PHH CORP
Form 10-Q
November 09, 2016
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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, 2016

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 November 3, 2016, 53,599,433 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 Maryland corporation, and its subsidiaries.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

our expectations related to our strategic review and related actions, including the estimated impacts on our results, the timing of any such actions, our estimates of transaction or exit costs and any other anticipated impacts on our results, client relationships or expected value to shareholders;
our assessment of our private label channel and our strategy to exit this business, including our expectation of exit costs;
the expected impacts of changes to certain client relationships on our subservicing portfolio and results;
our expectations of preserving balance sheet value through an effective MSR hedging program;
anticipated future origination volumes and loan margins in the mortgage industry;
our expectations of the impacts of regulatory changes on our business;
our assessment of legal and regulatory proceedings and the associated impact on our financial statements;
our expectations around future losses from representation and warranty claims, and associated reserves and provisions; and
the impact of the adoption of recently issued accounting pronouncements on our financial statements.
Actual results, performance or achievements may differ materially from those expressed or implied in forward-looking statements due to a variety of factors, including but not limited to the factors listed and discussed in “Part II—Item 1A. Risk Factors” in this Form 10-Q, and “Part I—Item 1A. Risk Factors” in our 2015 Form 10-K and those factors described below:
the effects of our comprehensive review of all strategic options and any transaction that may result on our business, management resources, customer and employee relationships, and financial position;
our ability to complete our strategic priorities and implement changes to meet our operational and financial objectives;
the effects of any declines in origination volumes sourced from our private label client relationships or joint venture with Realogy Corporation, driven by our clients' actions, business strategies or otherwise;
the effects of any termination of our subservicing agreements by any of our largest subservicing clients or on a material portion of our subservicing portfolio;
the effects of market volatility or macroeconomic changes and financial market regulations on the availability and cost of our financing arrangements, the value of our assets and the housing market;
the effects of changes in current interest rates on our business, the value of our mortgage servicing rights and our financing costs;
our decisions regarding the use of derivatives and hedge strategies related to our mortgage servicing rights;
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;

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the effects of any significant adverse changes in the underwriting criteria or the existence or programs of government-sponsored entities, such as 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, and our ability to operationalize changes necessary to comply with updates to such guides and programs;
the effects of changes in, or our failure to comply with, laws and regulations, including mortgage- and real estate-related laws and regulations and those that we are exposed to through our private label relationships;
the effects of the outcome or resolutions of any inquiries, investigations or appeals related to our mortgage origination or servicing activities, any litigation related to our mortgage origination or servicing activities, or any related fines, penalties and increased costs, and the associated impact on our liquidity;
the ability to maintain our relationships with our existing clients, including our ability to comply with the terms of our private label and subservicing client agreements and any related service level agreements;
the inability or unwillingness of any of the counterparties to our significant customer contracts, hedging agreements, or financing arrangements to perform their respective obligations under such contracts, or to renew on terms favorable to us;
the impacts of our credit ratings, including the impact on our cost of capital and ability to access the debt markets, as well as on our current or potential customers' assessment of our long-term stability;
the ability to obtain or renew financing on acceptable terms, if at all, to finance our mortgage loans held for sale and servicing advances, or to fund our strategies;
the ability to operate within the limitations imposed by our financing arrangements and to maintain or generate the amount of cash required to service our indebtedness and operate our business;
any failure to comply with covenants or asset eligibility requirements under our financing arrangements; and
the effects of any failure in or breach of our technology infrastructure, or those of our outsource providers, or any failure to implement changes to our information systems in a manner sufficient to comply with applicable laws, regulations and our contractual obligations.

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

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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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
REVENUES				
Origination and other loan fees	$75	$75	$215	$220
Gain on loans held for sale, net	87	69	212	237
Net loan servicing income:				
Loan servicing income	89	94	271	298
Change in fair value of mortgage servicing rights	(46)	(115)	(272)	(123)
Net derivative (loss) gain related to mortgage servicing rights	(4)	50	139	54
Net loan servicing income	39	29	138	229
Net interest expense:				
Interest income	11	13	32	35
Secured interest expense	(8)	(9)	(24)	(27)
Unsecured interest expense	(10)	(11)	(31)	(44)
Net interest expense	(7)	(7)	(23)	(36)
Other income	3	3	8	17
Net revenues	197	169	550	667
EXPENSES				
Salaries and related expenses	86	79	268	251
Commissions	19	19	49	65
Loan origination expenses	18	23	52	72
Foreclosure and repossession expenses	10	11	26	41
Professional and third-party service fees	35	39	111	126
Technology equipment and software expenses	10	9	30	28
Occupancy and other office expenses	11	15	35	39
Depreciation and amortization	4	4	13	13
Other operating expenses	33	57	64	162
Total expenses	226	256	648	797
Loss before income taxes	(29)	(87)	(98)	(130)
Income tax benefit	(8)	(40)	(38)	(50)
Net loss	(21)	(47)	(60)	(80)
Less: net income attributable to noncontrolling interest	6	3	9	11
Net loss attributable to PHH Corporation	$(27)	$(50)	$(69)	$(91)
Basic and Diluted loss per share attributable to PHH Corporation	$(0.50)	$(0.84)	$(1.28)	$(1.68)

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,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	$(21)	$(47)	$(60)	$(80)
Other comprehensive income, net of tax:				
Change in unfunded pension liability, net	1	—	1	1
Total other comprehensive income, net of tax	1	—	1	1
Total comprehensive loss	(20)	(47)	(59)	(79)
Less: comprehensive income attributable to noncontrolling interest	6	3	9	11
Comprehensive loss attributable to PHH Corporation	$(26)	$(50)	$(68)	$(90)

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	September 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 996	$ 906
Restricted cash	50	47
Mortgage loans held for sale	761	743
Accounts receivable, net	89	81
Servicing advances, net	668	691
Mortgage servicing rights	645	880
Property and equipment, net	50	47
Other assets	187	247
Total assets [1]	$ 3,446	$ 3,642
LIABILITIES		
Accounts payable and accrued expenses	$ 200	$ 251
Subservicing advance liabilities	318	314
Debt	1,332	1,348
Deferred taxes	117	182
Loan repurchase and indemnification liability	65	62
Other liabilities	154	137
Total liabilities [1]	2,186	2,294
Commitments and contingencies (Note 10)		
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; 53,585,565 shares issued and outstanding at September 30, 2016; 55,007,983 shares issued and outstanding at December 31, 2015	1	1
Additional paid-in capital	885	911
Retained earnings	347	416
Accumulated other comprehensive loss[2]	(9)	(10)
Total PHH Corporation stockholders' equity	1,224	1,318
Noncontrolling interest	36	30
Total equity	1,260	1,348
Total liabilities and equity	$ 3,446	$ 3,642

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 and liabilities of variable interest entities. The assets can be used only to settle the obligations of the variable interest entities, and the liabilities have creditors or beneficial interest holders that do not have recourse to PHH Corporation and subsidiaries. These assets and liabilities are as follows:

	September 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 61	$ 80
Restricted cash	20	18
Mortgage loans held for sale	436	389
Accounts receivable, net	26	5
Servicing advances, net	153	157
Property and equipment, net	1	1
Other assets	19	12
Total assets	$ 716	$ 662
LIABILITIES		
Accounts payable and accrued expenses	$ 15	$ 14
Debt	486	456
Other liabilities	6	6
Total liabilities	$ 507	$ 476

(2) Includes amounts recorded related to the Company’s defined benefit pension plan, net of income tax benefits of $6 million as of both September 30, 2016 and December 31, 2015. During both the three and nine months ended September 30, 2016 and September 30, 2015, there were no amounts reclassified out of Accumulated other comprehensive loss.

