH Corporation	$ 0.79	$ 1.30
Anti-dilutive securities excluded from the computation of dilutive securities:		
Outstanding stock-based compensation awards	479,323	1,576,342

(1) Represents incremental shares from restricted stock units and stock options. For the three months ended March 31, 2013 and 2012, excludes 719,606 shares and 267,355 shares, respectively, that are contingently issuable for which the contingency has not been met.

3. Restricted Cash, Cash Equivalents and Investments

The following table summarizes Restricted cash, cash equivalents and investment balances:

	March 31, 2013	December 31, 2012
	(In millions)	
Restricted cash and cash equivalents	$ 288	$ 304
Restricted investments, at fair value	114	121
Total	$ 402	$ 425

The restricted cash related to our reinsurance activities is invested in certain debt securities as permitted under the reinsurance agreements. The restricted investments are classified as available-for-sale securities and remain in trust for capital fund requirements and potential reinsurance losses.

The following tables summarize Restricted investments, at fair value:

	March 31, 2013				
	Amortized Cost	Fair Value	Unrealized Gains	Unrealized Losses	Weighted-average remaining maturity
			(In millions)		
Corporate securities	$ 36	$ 37	$ 1	$	26 mos.
Agency securities (1)	36	36			32 mos.
Government securities	41	41			20 mos.
Total	$ 113	$ 114	$ 1	$	26 mos.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2012				
	Amortized Cost	Fair Value	Unrealized Gains	Unrealized Losses	Weighted-average remaining maturity
			(In millions)		
Corporate securities	$ 30	$ 31	$ 1	$	25 mos.
Agency securities (1)	39	39			21 mos.
Government securities	51	51			19 mos.
Total	$ 120	$ 121	$ 1	$	21 mos.

(1) Represents bonds and notes issued by various agencies including, but not limited to, Fannie Mae, Freddie Mac and Federal Home Loan Banks.

During the three months ended March 31, 2013, the amount of realized gains and losses from the sale of available-for-sale securities was not significant. During the three months ended March 31, 2012, realized gains of $1 million from the sale of available-for-sale securities were recorded, and realized losses were not significant.

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 servicing portfolio associated with loans subserviced for others. The total servicing portfolio, including loans subserviced for others, was $181.8 billion and $183.7 billion as of March 31, 2013 and December 31, 2012, 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 activity in the loan servicing portfolio associated with capitalized servicing rights consisted of:

	Three Months Ended March 31,	
	2013	2012

	(In millions)			
Balance, beginning of period	$	140,381	$	147,088
Additions		6,964		10,794
Payoffs, sales and curtailments		(10,512)		(8,227)
Balance, end of period	$	136,833	$	149,655

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The activity in capitalized MSRs consisted of:

	Three Months Ended March 31, 2013	2012
	(In millions)	
Balance, beginning of period	$ 1,022	$ 1,209
Additions	74	108
Changes in fair value due to:		
Realization of expected cash flows	(77)	(64)
Changes in market inputs or assumptions used in the valuation model	82	43
Balance, end of period	$ 1,101	$ 1,296

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

	Three Months Ended March 31, 2013	2012
	(In millions)	
Servicing fees from capitalized portfolio	$ 100	$ 112
Late fees	5	5
Other ancillary servicing revenue	10	12

As of March 31, 2013 and December 31, 2012, the MSRs had a weighted-average life of approximately 4.9 years and 4.3 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:

	Three Months Ended March 31, 2013	2012
	(In millions)	
Proceeds from new loan sales or securitizations	$ 7,171	$ 11,220
Servicing fees from capitalized portfolio(1)	100	112
Other cash flows on retained interests (2)		5
Purchases of delinquent or foreclosed loans (3)	(20)	(16)
Servicing advances (4)	(285)	(361)
Repayment of servicing advances	290	359

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

(2) Represents cash flows received on retained interests other than servicing fees.

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

(4) As of March 31, 2013 and December 31, 2012, outstanding servicing advance receivables of $292 million and $293 million, respectively, were included in Accounts receivable, net.

