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

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission File Number: 1-7797

PHH CORPORATION

(Exact name of registrant as specified in its charter)

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

856-917-1744

(Registrant s telephone number, including area code)

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

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

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

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

As of October 29, 2014, 50,840,342 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 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 relationships will contribute positively to our cash flows;

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

§ our 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, re-negotiate our private label agreements, and implement changes to meet our operational and financial objectives;

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

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

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

§ 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 September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
REVENUES				
Mortgage fees	$ 64	$ 86	$ 170	$ 247
Gain on mortgage loans, net	69	109	200	493
Mortgage interest income	13	20	33	59
Mortgage interest expense	(31)	(47)	(104)	(143)
Mortgage net finance expense	(18)	(27)	(71)	(84)
Loan servicing income	110	116	335	312
Change in fair value of mortgage servicing rights	(84)	(74)	(215)	6
Net derivative gain (loss) related to mortgage servicing rights			26	(17)
Valuation adjustments related to mortgage servicing rights, net	(84)	(74)	(189)	(11)
Net loan servicing income	26	42	146	301
Other income	11	1	14	5
Net revenues	152	211	459	962
EXPENSES				
Salaries and related expenses	120	140	336	416
Occupancy and other office expenses	12	12	37	37
Other depreciation and amortization	6	6	18	17
Other operating expenses	143	154	311	388
Total expenses	281	312	702	858
(Loss) income from continuing operations before income taxes	(129)	(101)	(243)	104
Income tax (benefit) expense	(44)	(38)	(89)	33
(Loss) income from continuing operations, net of tax	(85)	(63)	(154)	71
Income from discontinued operations, net of tax	303	17	273	49
Net income (loss)	218	(46)	119	120
Less: net income attributable to noncontrolling interest	3	6	5	30
Net income (loss) attributable to PHH Corporation	$ 215	$ (52)	$ 114	$ 90
Basic earnings (loss) per share:				
From continuing operations	$ (1.64)	$ (1.19)	$ (2.83)	$ 0.73
From discontinued operations	5.64	0.29	4.86	0.85
Total attributable to PHH Corporation	$ 4.00	$ (0.90)	$ 2.03	$ 1.58
Diluted earnings (loss) per share:				
From continuing operations	$ (1.64)	$ (1.19)	$ (2.83)	$ 0.64
From discontinued operations	5.64	0.29	4.86	0.74
Total attributable to PHH Corporation	$ 4.00	$ (0.90)	$ 2.03	$ 1.38

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In millions)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Net income (loss)	$ 218	$ (46)	$ 119	$ 120
Other comprehensive (loss) income, net of tax:				
Currency translation adjustment	(22)	4	(22)	(7)
Change in unrealized gains on available-for-sale securities, net				(1)
Total other comprehensive (loss) income, net of tax	(22)	4	(22)	(8)
Total comprehensive income (loss)	196	(42)	97	112
Less: comprehensive income attributable to noncontrolling interest	3	6	5	30
Comprehensive income (loss) attributable to PHH Corporation	$ 193	$ (48)	$ 92	$ 82

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In millions, except share data)

	September 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 1,451	$ 1,126
Restricted cash	47	27
Investment securities (at amortized cost)	250	
Mortgage loans held for sale	721	834
Accounts receivable, net	672	630
Mortgage servicing rights	1,114	1,279
Property and equipment, net	38	51
Other assets	390	450
Assets held for sale		4,456
Total assets (1)	$ 4,683	$ 8,853
LIABILITIES AND EQUITY		
Accounts payable and accrued expenses	$ 1,072	$ 583
Debt	1,580	2,024
Deferred taxes	309	687
Other liabilities	114	150
Liabilities held for sale		3,719
Total liabilities (1)	3,075	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; 50,840,342 shares issued and outstanding at September 30, 2014; 57,265,517 shares issued and outstanding at December 31, 2013	1	1
Additional paid-in capital	985	1,142
Retained earnings	599	507
Accumulated other comprehensive (loss) income	(6)	16
Total PHH Corporation stockholders equity	1,579	1,666
Noncontrolling interest	29	24
Total equity	1,608	1,690
Total liabilities and equity	$ 4,683	$ 8,853

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 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:

	September 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 86	$ 94
Restricted cash	8	3
Mortgage loans held for sale	352	318
Accounts receivable, net	192	7
Property and equipment, net	1	2
Other assets	9	7
Assets held for sale (Note 2)		3,853
Total assets	$ 648	$ 4,284
LIABILITIES		
Accounts payable and accrued expenses	$ 14	$ 16
Debt	442	289
Other liabilities	10	12
Liabilities held for sale (Note 2)		3,471
Total liabilities	$ 466	$ 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 Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Nine Months Ended September 30, 2014							
Balance at December 31, 2013	**57,265,517**	**$ 1**	**$ 1,142**	**$ 507**	**$ 16**	**$ 24**	**$ 1,690**
Total comprehensive income (loss)				114	(22)	5	97
Stock compensation expense			6				6
Stock issued under share-based payment plans (includes $6 of excess tax benefit)	537,520		15				15
Repurchase of common stock	(6,962,695)		(178)	(22)			(200)
Conversion of Convertible notes			(4)				(4)
Recognition of deferred taxes related to Convertible notes			4				4
Balance at September 30, 2014	**50,840,342**	**$ 1**	**$ 985**	**$ 599**	**$ (6)**	**$ 29**	**$ 1,608**
Nine Months Ended September 30, 2013							
Balance at December 31, 2012	**56,975,991**	**$ 1**	**$ 1,127**	**$ 372**	**$ 26**	**$ 36**	**$ 1,562**
Total comprehensive income (loss)				90	(8)	30	112
Distributions to noncontrolling interest						(41)	(41)
Stock compensation expense			6				6
Stock issued under share-based payment plans	256,465		1				1
Recognition of deferred taxes related to Convertible notes			3				3
Balance at September 30, 2013	**57,232,456**	**$ 1**	**$ 1,137**	**$ 462**	**$ 18**	**$ 25**	**$ 1,643**

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In millions)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Cash flows from operating activities:		
Net income	$ 119	$ 120
Adjustments to reconcile Net income to net cash provided by operating activities:		
Net gain on sale of business	(243)	
Capitalization of originated mortgage servicing rights	(76)	(209)
Net loss on mortgage servicing rights and related derivatives	189	11
Vehicle depreciation	596	912
Other depreciation and amortization	23	24
Origination of mortgage loans held for sale	(9,555)	(22,213)
Proceeds on sale of and payments from mortgage loans held for sale	9,845	23,772
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(162)	(459)
Deferred income tax (benefit) expense	(54)	54
Other adjustments and changes in other assets and liabilities, net	(27)	39
Net cash provided by operating activities	655	2,051
Cash flows from investing activities:		
Investment in vehicles	(850)	(1,289)
Proceeds on sale of investment vehicles	201	254
Net cash received (paid) on derivatives related to mortgage servicing rights	22	(22)
Proceeds on sale of mortgage servicing rights	29	
Proceeds from sale of business, net of cash transferred and transaction costs	1,090	
Purchases of property and equipment	(11)	(22)
Purchases of certificates of deposit	(250)	
(Increase) decrease in restricted cash	(78)	49
Purchases of restricted investments		(85)
Proceeds from sales and maturities of restricted investments		205
Other, net	6	2
Net cash provided by (used in) investing activities	159	(908)
Cash flows from financing activities:		
Proceeds from secured borrowings	14,246	36,759
Principal payments on secured borrowings	(14,222)	(37,575)
Proceeds from unsecured borrowings		350
Principal payments on unsecured borrowings	(425)	(280)
Issuances of common stock	10	2
Repurchase of common stock	(200)	
Cash paid for debt issuance costs	(14)	(26)
Distributions to noncontrolling interest		(41)
Other, net	(3)	(5)
Net cash used in financing activities	(608)	(816)
Effect of changes in exchange rates on Cash and cash equivalents		(1)
Net increase in Cash and cash equivalents	206	326
Cash and cash equivalents at beginning of period	1,245	829
Less: Cash balance of discontinued operations at end of period		(126)
Cash and cash equivalents at end of period	$ 1,451	$ 1,029
Supplemental Disclosure of Cash Flows Information:		

Payments for debt retirement premiums	$	22	$	50

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.

Effective on July 1, 2014, the Company sold its Fleet Management Services business and related fleet entities (collectively the Fleet business) to certain wholly owned subsidiaries of Element Financial Corporation. The results of the Fleet business are presented as discontinued operations in the Condensed Consolidated Statements of Operations, and have been excluded from continuing operations and segment results for all periods presented. The 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 at December 31, 2013. 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 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 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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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.