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				Accumulated		
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Nine Months Ended September 30, 2016							
Balance at December 31, 2015	55,007,983	$ 1	$ 911	$ 416	$ (10)	$ 30	$ 1,348
Total comprehensive (loss) income	—	—	—	(69)	1	9	(59)
Distributions to noncontrolling interest	—	—	—	—	—	(3)	(3)
Stock compensation expense	—	—	6	—	—	—	6
Stock issued under share-based payment plans (includes $9 benefit from excess tax shortfall)	86,354	—	(9)	—	—	—	(9)
Repurchase of Common stock	(1,508,772)	—	(23)	—	—	—	(23)
Balance at September 30, 2016	53,585,565	$ 1	$ 885	$ 347	$ (9)	$ 36	$ 1,260
Nine Months Ended September 30, 2015							
Balance at December 31, 2014	51,143,723	$ 1	$ 989	$ 566	$ (11)	$ 26	$ 1,571
Total comprehensive (loss) income	—	—	—	(91)	1	11	(79)
Distributions to noncontrolling interest	—	—	—	—	—	(5)	(5)
Stock compensation expense	—	—	7	—	—	—	7
Stock issued under share-based payment plans	202,901	—	2	—	—	—	2
Repurchase of Common stock	(1,574,252)	(1)	5	(5)	—	—	(1)
Conversion of Convertible Notes	10,075,653	1	(19)	—	—	—	(18)
Recognition of deferred taxes related to Convertible notes	—	—	2	—	—	—	2
Balance at September 30, 2015	59,848,025	$ 1	$ 986	$ 470	$ (10)	$ 32	$ 1,479

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, 2016	2015
Cash flows from operating activities:		
Net loss	$ (60)	$ (80)
Adjustments to reconcile Net loss to net cash used in operating activities:		
Capitalization of originated mortgage servicing rights	(45)	(80)
Net loss on mortgage servicing rights and related derivatives	133	69
Loss on early extinguishment of debt	—	30
Origination of mortgage loans held for sale	(7,848)	(10,910)
Proceeds on sale of and payments from mortgage loans held for sale	8,029	11,245
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(219)	(218)
Depreciation and amortization	13	13
Deferred income tax benefit	(75)	(54)
Other adjustments and changes in other assets and liabilities, net	92	44
Net cash provided by operating activities	20	59
Cash flows from investing activities:		
Net cash received on derivatives related to mortgage servicing rights	121	49
Proceeds on sale of mortgage servicing rights	7	45
	(13)	(25)

Purchases of property and equipment				
(Increase) decrease in restricted cash	(3	)	13	
Other, net	5		2	
Net cash provided by investing activities	117		84	
Cash flows from financing activities:				
Proceeds from secured borrowings	9,301		13,845	
Principal payments on secured borrowings	(9,319	)	(13,978	)
Principal payments on unsecured borrowings	—		(245	)
Cash tender premiums for convertible debt	—		(30	)
Repurchase of Common stock	(23	)	—	
Cash paid for debt issuance costs	(3	)	(6	)
Distributions to noncontrolling interest	(3	)	(5	)
Issuances of Common stock	—		2	
Other, net	—		(3	)
Net cash used in financing activities	(47	)	(420	)
Net increase (decrease) in Cash and cash equivalents	90		(277	)
Cash and cash equivalents at beginning of period	906		1,259	
Cash and cash equivalents at end of period	$ 996		$ 982	

See accompanying Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization

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

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

Preparation of Financial Statements

The Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. In management’s opinion, the unaudited Condensed Consolidated Financial Statements contain all adjustments, which include normal and recurring adjustments, necessary for a fair presentation of the financial position and results of operations for the interim periods presented. The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Company’s 2015 Form 10-K.

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

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

Changes in Accounting Pronouncements

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 Company adopted this guidance prospectively as of January 1, 2016, and there was no impact to the Company's financial statements.

Consolidation. In February 2015, the FASB issued ASU 2015-02, “Amendments to the Consolidation Analysis.” The update impacts an entity’s consolidation analysis of its variable interest entities, particularly those that have fee arrangements and related party relationships. The update eliminates certain conditions for evaluating whether a fee paid to a decision maker or a service provider represents a variable interest, and places more emphasis in the evaluation of variable interests other than fee arrangements. Additionally, the amendments reduce the extent to which related party arrangements cause an entity to be considered a primary beneficiary. This guidance was adopted retrospectively as of January 1, 2016, and the Company updated its consolidation analyses for relevant entities. The adoption of this update did not change any consolidation conclusions, and there was no impact to the Company's financial statements or disclosures.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Interest. In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs" which requires that debt issuance costs related to a recognized debt liability be presented in the Balance Sheets as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. In August 2015, the FASB issued ASU 2015-15, "Presentation and Subsequent Measurement of Debt Issue Costs Associated with Line-of-Credit Arrangements" which states that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

The Company adopted this guidance retrospectively as of January 1, 2016 which resulted in a $10 million decrease to both Other assets and Debt in the Condensed Consolidated Balance Sheets as of December 31, 2015. The Company elected not to reclass debt issuance costs related to line-of-credit and mortgage warehouse arrangements, which continue to be presented in Other assets for all periods. The adoption of this standard did not impact the Company's results of operations or cash flows.

Intangibles—Goodwill and Other—Internal-Use Software. In April 2015, the FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." This update clarifies whether a cloud computing arrangement should be accounted for as a software license or as a service contract by the customer, depending on the terms of the arrangement. In addition, the guidance requires all software licenses within the scope of the internal use software subtopic to be accounted for consistent with other licenses of intangible assets. The Company adopted this guidance prospectively to all arrangements entered into or materially modified after January 1, 2016. The adoption of this standard did not have an impact to the Company's financial statements.

Recently Issued Accounting Pronouncements

Financial Instruments. In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." This update revises an entity's accounting related to the classification and measurement of investments in equity securities (except those accounted for under the equity method of accounting or those that result in consolidation of the investee), changes the presentation of certain fair value changes relating to instrument specific credit risk for financial liabilities and amends certain disclosure requirements associated with the fair value of financial instruments. This update is effective for the first interim and annual periods beginning after December 15, 2017 with early adoption permitted for certain provisions of the update. The Company is currently evaluating the impact of adopting this new standard.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This standard is applicable to financial instruments not accounted for at fair value, including but not limited to, trade receivables and off-balance sheet credit exposures. This update is effective for the first interim and annual periods beginning after December 15, 2019, with early adoption permitted for fiscal years beginning after December 15, 2018. At adoption, this update will be applied using a modified retrospective approach. The Company is currently evaluating the impact of adopting this new standard.

Leases. In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This update revises an entity's accounting for operating leases by a lessee, among other changes, and requires a lessee to recognize a liability to make lease payments and an asset representing its right to use the underlying asset for the lease term in the statement of financial position. The distinction between finance and operating leases has not changed and the update does not

significantly change the effect of finance and operating leases on the statement of comprehensive income and the statement of cash flows. Additionally, this update requires both qualitative and specific quantitative disclosures. This update is effective for the first interim and annual periods beginning after December 15, 2018, with early adoption permitted. At adoption, this update will be applied using a modified retrospective approach. The Company is currently evaluating the impact of adopting this new standard.

Derivatives and Hedging.   In March 2016, the FASB issued ASU 2016-06, “Contingent Put and Call Options in Debt Instruments.” This update clarifies that in assessing whether an embedded contingent put or call option is clearly and closely related to the debt host, an entity is required to perform only a specific four-step decision sequence. An entity is no longer required to assess whether the contingency for exercising the option is indexed to interest rate or credit risk. This update is effective for the first interim and annual periods beginning after December 15, 2016, with early adoption permitted. At adoption, this update will be applied using a modified retrospective approach. The Company is currently evaluating the impact of adopting this new standard.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Revenue Recognition. The FASB has issued several amendments to the new revenue standard ASU 2014-09 (as amended by ASU 2015-14), including:

- ASU 2016-08, “Principal Versus Agent Considerations (Reporting Revenue Gross versus Net).” The amendments to this update were issued in March 2016 and are intended to improve the implementation guidance on principal versus agent considerations in ASU 2014-09 by clarifying how an entity should identify the unit of accounting (i.e. the specified good or service) and how an entity should apply the control principle to certain types of arrangements.
- ASU 2016-10, “Identifying Performance Obligations and Licensing.” The amendments to this update were issued in April 2016 and are intended to improve the implementation guidance on identifying performance obligations by reducing the cost and complexity of identifying promised goods or services and improving the guidance for determining whether promises are separately identifiable. The amendments also provide implementation guidance on accounting for licenses of intellectual property.
- ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients." The amendments to this update were issued in May 2016 and clarify certain core recognition principles and provide practical expedients available at transition. The improvements address collectability, sales tax presentation, noncash consideration, contract modifications and completed contracts at transition.