During the three months ended March 31, 2013 and 2012, pre-tax gains of $242 million and $228 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Derivatives

Derivative instruments and the risks they manage are as follows:

- **Forward delivery commitments** Related to interest rate and price risk for Mortgage loans held for sale and interest rate lock commitments
- **Option contracts** Related to interest rate and price risk for interest rate lock commitments
- **MSR-related agreements** Related to interest rate risk for mortgage servicing rights
- **Interest rate contracts** Related to interest rate risk for variable-rate debt arrangements and fixed-rate leases
- **Convertible note-related agreements** Related to the issuance of the Convertible notes due in 2014
- **Foreign exchange contracts** Related to exposure to currency fluctuations that would impact our investment in or borrowings related to our Canadian operations

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.

DERIVATIVE ACTIVITY

The following table summarizes the gross notional amount of derivatives:

	March 31, 2013	December 31, 2012
	(In millions)	
Notional Amounts:		
Interest rate lock commitments	$ 4,472	$ 4,993
Forward delivery commitments	12,144	12,303
Option contracts	700	1,070
Interest rate contracts	638	614
Convertible note-related agreements(1)		
MSR-related agreements	1,565	3,915

(1) The notional 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 Company is exposed to risk in the event of non-performance by counterparties to our derivative contracts. In general, the Company manages such risk by evaluating the financial position and creditworthiness of counterparties, monitoring the amount of exposure and/or dispersing the risk among multiple counterparties. The Company s derivatives may also be governed by an ISDA or an MSFTA, and bilateral collateral agreements are in place with certain counterparties. When the Company has more than one outstanding derivative transaction with a single counterparty and a legally enforceable master netting agreement is in effect with that counterparty, the Company considers its exposure to be the net fair value of all positions with that counterparty including the value of any cash collateral amounts posted or received.

The Company also has collateral posting arrangements with certain counterparties that do not qualify for net presentation. As of both March 31, 2013 and December 31, 2012, $1 million was recorded in Other assets in the Condensed Consolidated Balance Sheets for collateral that did not qualify for net presentation.

In addition, the Company has global netting arrangements with certain counterparties whereby the Company s outstanding derivative and cash collateral positions may be settled net against amounts outstanding under borrowing arrangements and other obligations when an event of default has occurred. These amounts are not presented net in the Condensed Consolidated Balance Sheets as the netting provisions are contingent upon an event of default.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Derivative instruments are recorded in Other assets and Other liabilities in the Condensed Consolidated Balance Sheets. The following tables present the balances of outstanding derivative instruments on a gross basis and the application of counterparty and collateral netting:

	March 31, 2013			
	Gross Assets	Offsetting Payables	Cash Collateral (Received) Paid	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$ 13	$ (17)	$ 4	$
MSR-related agreements	1		(1)	
Derivative assets subject to netting	14	(17)	3	
Not subject to master netting arrangements:				
Interest rate lock commitments	114			114
Forward delivery commitments	5			5
Option contracts	1			1
Interest rate contracts	1			1
Convertible note-related agreements	16			16
Derivative assets not subject to netting	137			137
Total derivative assets	$ 151	$ (17)	$ 3	$ 137

	Gross Liabilities	Offsetting Receivables	Cash Collateral (Paid) Received	Net Amount
	(In millions)			
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 22	$ (17)	$	$ 5
Not subject to master netting arrangements:				
Interest rate lock commitments	1			1
Forward delivery commitments	5			5
Convertible note-related agreements	16			16
Derivative liabilities not subject to netting	22			22
Total derivative liabilities	$ 44	$ (17)	$	$ 27

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2012			
	Gross Assets	Offsetting Payables	Cash Collateral (Received) Paid	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$ 10	$ (12)	$ 5	$ 3
MSR-related agreements	5	(4)	(1)	
Derivative assets subject to netting	15	(16)	4	3
Not subject to master netting arrangements:				
Interest rate lock commitments	140			140
Forward delivery commitments	5			5
Option contracts	2			2
Interest rate contracts	1			1
Convertible note-related agreements	27			27
Derivative assets not subject to netting	175			175
Total derivative assets	$ 190	$ (16)	$ 4	$ 178

	Gross Liabilities	Offsetting Receivables	Cash Collateral (Paid) Received	Net Amount
	(In millions)			
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 14	$ (12)	$ (1)	$ 1
MSR-related agreements		(4)	9	5
Derivative liabilities subject to netting	14	(16)	8	6
Not subject to master netting arrangements:				
Interest rate lock commitments	1			1
Forward delivery commitments	5			5
Convertible note-related agreements	27			27
Derivative liabilities not subject to netting	33			33
Total derivative liabilities	$ 47	$ (16)	$ 8	$ 39

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