In August 2014, the FASB issued ASU 2014-14, Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure which requires, if certain conditions are met, an entity to derecognize a mortgage loan with a government guarantee upon foreclosure and to recognize a separate other receivable. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The accounting changes in this Update are effective for the first interim and annual periods beginning after December 15, 2014 using the same transition method elected under ASU 2014-04 noted above. Early adoption is permitted if ASU 2014-04 has already been adopted. The Company is currently evaluating the impact of adopting this new standard.

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

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern which requires an entity s management, at each annual and interim reporting period, to evaluate the entity s ability to continue as a going concern within one year after the date that the financial statements are issued and to provide enhanced footnote disclosures surrounding any uncertainties and management s evaluation of the uncertainties. Management s evaluation should be based on relevant conditions and events that are known at the date financial statements are issued. The amendments in this Update are effective for the first interim and annual periods beginning after December 15, 2016. Early adoption is permitted. This new standard enhances disclosure requirements but will not impact the Company s financial position, results of operations or cash flows.

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 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Accounting Policies

Investment Securities

Investment securities represent investments in fixed and floating rate financial instruments with maturities greater than three months and up to twelve months at the time of purchase. They are classified as held-to-maturity and recorded at amortized cost. As of September 30, 2014, Investment securities represent certificates of deposit with 2-months to maturity, and the carrying value approximates fair value due to the short-term nature of the investments.

2. Discontinued Operations

During the second quarter of 2014, the Company entered into a definitive agreement to sell its Fleet Management Services business and related fleet entities (collectively the Fleet business) to Element Financial Corporation for a purchase price of $1.4 billion. The sale was completed effective on July 1, 2014.

The results of discontinued operations are summarized below:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
	(In millions)							
Net revenues	$		$	404	$	820	$	1,205
Total expenses				377		774		1,129
Income before income taxes(1)				27		46		76
Income tax expense(1)				10		16		27
Gain from sale of discontinued operations, net of tax		303				243		
Income from discontinued operations, net of tax	$	303	$	17	$	273	$	49

(1) Represents the results of the Fleet business.

The Gain from sale of discontinued operations, net of tax for the three and nine months ended September 30, 2014 includes a gain of $22 million resulting from the reclassification of currency translation adjustments from Accumulated other comprehensive income as discussed further in Note 14, Accumulated Other Comprehensive Income . The income tax expense related to the Gain on sale of discontinued operations was $183 million and $228 million for the three and nine months ended September 30, 2014, respectively. For the nine months ended September 30, 2014, the $228 million income tax expense related to the gain includes $52 million of expense associated with the earnings of Canadian subsidiaries that were previously considered to be indefinitely invested.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Upon the classification of these entities as held for sale during the second quarter of 2014, the accumulated earnings were no longer deemed to be indefinitely invested and the Company recognized expense related to the cumulative earnings of such Canadian subsidiaries.

The Company and Element Financial Corporation entered into a transition services arrangement, whereby the Company will perform certain administrative or overhead functions for a period of one year or less, in exchange for a fee. Revenues associated with the transition services agreement are included in Other income in the Condensed Consolidated Statements of Income. Costs incurred by the Company to provide such transition services are included primarily in Other operating expenses and billed to Element Financial Corporation based upon the terms of the transition services agreement. The Company will have no continuing involvement in the operations, results or cash flows of the Fleet business.

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

		December 31, 2013 (In millions)
ASSETS		
Cash	$	119
Restricted cash		207
Accounts receivable, net		351
Net investment in fleet leases		3,653
Property and equipment, net		24
Goodwill		25
Other assets		77
Total assets held for sale(1)	$	4,456
LIABILITIES		
Accounts payable and accrued expenses	$	223
Debt		3,481
Other liabilities		15
Total liabilities held for sale(1)	$	3,719

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

		December 31, 2013 (In millions)
Chesapeake and D.L. Peterson Trust:		
Total assets held for sale	**$**	3,202

Total liabilities held for sale		2,868
FLRT and PHH Lease Receivables LP:		
Total assets held for sale	$	651
Total liabilities held for sale		603

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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.