Consistent with ASU 2014-09 (as amended by ASU 2015-14), these updates are to be applied retrospectively to all prior periods presented or through a cumulative adjustment in the year of adoption, and are effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Company does not expect to early adopt the revenue standard amendments and is currently evaluating the impact of adoption.

Share-Based Payments. In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting." This update is intended to simplify several aspects of the accounting for share-based payment transactions, including accounting for income taxes, the classification of awards as either equity or liabilities and the classification of excess tax benefits and payments for tax withholdings on the statement of cash flows. This update is effective for the first interim and annual periods beginning after December 15, 2016, with early adoption permitted. At adoption, this update will be applied either prospectively, retrospectively or by using a modified retrospective approach, depending on the area of change. The Company is currently evaluating the impact of adopting this new standard.

Statement of Cash Flows. In August 2016, the FASB issued ASU 2016-15, “Classification of Certain Cash Receipts and Cash Payments." This update addresses eight specific cash flow issues and is intended to reduce diversity in practice in how entities present and classify certain cash receipts and cash payments in the statement of cash flows. This update is effective for the first interim and annual periods beginning after December 15, 2017, with early adoption permitted. At adoption, this update will be applied retrospectively. For issues that are impracticable to apply retrospectively, the amendments may be applied prospectively from the earliest date practicable. The Company is currently evaluating the impact of adopting this new standard.

Consolidation. In October 2016, the FASB issued ASU 2016-17, "Interests Held through Related Parties That Are under Common Control." This update requires an entity to include indirect interest held through related parties that are under common control on a proportionate basis when evaluating if a reporting entity is the primary beneficiary of a variable interest entity. This update is effective for the first interim and annual periods beginning after December 15, 2016, with early adoption permitted. At adoption, this update will be applied retrospectively. The Company is currently evaluating the impact of adopting this new standard.

2. 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 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 by the weighted-average number of shares outstanding during the period, assuming all potentially dilutive common shares were issued. Share repurchases or issuances are included in the outstanding shares as of each settlement date.

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 excludes the effect of securities that would be anti-dilutive. Anti-dilutive securities may include: (i) outstanding stock-based compensation awards representing shares from restricted stock units and stock options; and (ii) stock assumed to be issued related to convertible notes.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Weighted-average common shares outstanding includes the following activity:

- the repurchase of 1,508,772 shares during January 2016 under an open market repurchase program;
- the issuance of 10,075,653 shares during June 2015 which represented the amount by which the conversion value exceeded the note principal under an exchange offer of certain convertible debt; and
- the receipt and retirement of 1,574,252 shares during March 2015 which represented the final delivery of shares under accelerated repurchase programs.

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,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions, except share and per share data)			
Net loss attributable to PHH Corporation	$ (27)	$ (50)	$ (69)	$ (91)
Weighted-average common shares outstanding — basic & diluted	53,578,044	59,830,544	53,616,463	54,078,072
Basic and Diluted loss per share attributable to PHH Corporation	$ (0.50)	$ (0.84)	$ (1.28)	$ (1.68)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Outstanding stock-based compensation awards[1]	1,971,055	1,386,775	1,971,055	1,386,775
Assumed conversion of debt securities	—	7,001	—	5,804,349

(1) For the three and nine months ended September 30, 2016, excludes 383,400 shares that are contingently issuable for which the contingency has not been met.

3. Transfers and Servicing of Mortgage Loans

Residential mortgage loans are sold through one of the following methods: (i) sales to or pursuant to programs sponsored by Fannie Mae, Freddie Mac and the Government National Mortgage Association (collectively, the “Agencies”) or (ii) sales to private investors. The Company may have continuing involvement in mortgage loans sold by retaining mortgage servicing rights ("MSRs") and/or recourse obligations, as discussed further in Note 9, 'Credit Risk'.

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 $227.9 billion and $226.3 billion, as of September 30, 2016 and December 31, 2015, respectively. MSRs recorded in the Condensed Consolidated Balance Sheets are related to the capitalized servicing portfolio and are created primarily through sales of originated loans on a servicing-retained basis or through the direct purchase of servicing from a third party.

The approval or consents of the Agencies may be required prior to the Company completing sales of MSRs. In addition, as of September 30, 2016, 27% of the capitalized MSRs were specifically restricted from sale without prior approval from private label clients or private investors. The Company has agreements to sell a portion of its newly-created MSRs to third parties and will have continuing involvement as a subservicer. As of September 30, 2016, the Company had commitments to sell MSRs related to $109 million of the unpaid principal balance of Mortgage loans held for sale and Interest rate lock commitments that are expected to result in closed loans and $329 million of the unpaid principal balance of loans, with a fair value of MSRs of $4 million, that were included in the capitalized servicing portfolio. In November 2016, the Company entered into a commitment to sell an additional population of its MSRs, as discussed further in Note 14, 'Subsequent Events'.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Nine Months Ended September 30,	
	2016	2015
	(In millions)	
Balance, beginning of period	$98,990	$112,686
Additions	4,476	7,086
Payoffs and curtailments	(14,102)	(14,854)
Sales	(742)	(3,080)
Balance, end of period	$88,622	$101,838

The activity in capitalized MSRs consisted of:

	Nine Months Ended September 30,	
	2016	2015
	(In millions)	
Balance, beginning of period	$880	$1,005
Additions	45	80
Sales	(8)	(35)
Changes in fair value due to:		
Realization of expected cash flows	(98)	(132)
Changes in market inputs or assumptions used in the valuation model	(174)	9
Balance, end of period	$645	$927

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,	
	2016	2015	2016	2015
	(In millions)			
Servicing fees from capitalized portfolio	$67	$ 72	$204	$228
Late fees	3	4	11	11
Other ancillary servicing revenue	6	4	14	19

As of September 30, 2016 and December 31, 2015, the MSRs had a weighted-average life of 5.3 years and 6.4 years, respectively. See Note 11, 'Fair Value Measurements' for additional information regarding the valuation of MSRs.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2016	2015
	(In millions)	
Proceeds from new loan sales or securitizations	$4,647	$7,267
Servicing fees from capitalized portfolio [1]	204	228
Purchases of previously sold loans [2]	(232)	(124)
Servicing advances [3]	(1,217)	(1,576)
Repayment of servicing advances [3]	1,241	1,527

(1) Excludes late fees and other ancillary servicing revenue.
(2) Includes purchases of repurchase eligible loans and excludes indemnification payments to investors and insurers of the related mortgage loans.
(3) Outstanding servicing advance receivables are presented in Servicing advances, net in the Condensed Consolidated Balance Sheets, except for advances related to loans in foreclosure or real estate owned, which are included in Other assets.

During the three and nine months ended September 30, 2016, pre-tax gains of $77 million and $185 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on loans held for sale, net in the Condensed Consolidated Statements of Operations.

During the three and nine months ended September 30, 2015, pre-tax gains of $82 million and $231 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on loans held for sale, net in the Condensed Consolidated Statements of Operations.

4. Derivatives

Derivative instruments and the risks they manage are as follows:

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

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

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

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

The following table summarizes the gross notional amount of derivatives:

	September 30, 2016	December 31, 2015

	(In millions)	
Interest rate lock commitments	$1,591	$ 1,048
Forward delivery commitments	2,987	2,468
Option contracts	70	125
MSR-related agreements	4,867	3,945

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2016			
	Gross Assets	Offsetting Payables	Cash Collateral Paid	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$2	$ (2)	$ 1	$ 1
MSR-related agreements	44	(41)	19	22
Derivative assets subject to netting	46	(43)	20	23
Not subject to master netting arrangements:				
Interest rate lock commitments	47	—	—	47
Total derivative assets	$93	$ (43)	$ 20	$ 70

	Gross Liabilities	Offsetting Receivables	Cash Collateral Received	Net Amount
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 7	$ (7)	$ 1	$ 1
MSR-related agreements	1	(36)	39	4
Total derivative liabilities	$ 8	$ (43)	$ 40	$ 5

	December 31, 2015			
	Gross Assets	Offsetting Payables	Cash Collateral Received	Net Amount
	(In millions)			
ASSETS				
Subject to master netting arrangements:				
Forward delivery commitments	$2	$ (2)	$ —	$ —
MSR-related agreements	27	—	(23)	4
Derivative assets subject to netting	29	(2)	(23)	4
Not subject to master netting arrangements:				
Interest rate lock commitments	21	—	—	21
Forward delivery commitments	1	—	—	1
Derivative assets not subject to netting	22	—	—	22
Total derivative assets	$51	$ (2)	$ (23)	$ 26

	Gross Liabilities	Offsetting Receivables	Cash Collateral Received	Net Amount
LIABILITIES				
Subject to master netting arrangements:				
Forward delivery commitments	$ 2	$ (2)	$ 2	$ 2
Total derivative liabilities	$ 2	$ (2)	$ 2	$ 2

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2016	2015	2016	2015
	(In millions)			
Gain on loans held for sale, net:				
Interest rate lock commitments	$100	$81	$278	$216
Forward delivery commitments	(6)	(25)	(41)	(14)
Option contracts	—	—	(1)	(1)
Net derivative (loss) gain related to mortgage servicing rights:				
MSR-related agreements	(4)	50	139	54

5. Other Assets

Other assets consisted of:

	September 30, 2016	December 31, 2015
	(In millions)	
Derivatives	$ 70	$ 26
Repurchase eligible loans[(1)]	34	104
Equity method investments	32	32
Mortgage loans in foreclosure, net	21	24
Real estate owned, net	15	21
Income taxes receivable	—	23
Other	15	17
Total	$ 187	$ 247

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

6. Other Liabilities

Other liabilities consisted of:

	September 30, 2016	December 31, 2015
	(In millions)	
Legal and regulatory matters (Note 10)	$ 121	$ 105
Pension and other post-employment benefits	10	11

Income tax contingencies	10	9
Derivatives	5	2
Other	8	10
Total	$ 154	$ 137

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. Debt and Borrowing Arrangements

The following table summarizes the components of Debt:

	September 30, 2016			December 31, 2015
	Balance	Interest Rate[1]	Available Capacity[2]	Balance
	(In millions)			
Committed warehouse facilities	$628	2.7 %	$ 622	$ 632
Uncommitted warehouse facilities	—	— %	2,800	—
Servicing advance facility	97	2.5 %	58	111
Term notes due in 2019[3]	272	7.375%	n/a	271
Term notes due in 2021[3]	335	6.375%	n/a	334
Unsecured debt	607			605
Total	$1,332			$ 1,348

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

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

(3) Deferred issuance costs were reclassified from the prior year presentation in Other assets to a reduction in Unsecured debt.

Assets held as collateral that are not available to pay the Company's general obligations as of September 30, 2016 consisted of:

	Warehouse Facilities	Servicing Advance Facility
	(In millions)	
Restricted cash	$7	$ 15
Servicing advances	—	153
Mortgage loans held for sale (unpaid principal balance)	657	—
Total	$664	$ 168

The following table provides the contractual debt maturities as of September 30, 2016:

	Warehouse Facilities	Servicing Advance Facility[1]	Unsecured Debt	Total
	(In millions)			
Within one year	$628	$ 97	$ —	$725
Between one and two years	—	—	—	—
Between two and three years	—	—	275	275
Between three and four years	—	—	—	—

Between four and five years	—	—	340	340
Thereafter	—	—	—	—
	$628	$ 97	$ 615	$1,340

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

See Note 11, 'Fair Value Measurements' for the measurement of the fair value of Debt.

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Mortgage Warehouse Facilities

On March 29, 2016, the Company entered into a new committed mortgage repurchase facility of $100 million and an uncommitted mortgage repurchase facility of $100 million with Barclays Bank PLC. The expiration date of the committed facility is March 28, 2017.

On March 31, 2016, the committed mortgage repurchase facilities with Wells Fargo Bank were extended to April 2, 2017. On June 22, 2016, the facilities were returned to a $450 million capacity, after having been downsized in the March amendment.

On June 13, 2016, the committed mortgage repurchase facilities with Fannie Mae were reduced by $200 million to $300 million at the Company's request. The total combined committed and uncommitted mortgage repurchase facilities with Fannie Mae remains unchanged at $3 billion.

On June 17, 2016, the $250 million committed and $325 million uncommitted mortgage repurchase facilities with Credit Suisse expired and were not renewed.

Servicing Advance Facility

On June 15, 2016, PHH Service Advance Receivables Trust 2013-1, an indirect, wholly-owned subsidiary of the Company, extended the revolving period of the note purchase agreement with Wells Fargo Bank for the Series 2015-1 variable funding notes with an aggregate maximum principal amount of $155 million, by one year through June 15, 2017 and also extended the final maturity of the notes by one year to June 15, 2018. The notes bear interest, payable monthly, based on LIBOR plus an agreed-upon margin.

Debt Covenants

During 2016, profitability conditions precedent to borrowing in certain of the Company's mortgage repurchase facility agreements have been modified to exclude legal and regulatory provisions, while liquidity covenants have been enhanced to require that the Company maintain $150 million of cash and cash equivalents in excess of its liability for legal and regulatory matters. In addition, the mortgage repurchase facilities were amended to reduce the minimum tangible net worth covenants to $750 million from $1 billion and to introduce a covenant requiring the Company to maintain a ratio of unsecured indebtedness to tangible net worth of not more than 1.25 to 1.00. There were no other significant amendments to the terms of the debt covenants during the nine months ended September 30, 2016.

As of September 30, 2016, the Company was in compliance with all financial covenants related to its debt arrangements.

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8. Income Taxes

For the three and nine months ended September 30, 2016, interim income tax benefits were recorded using the discrete effective tax rate method. Management believes the use of the discrete method for this period is more appropriate than applying the full-year effective tax rate method due to the actual results for the nine months ended September 30, 2016 compared to the expected results for the full year and the sensitivity of the effective tax rate to small changes in forecasted annual pre-tax income or loss. Under the discrete method, the Company determines the tax provision based upon actual results as if the interim period were a full year period. The resulting effective tax rates for the three and nine months ended September 30, 2016 were (27.5)% and (39.1)%, respectively. The difference between the Company’s effective tax rate and the statutory 35% rate was primarily due to:

(i) state and local income taxes determined by the mix of income or loss from the operations by entity and state income tax jurisdiction;
(ii) a decrease in the valuation allowance driven by the utilization of state tax losses;
(iii) an increase in nondeductible expenses related to legal and regulatory matters; and
(iv) tax benefits related to income attributable to noncontrolling interests for which no taxes are provided.

For the three and nine months ended September 30, 2015, interim income tax benefits were recorded by applying a projected full-year effective income tax rate to the quarterly Loss before income taxes for results that are deemed to be reliably estimable. Certain results dependent on fair value adjustments are considered not to be reliably estimable, and therefore, discrete year-to-date income tax provisions are recorded on those results. The resulting effective tax rates for the three and nine months ended September 30, 2015 were (46.2)% and (38.8)%, respectively. The difference between the Company’s effective tax rate and the statutory 35% rate was primarily due to:

(i) state and local income taxes determined by the mix of income or loss from the operations by entity and state income tax jurisdiction;
(ii) an increase in nondeductible expenses related to legal and regulatory matters, premiums paid to exchange the Convertible notes due in 2017 and certain amounts of officer's compensation;
(iii) an increase in the valuation allowance driven by state tax losses generated and an increase in the non net operating loss deferred tax assets;
(iv) tax benefits related to income attributable to noncontrolling interests for which no taxes are provided; and
(v) adjustments to deferred tax items related to the sale of the Fleet business.