In the third quarter of 2014, as discussed in Note 13, Stock-Related Matters , the Company entered into two separate Accelerated Share Repurchase agreements to repurchase an aggregate of $200 million of PHH s Common stock. The initial delivery of shares resulted in an immediate 6,962,695 reduction of the outstanding shares used to calculate the weighted-average common shares outstanding for basic and diluted earnings or loss per share on the effective date of the agreement.

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 issuance of the Convertible notes due 2014 and the related purchased options as they were required to be settled in cash, which matured and expired, respectively, on September 1, 2014. Shares associated with anti-dilutive securities are outlined in the table below.

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(In millions, except share and per share data)			
(Loss) income from continuing operations, net of tax	$ (85)	$ (63)	$ (154)	$ 71
Less: net income attributable to noncontrolling interest	3	6	5	30
Net (loss) income from continuing operations attributable to PHH Corporation	(88)	(69)	(159)	41
Income from discontinued operations, net of tax	303	17	273	49
Net income (loss) attributable to PHH Corporation	$ 215	$ (52)	$ 114	$ 90
Weighted-average common shares outstanding basic	53,781,049	57,383,139	56,307,165	57,318,131
Effect of potentially dilutive securities:				
Share-based payment arrangements(1)				207,572
Conversion of debt securities				7,977,723
Weighted-average common shares outstanding diluted	53,781,049	57,383,139	56,307,165	65,503,426
Basic earnings (loss) per share:				
From continuing operations	$ (1.64)	$ (1.19)	$ (2.83)	$ 0.73
From discontinued operations	5.64	0.29	4.86	0.85
Total attributable to PHH Corporation	$ 4.00	$ (0.90)	$ 2.03	$ 1.58
Diluted earnings (loss) per share:				
From continuing operations	$ (1.64)	$ (1.19)	$ (2.83)	$ 0.64
From discontinued operations	5.64	0.29	4.86	0.74
Total attributable to PHH Corporation	$ 4.00	$ (0.90)	$ 2.03	$ 1.38

(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 September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Outstanding stock-based compensation awards(1)	1,575,780	2,037,307	1,575,780	688,338
Assumed conversion of debt securities	8,794,619	8,274,740	9,124,934	

(1) For both the three and nine months ended September 30, 2014, excludes 619,398 shares that are contingently issuable for which the contingency has not been met.

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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 $226.0 billion and $226.8 billion, as of September 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.

Beginning in the fourth quarter of 2013, the Company has agreements to sell a portion of its newly-created Mortgage servicing rights to third parties, and will have continuing involvement as subservicer. During the nine months ended September 30, 2014, sales with a fair value of $26 million were completed under the terms of these arrangements. As of September 30, 2014, the Company had commitments to sell servicing rights related to $743 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. The Company also has commitments to sell servicing rights related to $1.1 billion of unpaid principal balance of mortgage loans with a fair value of $13 million that were included in the capitalized servicing portfolio as of September 30, 2014.

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

	Nine Months Ended September 30,			
		2014		2013
	(In millions)			
Balance, beginning of period	$	129,145	$	140,381
Additions		6,986		19,031
Payoffs, sales and curtailments		(16,330)		(28,254)
Balance, end of period	$	119,801	$	131,158

The activity in capitalized MSRs consisted of:

Nine Months Ended

	September 30, 2014	September 30, 2013
	(In millions)	
Balance, beginning of period	$ 1,279	$ 1,022
Additions	76	209
Sales	(26)	
Changes in fair value due to:		
Realization of expected cash flows	(118)	(220)
Changes in market inputs or assumptions used in the valuation model	(97)	226
Balance, end of period	$ 1,114	$ 1,237

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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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In millions)			
Servicing fees from capitalized portfolio	$ 88	$ 95	$ 270	$ 294
Late fees	5	5	13	14
Other ancillary servicing revenue	6	12	22	31

As of September 30, 2014 and December 31, 2013, the MSRs had a weighted-average life of 6.1 years and 6.5 years, respectively. See Note 15, 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:

	Nine Months Ended September 30,	
	2014	2013
	(In millions)	
Proceeds from new loan sales or securitizations	$ 7,205	$ 19,401
Servicing fees from capitalized portfolio(1)	270	294
Purchases of delinquent or foreclosed loans (2)	(24)	(50)
Servicing advances (3)	(1,507)	(1,003)
Repayment of servicing advances (3)	1,487	946