9. 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 and if the loans were originated in accordance with applicable underwriting standards, the Company may not have exposure to future risk of loss; however, in its capacity as a loan originator and servicer, the Company has exposure to loan repurchases and indemnifications through representation and warranty provisions and government servicing contracts.

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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:

	September 30, 2016	December 31, 2015
	(In millions)	
Loan Servicing Portfolio Composition		
Owned	$89,598	$ 99,869
Subserviced	138,285	126,390
Total	$227,883	$ 226,259
Conventional loans	$200,592	$ 197,971
Government loans	23,415	24,087
Home equity lines of credit	3,876	4,201
Total	$227,883	$ 226,259
Weighted-average interest rate	3.8 %	3.8 %

	September 30, 2016		December 31, 2015	
	Number of Loans	Unpaid Balance	Number of Loans	Unpaid Balance
Portfolio Delinquency [1]				
30 days	2.13%	1.47 %	2.22%	1.55 %
60 days	0.42	0.28	0.44	0.30
90 or more days	0.67	0.49	0.82	0.62
Total	3.22%	2.24 %	3.48%	2.47 %
Foreclosure/real estate owned [2]	1.62%	1.35 %	1.74%	1.51 %

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

(2) As of September 30, 2016 and December 31, 2015, the total servicing portfolio included 13,710 and 15,487 of loans in foreclosure with an unpaid principal balance of $2.7 billion and $3.0 billion, respectively.

Repurchase and Foreclosure-Related Reserves

Repurchase and foreclosure-related reserves are maintained for probable losses related to repurchase and indemnification obligations and for on-balance sheet loans in foreclosure and real estate owned. A summary of the activity in repurchase and foreclosure-related reserves is as follows:

	Nine Months Ended September 30, 2016	2015
	(In millions)	

Balance, beginning of period	$ 89	$ 93
Realized losses	(17)	(15)
Increase in reserves due to:		
Changes in assumptions	10	5
New loan sales	5	10
Balance, end of period	$ 87	$ 93

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Repurchase and foreclosure-related reserves consist of the following:

Loan Repurchases and Indemnifications

Liabilities for probable losses related to repurchase and indemnification obligations of $65 million and $62 million as of September 30, 2016 and December 31, 2015, respectively, are presented 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.

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 September 30, 2016, the estimated amount of reasonably possible losses in excess of the recorded liability was $35 million, which primarily relates to the Company's estimate of repurchase and foreclosure-related charges that may not be reimbursed pursuant to government mortgage insurance programs in the event we do not file insurance claims. The estimate is based on an expectation of future defaults and the historical defect rate for government insured loans and is based upon significant judgments and assumptions which can be influenced by many factors, including: (i) home prices and the levels of home equity; (ii) the quality of underwriting procedures; (iii) borrower delinquency and default patterns; and (iv) general economic conditions.

The liability from loan repurchases and indemnification requests does not reflect losses from litigation or governmental and regulatory examinations, investigations or inquiries. The maximum liability for future repurchase and indemnification requests, or the ranges of reasonably possible losses, cannot be estimated for the entire exposure for reasons including, but not limited to, the following:

- the Company does not service all of the loans for which it has provided representations and warranties;
- uncertainty related to loss exposure to loans from origination years where the Agencies have substantially completed or resolved their file reviews; and
- uncertainty related to losses associated with loans with defects that were excluded from the resolution agreement with Fannie Mae (which excludes loans with certain title defects or violations of law that were originated and delivered prior to July 1, 2012).

As of September 30, 2016, $172 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; 12% of which were at least 90 days delinquent (calculated based upon the unpaid principal balance of the loans).

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:

	September 30, 2016	December 31, 2015
	(In millions)	
Mortgage loans in foreclosure and related advances	$ 30	$ 34
Allowance for probable foreclosure losses	(9)	(10)
Mortgage loans in foreclosure, net	$ 21	$ 24

Real estate owned and related advances	$ 28	$ 38
Adjustment to value for real estate owned	(13)	(17)
Real estate owned, net	$ 15	$ 21

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10. Commitments and Contingencies

The Company and its subsidiaries are routinely, and currently, defendants in various legal proceedings that arise in the ordinary course of business, including class actions and other private and civil litigation. These proceedings are generally based on alleged violations of consumer protection laws (including the Real Estate Settlement Procedures Act ("RESPA")), employment laws and contractual obligations. Similar to other mortgage loan originators and servicers, the Company and its subsidiaries are also routinely, and currently, subject to government and regulatory examinations, investigations and inquiries or other requests for information. The resolution of these various legal and regulatory 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. In particular, legal proceedings brought under RESPA and other federal or state consumer protection laws that are ongoing, or may arise from time to time, may include the award of treble and other damages substantially in excess of actual losses, attorneys' fees, costs and disbursements, and other consumer and injunctive relief. These proceedings and matters are at varying procedural stages and the Company may engage in settlement discussions on certain matters in order to avoid the additional costs of engaging in litigation.

The outcome of legal and regulatory matters is difficult to predict or estimate and the ultimate time to resolve these matters may be protracted. In addition, the outcome of any legal proceeding or governmental and regulatory matter may affect the outcome of other pending legal proceedings or governmental and regulatory matters.

A liability is established for legal and regulatory contingencies 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, legal proceedings and other governmental and regulatory matters, 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.

As of September 30, 2016, the Company’s recorded liability associated with legal and regulatory contingencies was $121 million and is presented in Other liabilities in the Condensed Consolidated Balance Sheets. Given the inherent uncertainties and status of the Company’s outstanding legal proceedings, the range of reasonably possible losses cannot be estimated for all matters. For matters where the Company can estimate the range, the Company believes reasonably possible losses in excess of recorded liability may be up to $130 million in aggregate as of September 30, 2016.

There can be no assurance that the ultimate resolution of these matters will not result in losses in excess of the Company’s recorded liability, or in excess of the estimate of reasonably possible losses. As a result, the ultimate resolution of any particular legal matter, or matters, could be material to the Company’s results of operations or cash flows for the period in which such matter is resolved.

The following are descriptions of the Company’s significant legal and regulatory matters.

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

In June 2015, the Director of the CFPB issued a final order requiring the Company to pay $109 million, based upon the gross reinsurance premiums the Company received on or after July 21, 2008. Subsequently, the Company filed an appeal to the United States Court of Appeals for the District of Columbia Circuit (the "Court of Appeals").

In October 2016, the Court of Appeals issued its decision, vacating the decision of the Director of the CFPB, and finding in favor of the Company's arguments, among others, around the correct interpretations of Section 8 of RESPA, the applicability of prior HUD interpretations around captive re-insurance and the applicability of statute of limitations to administrative enforcement proceedings at the CFPB. The Court of Appeals remanded the case to the CFPB to determine the Company's compliance with provisions of RESPA specific to whether any mortgage insurers paid more than reasonable market value to the Company for reinsurance. The Company continues to believe that it has complied with RESPA and other laws applicable to its former mortgage reinsurance activities.
Given the nature of this matter and the current status, the Company cannot estimate the amount of loss, or a range of possible losses, if any, in connection with this matter.

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

In the second quarter of 2016, the New York Department of Financial Services (the "NYDFS") proposed terms for a consent order to close out pending examination report findings, including New York findings stemming from the MMC examination. The Company has reached an agreement in principle with the NYDFS on the terms of the consent order; however, the final consent order has not been executed by the NYDFS.

As of September 30, 2016, the Company included an estimate of probable losses in connection with the MMC and NYDFS matters in the recorded liability.

HUD Subpoenas. The Company has received document subpoenas from the Office of Inspector General of the U.S. Department of Housing and Urban Development (“HUD”) requesting production of certain documents related to, among other things, the Company’s origination and underwriting process for loans insured by the Federal Housing Administration (“FHA”) during the period between January 1, 2006 and December 31, 2011. As part of the investigation, HUD has also requested documents related to a small sample of loans originated during this period. This investigation could lead to a demand or claim under the False Claims Act, which allows for civil penalties and treble damages substantially in excess of actual losses. Several large mortgage originators that participate in FHA lending programs have been subject to similar investigations, which have resulted in settlement agreements that included the payment of substantial fines and penalties.

The Company has been cooperating in this investigation since its receipt of the subpoenas in 2013, and certain current and former employees of the Company have been deposed in connection with this matter. The Company is continuing its discussions with HUD about the ongoing investigation. As of September 30, 2016, the Company included an estimate of probable losses in connection with this matter in the recorded liability.

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, in November 2016, the Company reached agreement on all material terms to settle outstanding litigation relating to this matter. The settlement is subject to definitive documentation and court approval. The Company’s recorded estimate of probable losses as of September 30, 2016 for this matter was not materially different than the losses we expect to incur in connection with the resolution.

Other Subpoenas and Investigations. The Company has received document subpoenas from the U.S. Attorney’s Offices for the Southern and Eastern Districts of New York. The subpoenas requested production of certain documents related to, among other things: (i) foreclosure expenses that we incurred in connection with the foreclosure of loans insured or guaranteed by FHA, Fannie Mae or Freddie Mac and (ii) the origination and underwriting of loans

sold pursuant to programs sponsored by Fannie Mae, Freddie Mac or Ginnie Mae. In July 2016, the U.S. Attorney's Office for the Eastern District of New York requested production of additional documents responsive to the subpoenas. There can be no assurance that claims or litigation will not arise from these inquiries, or that fines and penalties, as well as other consumer or injunctive relief, will not be incurred in connection with any of these matters.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

11. Fair Value Measurements

The Company updates the valuation of each instrument recorded at fair value on a quarterly basis, evaluating all available observable information, which may include current market prices or bids, recent trade activity, changes in the levels of market activity and benchmarking of industry data. The assessment also includes consideration of identifying the valuation approach that would be used currently by market participants. If it is determined that a change in valuation technique or its application is appropriate, or if there are other changes in availability of observable data or market activity, the current methodology will be analyzed to determine if a transfer between levels of the valuation hierarchy is appropriate. Such reclassifications are reported as transfers into or out of a level as of the beginning of the quarter that the change occurs. There has been no change in the valuation methodologies and classification pursuant to the valuation hierarchy during the nine months ended September 30, 2016.

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 September 30, 2016 or December 31, 2015.

Recurring Fair Value Measurements

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

	September 30, 2016				
	Level One	Level Two	Level Three	Cash Collateral and Netting	Total
	(In millions)				
ASSETS					
Mortgage loans held for sale	$ —	$ 716	$ 45	$ —	$ 761
Mortgage servicing rights	—	—	645	—	645
Other assets—Derivative assets:					
Interest rate lock commitments	—	—	47	—	47
Forward delivery commitments	—	2	—	(1)	1
MSR-related agreements	—	44	—	(22)	22
LIABILITIES					
Other liabilities—Derivative liabilities:					
Forward delivery commitments	$ —	$ 7	$ —	$ (6)	$ 1
MSR-related agreements	—	1	—	3	4

	December 31, 2015				
	Level One	Level Two	Level Three	Cash Collateral and Netting	Total
	(In millions)				
ASSETS					
Mortgage loans held for sale	$ —	$ 704	$ 39	$ —	$ 743
Mortgage servicing rights	—	—	880	—	880
Other assets—Derivative assets:					
Interest rate lock commitments	—	—	21	—	21
Forward delivery commitments	—	3	—	(2)	1
MSR-related agreements	—	27	—	(23)	4

LIABILITIES				
Other liabilities—Derivative liabilities:				
Forward delivery commitments	$ — $ 2	$ —	$ —	$ 2

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Mortgage Loans Held for Sale ("MLHS"). The Company has elected to record MLHS at fair value which is intended to better reflect the underlying economics and eliminate the operational complexities of risk management activities and hedge accounting requirements. The following table reflects the difference between the carrying amounts of MLHS measured at fair value and the aggregate unpaid principal amount that the Company is contractually entitled to receive at maturity:

	September 30, 2016		December 31, 2015	
	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	$761	$ 8	$ 743	$ 9
Aggregate unpaid principal balance	753	11	738	11
Difference	$8	$ (3)	$ 5	$ (2)

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

	September 30, 2016	December 31, 2015
	(In millions)	
First mortgages:		
Conforming	$ 611	$ 616
Non-conforming	104	88
Total first mortgages	715	704
Second lien	3	4
Scratch and Dent	42	35
Other	1	—
Total	$ 761	$ 743

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

	Nine Months Ended September 30,	
	2016	2015
Initial capitalization rate of additions to MSRs	1.00%	1.13%

	September 30, 2016	December 31, 2015
Capitalization servicing rate	0.73 %	0.89 %
Capitalization servicing multiple	2.6	3.1
Weighted-average servicing fee (in basis points)	28	29

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

	September 30, 2016		December 31, 2015	
Weighted-average prepayment speed (CPR)	12.6	%	9.1	%
Option adjusted spread, in basis points (OAS)	987		977	
Weighted-average delinquency rate	5.5	%	5.3	%

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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:

	September 30, 2016		
	Weighted-Average Prepayment Speed	Option Adjusted Spread	Weighted-Average Delinquency Rate
	(In millions)		
Impact on fair value of 10% adverse change	$(32)	$ (26)	$ (18)
Impact on fair value of 20% adverse change	(62)	(50)	(35)

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

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

Derivative Instruments. Derivative instruments are classified within Level Two and Level Three of the valuation hierarchy. The average pullthrough percentage used in measuring the fair value of interest rate lock commitments (IRLCs) as of September 30, 2016 and December 31, 2015 was 76% and 74%, respectively. The pullthrough percentage is considered a significant unobservable input and is estimated based on changes in pricing and actual borrower behavior using a historical analysis of loan closing and fallout data. Actual loan pullthrough is compared to the modeled estimates in order to evaluate this assumption each period based on current trends. Generally, a change in interest rates is accompanied by a directionally opposite change in the assumption used for the pullthrough percentage, and the impact to fair value of a change in pullthrough would be partially offset by the related change in price.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Level Three Measurements

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

	Three Months Ended September 30, 2016			Three Months Ended September 30, 2015		
	MLHS	MSRs	IRLCs, net	MLHS	MSRs	IRLCs, net
	(In millions)					
Balance, beginning of period	$42	$679	$ 39	$48	$1,020	$ 22
Purchases, Issuances, Sales and Settlements:						
Purchases	3	—	—	7	—	—
Issuances	2	15	—	2	32	—
Sales	(6)	(3)	—	(15)	(10)	—
Settlements	(4)	—	(92)	(3)	—	(74)
	(5)	12	(92)	(9)	22	(74)
Realized and unrealized gains (losses) included in:						
Gain on loans held for sale, net	—	—	100	—	—	81
Change in fair value of MSRs	—	(46)	—	—	(115)	—
Interest income	—	—	—	1	—	—
	—	(46)	100	1	(115)	81
Transfers into Level Three	13	—	—	8	—	—
Transfers out of Level Three	(5)	—	—	(9)	—	—
Balance, end of period	$45	$645	$ 47	$39	$927	$ 29

	Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015		
	MLHS	MSRs	IRLCs, net	MLHS	MSRs	IRLCs, net
	(In millions)					
Balance, beginning of period	$39	$880	$ 21	$42	$1,005	$ 22
Purchases, Issuances, Sales and Settlements:						
Purchases	11	—	—	24	—	—
Issuances	5	45	—	4	80	—
Sales	(20)	(8)	—	(23)	(35)	—
Settlements	(9)	—	(252)	(8)	—	(209)
	(13)	37	(252)	(3)	45	(209)
Realized and unrealized gains (losses) included in:						
Gain on loans held for sale, net	—	—	278	1	—	216
Change in fair value of MSRs	—	(272)	—	—	(123)	—
Interest income	2	—	—	4	—	—
	2	(272)	278	5	(123)	216
Transfers into Level Three	33	—	—	23	—	—
Transfers out of Level Three	(16)	—	—	(28)	—	—
Balance, end of period	$45	$645	$ 47	$39	$927	$ 29

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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unrealized gains (losses) included in the Condensed Consolidated Statements 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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Gain on loans held for sale, net	$42	$27	$43	$ 26
Change in fair value of mortgage servicing rights	(9)	(72)	(174)	9

Fair Value of Other Financial Instruments

As of September 30, 2016 and December 31, 2015, all financial instruments were either recorded at fair value or the carrying value approximated fair value, with the exception of Debt. For financial instruments that were not recorded at fair value, such as Cash and cash equivalents, Restricted cash, Accounts receivable and Servicing advance receivables, the carrying value approximates fair value due to the short-term nature of such instruments.