(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 September 30, 2014 and December 31, 2013, outstanding servicing advance receivables of $573 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 nine months ended September 30, 2014, pre-tax gains of $73 million and $218 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 nine months ended September 30, 2013, pre-tax gains of $214 million and $642 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

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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The following table summarizes the gross notional amount of derivatives:

	September 30, 2014	December 31, 2013
	(In millions)	
Notional amounts:		
Interest rate lock commitments	$ 1,363	$ 1,378
Forward delivery commitments	4,769	4,527
Option contracts	100	190
MSR-related agreements	4,011	860
Convertible note-related agreements(1)		

(1) As of December 31, 2013, the notional amount of derivative instruments underlying the Convertible-note related agreements was 9.6881 million shares of the Company s Common stock related to the issuance of the Convertible notes due 2014. These instruments expired in September 2014, consistent with the repayment date of the Convertible note series.

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

	September 30, 2014			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$ 3	$ (3)	$	$
MSR-related agreements	28		(25)	3
Derivative assets subject to netting	31	(3)	(25)	3
Not subject to master netting arrangements:				
Interest rate lock commitments	21			21
Forward delivery commitments	3			3
Derivative assets not subject to netting	24			24
Total derivative assets	$ 55	$ (3)	$ (25)	$ 27

	Gross Liabilities	Offsetting Receivables	Cash Collateral Received	Net Amount
	(In millions)			
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 4	$ (3)	$	$ 1

Not subject to master netting arrangements:									
Forward delivery commitments		1							1
Total derivative liabilities	$	5	$	(3)	$		$		2

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	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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
		(In millions)		
Gain on mortgage loans, net:				
Interest rate lock commitments	$ 63	$ 136	$ 232	$ 405
Forward delivery commitments		(22)	(59)	217
Option contracts		(1)	(3)	17
Net derivative gain (loss) related to mortgage servicing rights:				

MSR-related agreements	26	(17)

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6. Other Assets

Other assets consisted of:

	September 30, 2014		December 31, 2013
	(In millions)		
Mortgage loans in foreclosure, net	$	166	$ 172
Repurchase eligible loans(1)		80	94
Real estate owned, net		51	51
Equity method investments		35	37
Derivatives		27	46
Deferred financing costs		17	26
Other		14	24
Total	$	390	$ 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:

	September 30, 2014	December 31, 2013
	(In millions)	
Income taxes payable(1)	$ 477	$
Subservicing advance liabilities	333	302
Accounts payable	94	98
Repurchase eligible loans	80	94

Accrued payroll and benefits		76		62
Accrued interest		10		26
Other		2		1
Total	$	1,072	$	583

(1) As of September 30, 2014, the balance reflects tax liabilities associated with the disposition of the Fleet business that were partially offset by a benefit for income taxes related to the loss from continuing operations during 2014.

8. Other Liabilities

Other liabilities consisted of:

		September 30, 2014		December 31, 2013
		(In millions)		
Loan repurchase and indemnification liability	$	68	$	100
Litigation and regulatory reserves		23		2
Pension and other post employment benefits liability		5		7
Derivatives		2		20
Capital lease obligation		2		7
Other		14		14
Total	$	114	$	150

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. Debt and Borrowing Arrangements

The following table summarizes the components of Debt:

	September 30, 2014			December 31, 2013		
	Balance		Wt. Avg- Interest Rate(1)	Balance		Wt. Avg- Interest Rate(1)
			(In millions)			
Committed warehouse facilities	$	625	2.2 %	$	709	2.1 %
Uncommitted warehouse facilities			%			%
Servicing advance facility		118	2.7 %		66	2.7 %
Mortgage Asset-Backed Debt		743			775	
Term notes		625	6.8 %		795	7.3 %
Convertible notes(2)		212	6.0 %		454	5.0 %
Unsecured credit facilities			%			%
Unsecured Debt		837			1,249	
Total	$	1,580		$	2,024	

(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 $33 million and $46 million as of September 30, 2014 and December 31, 2013, respectively. The effective interest rate of the Convertible notes is 13.0%, 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 September 30, 2014 consisted of:

	Warehouse Facilities		Servicing Advance Facility	
	(In millions)			
Restricted cash	$	6	$	4
Accounts receivable				172
Mortgage loans held for sale (unpaid principal balance)		662		
Total	$	668	$	176

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

	Mortgage