Debt. As of both September 30, 2016 and December 31, 2015, the total fair value of Debt was $1.3 billion, and is measured using Level Two inputs. As of September 30, 2016, the fair value of Level Two Debt was estimated using the following valuation techniques: (i) $609 million 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) $725 million was measured using observable spreads and terms for recent pricing of similar instruments.

12. Variable Interest Entities

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

	September 30, 2016		December 31, 2015	
	PHH Home Loans	Servicing Advance Receivables Trust	PHH Home Loans	Servicing Advance Receivables Trust
	(In millions)			
ASSETS				
Cash	$61	$ —	$ 80	$ —
Restricted cash	5	15	5	13
Mortgage loans held for sale	436	—	389	—
Accounts receivable, net	26	—	5	—
Servicing advances, net	—	153	—	157
Property and equipment, net	1	—	1	—

Other assets	18	1	11	1
Total assets	$547	$ 169	$ 491	$ 171
Assets held as collateral	$411	$ 168	$ 361	$ 170
LIABILITIES				
Accounts payable and accrued expenses	$15	$ —	$ 14	$ —
Debt	388	98	345	111
Other liabilities	6	—	6	—
Total liabilities[1]	$409	$ 98	$ 365	$ 111

(1) Excludes intercompany payables.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

13. 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 loans originated by the Company and mortgage servicing rights purchased from others, and acts as a subservicer for certain clients that own the underlying mortgage servicing rights.

The Company's operations are located in the U.S. The heading Other includes expenses that are not allocated back to the two reportable segments. 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 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's noncontrolling interest in the profit or loss of PHH Home Loans.

Segment results were as follows:

	Total Assets	
	September 30, 2016	December 31, 2015
	(In millions)	
Mortgage Production segment	$1,062	$ 1,036
Mortgage Servicing segment	1,476	1,802
Other	908	804
Total	$3,446	$ 3,642

	Net Revenues			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Mortgage Production segment	$168	$149	$443	$460
Mortgage Servicing segment	29	20	107	201
Other	—	—	—	6
Total	$197	$169	$550	$667

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Segment Profit (Loss) [2]			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Mortgage Production segment	$22	$(10)	$9	$(26)
Mortgage Servicing segment	(52)	(77)	(106)	(66)
Other [1]	(5)	(3)	(10)	(49)
Total	$(35)	$(90)	$(107)	$(141)

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(1) For the nine months ended September 30, 2015, the net results for Other include a $30 million loss on the exchange of the Convertible notes due in 2017.

(2) The following is a reconciliation of Income or loss before income taxes to Segment profit or loss:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Loss before income taxes	$(29)	$(87)	$(98)	$(130)
Less: net income attributable to noncontrolling interest	6	3	9	11
Segment loss	$(35)	$(90)	$(107)	$(141)

14. Subsequent Events

GNMA MSR Portfolio Sale

On November 8, 2016, the Company entered into an agreement to sell substantially all of our Ginnie Mae ("GNMA") Mortgage servicing rights and related advances to Lakeview Loan Servicing. As of September 30, 2016, the unpaid principal balance of the GNMA MSR portfolio totaled $14.8 billion, and the fair value was $104 million, representing a 70 bps capitalized servicing rate. Servicing advance receivables that will be transferred under the sale agreement were $16 million as of September 30, 2016. This MSR sale agreement is subject to GNMA approval as well as approvals of certain loan origination sources. Approximately 30% of the GNMA MSR subject to this sale agreement requires the consent of an origination source prior to sale.

Based on the portfolio composition as of September 30, 2016, current market conditions and assuming the receipt of all required approvals, the expected proceeds from this sale are $122 million, excluding transaction and other related costs. The final proceeds received from this transaction are dependent on the portfolio composition and market conditions at each respective sale date and the aggregate amount of origination source consents received. Upon sale, the subservicing responsibilities with respect to the related mortgage loans will transfer to a successor subservicer appointed by the purchaser.

Exit of Private Label Services Channel

On November 8, 2016, the Company announced its plan to exit its private label solutions business channel. This business channel involves providing end-to-end origination services to financial institution clients, and represented 78% of the Company's total mortgage production volume (based on dollars) for the nine months ended September 30, 2016. The Company expects it will be in a position to substantially exit this channel by the first quarter of 2018, subject to transition support requirements, and estimates that it will incur pre-tax costs of $75 million to $105 million in connection with the exit, which includes severance and retention programs, facility-related exit costs, and other expected payments.

The Company did not recognize any amounts in the September 30, 2016 financial statements related to the plans to exit this business, as exit decisions were not completed until the fourth quarter of 2016.

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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 and our Condensed Consolidated Financial Statements and Part II—Item 1A. Risk Factors in this Form 10-Q and Part I—Item 1. Business, Part I—Item 1A. Risk Factors, Part II—Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements included in our 2015 Form 10-K.

We are a leading provider of end to end mortgage solutions. We operate 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 subservicer.

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

Results of Operations
Risk Management
Liquidity and Capital Resources
Critical Accounting Policies and Estimates
Recently Issued Accounting Pronouncements

Executive Summary

Strategic Review

In March 2016, we announced that our Board of Directors and management were undertaking a comprehensive review of all strategic options, including capital deployment alternatives, to maximize value for shareholders and that we had retained advisors to assist in the process. After the 2014 separation from the Fleet business, this strategic review was prompted by changing industry and regulatory dynamics impacting our business.

Over the course of our review process, we, with the assistance of our advisors, solicited initial indications of interest in our business from over 50 potentially interested parties. As part of the process, we evaluated, and continue to evaluate, several potential options, including but not limited to: (i) the sale of our individual business platforms and/or certain assets; (ii) potential business combinations to achieve greater scale; and (iii) operating as a smaller, more focused enterprise. Due to a number of factors, as an outcome of the process, we did not receive a definitive bid for the entire company nor have we identified any actionable attractive merger partner or acquisition target at the present time.

We, along with our Board of Directors and advisors, evaluated the interest in our business, narrowed the field to a competitive level, facilitated due diligence, and conducted several rounds of bids with the interested counterparties. Our guiding principle for evaluating alternatives has been, and continues to be, maximizing shareholder value, after considering execution risks.

We made substantial progress through the third quarter, and we have decided to take certain actions as a result of our strategic review process to include the sale of substantially all of our Ginnie Mae ("GNMA") MSR portfolio and the exit from the Private Label Solutions ("PLS") business. For our remaining businesses, we are continuing to engage in a comprehensive process to evaluate the best course of action. Further details on our strategic plans specific to each line of business follows:

- Agreement to Sell Mortgage Servicing Rights

In November 2016, we entered into an agreement to sell substantially all of our GNMA MSR portfolio and related advances to Lakeview Loan Servicing. As of September 30, 2016, the unpaid principal balance of loans in our GNMA MSR portfolio totaled $14.8 billion. Additionally, as of September 30, 2016, the fair value of our GNMA

MSRs was $104 million, representing a 70 bps capitalized servicing rate, and Servicing advance receivables related to the sale population were $16 million. The MSR sale agreement with Lakeview Loan Servicing is subject to GNMA approval as well as the approvals of certain loan origination sources. Approximately 70% of our GNMA MSR underlying this sale agreement is able to be sold without any origination source.

Based on the portfolio composition as of September 30, 2016, current market conditions, and assuming the receipt of all required approvals, the expected proceeds from this sale are $122 million, excluding transaction and other related costs.

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The final proceeds received from this transaction are dependent on the portfolio composition and market conditions at each respective sale date and the aggregate amount of origination source consents received.
We expect this sale of our GNMA MSR portfolio to close in a series of three transactions beginning in the first quarter 2017. Upon sale, the subservicing responsibilities with respect to the related mortgage loans will transfer to a successor subservicer appointed by the purchaser. We prioritized the sale of GNMA MSRs since it represents the least profitable component of our total MSR portfolio, has high inherent complexity, and due to more limited market demand for this MSR class.

We are continuing to evaluate possible additional sales of our remaining MSR assets, and will provide further updates on our progress when appropriate.

• Plan to Exit Private Label Channel
Our PLS business model has faced inherent difficulties in the current mortgage environment including escalating costs associated with regulatory oversight and compliance efforts and requirements to customize our products and service levels. In our strategic review of PLS, we considered industry, customer and regulatory trends, cost re-engineering opportunities and the potential for alternative business models.
After exhaustive consideration of the available alternatives, management and the Board of Directors believe there are insurmountable challenges to the long term viability of the PLS business model, due to the ever increasing regulatory demands and associated costs that have no prospects for moderating, the costs associated with both large and small clients’ need for customization to satisfy their unique business and compliance requirements, and the expectation for a shrinking market as clients are insourcing to gain greater control of their mortgage programs. We have determined that solving the complex business challenges of our PLS model is too uncertain, would require an extended period of time and would result in elevated level of operating losses over a prolonged period, and the best alternative is to exit the PLS business in the quickest and most cost effective way possible.
We are working with our PLS clients to help facilitate our exit from the business in the most cost effective manner possible, while continuing to satisfy our regulatory and contractual compliance requirements. We currently have exit plans in place with clients representing approximately 50% of our PLS volume (based on closing dollars for the nine months ending September 30, 2016, which includes the previously announced termination of the Merrill Lynch agreement). At this time, we believe we will be in a position to substantially exit the PLS business by the first quarter of 2018, subject to certain transition support requirements.
While we implement the exit from this business channel, we expect to incur pre-tax operating losses of approximately $100 million for PLS, including maintaining the support and compliance infrastructure needed to comply with both regulatory and contractual requirements. Further, we estimate we will incur $75 million to $105 million of additional costs (pre-tax) related to the exit of PLS over the next 18 months, which includes severance and retention programs, facility-related exit costs and other expected payments.

For discussion of risks related to the PLS exit, see “Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—Our decision to exit our Private Label client agreements will result in a decline in future revenues and will involve a significant amount of restructuring costs. Furthermore, there can be no assurances that such action will be as beneficial to shareholders as if we had not taken such action.” in this Form 10-Q.
We are working diligently and with a great sense of urgency to determine the best course of action for the remainder of our business, which includes our servicing platform and our Home Loans joint venture with Realogy Corporation. Through this process, we are evaluating multiple scenarios and a number of complexities, which include, but are not limited to, transaction, restructuring and execution costs, contractual and relationship arrangements, and strategies to optimize our tax position and preserve maximum tax benefits.
We expect to complete the strategic review process by the end of January 2017. At that time, we expect to provide more information with respect to the amount and timing of any shareholder distributions, and the path forward with respect to our MSRs and our remaining business platforms.

For discussion of risks related to our remaining business, see "Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—We have announced our intention to exit our Private Label Solutions business. Our remaining mortgage loan origination business is substantially dependent upon the Real Estate channel and our relationship with Realogy. The termination of our contractual agreements with Realogy would have a material adverse effect on our business, financial position, results of operations

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and cash flows." and "Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—The terms of a substantial portion of our subservicing agreements allow the owners of the servicing to terminate the subservicing agreement without cause, or to otherwise significantly decrease the number of loans we subservice on their behalf at any time.” in this Form 10-Q.

For discussion of risks related to the strategic review, see “Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—Our continued exploration of strategic options, and any actions resulting from the strategic review process, could materially and adversely affect our business, results of operations and cash flows, and there can be no assurance that such actions will be beneficial to our shareholders.” in this Form 10-Q.

Legal and Regulatory Matters

Our significant outstanding legal and regulatory matters at the end of the third quarter include matters with the Bureau of Consumer Financial Protection (the “CFPB”), a multistate coalition of certain mortgage banking regulators, the New York Department of Financial Services (the "NYDFS"), and the Office of the Inspector General of the U.S. Department of Housing and Urban Development. For the third quarter of 2016, we recorded an $11 million provision for all of our outstanding legal and regulatory matters based on recent developments and our current expectations.

In October 2016, the D.C. Circuit Court of Appeals overturned the Director of the CFPB's $109 million final order related to our former mortgage reinsurance activities, and remanded the case to the CFPB to determine our compliance with certain provisions of RESPA specific to whether any mortgage insurers paid more than reasonable market value to our reinsurance business. There was no significant impact to our results from this decision, as our recorded reserve for this matter was not material and had been substantially less than the Director's final order.

In November 2016, we reached an agreement in principle with the NYDFS on the terms of the consent order to close out pending examination report findings; however, the final consent order has not been executed by the NYDFS. Although there can be no assurances, we expect final resolution to be imminent and believe in any event that it will happen in the fourth quarter of 2016. At this time, we believe that any final consent order will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

For further information about these matters, see Note 10, 'Commitments and Contingencies' in the accompanying Notes to Condensed Consolidated Financial Statements and “Part I—Item 1A. Risk Factors—Legal and Regulatory Risks—We are subject to litigation and regulatory investigations, inquiries and proceedings, and we may incur fines, penalties, increased costs, and other consequences that could negatively impact our business, results of operations, liquidity and cash flows or damage our reputation." in our 2015 Form 10-K.

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RESULTS OF OPERATIONS

The following table presents our consolidated results of operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions, except per share data)			
Net revenues	$197	$169	$550	$667
Total expenses	226	256	648	797
Loss before income taxes	(29)	(87)	(98)	(130)
Income tax benefit	(8)	(40)	(38)	(50)
Net loss	(21)	(47)	(60)	(80)
Less: net income attributable to noncontrolling interest	6	3	9	11
Net loss attributable to PHH Corporation	$(27)	$(50)	$(69)	$(91)
Basic and Diluted loss per share attributable to PHH Corporation	$(0.50)	$(0.84)	$(1.28)	$(1.68)

Our financial results for the third quarter of 2016 reflect a performance consistent with our expectations, including an increase in refinancing volume, higher loan margins and MSR payoffs as a result of the decline in interest rates from a decline in 10-year Treasury yield in late June. The third quarter of 2016 also reflected the benefits of our completed cost and contract re-engineering in our private label channel. However, in the three months ending September 30, 2016, we incurred $7 million of costs related to our strategic evaluation.

We continued high hedge coverage on our MSR, resulting in minimal losses in MSR market-related fair value adjustments and related derivatives, of $13 million in the third quarter of 2016. While we continue to evaluate our strategic options, we are running the business in a manner that preserves the value of our balance sheet.

Going into 2017, we expect our results to be negatively impacted by our planned exit of the private label services channel, as discussed further in "Overview—Executive Summary—Strategic Review". We also expect declines in our subservicing revenues from Merrill Lynch and HSBC's intentions to insource or transfer subservicing units from our portfolio and declines in revenues due to reductions in our owned MSR asset, as discussed further in "—Mortgage Servicing". We are expecting higher levels of compliance-related costs to continue and are working to resolve our existing legal and regulatory matters, as discussed further in Note 10, 'Commitments and Contingencies' in the accompanying Notes to Condensed Consolidated Financial Statements.

Income Taxes. We recorded our interim tax benefit for 2016 using the discrete effective tax rate method due to actual results for the nine months ended September 30, 2016 as compared to the expected results for the full year and the sensitivity of the effective tax rate to small changes in forecasted results. For 2015, we recorded our interim tax benefit 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 not to be reliably estimable; therefore, we record discrete year-to-date income tax provisions on those results.

Our effective income tax rate for the nine months ended September 30, 2016 and 2015 was (39.1)% and (38.8)%, respectively. Our effective tax rates differ from our federal statutory rate of 35% primarily due to state tax provision, changes in the valuation allowance, income attributable to noncontrolling interest for which no taxes are provided, and nondeductible expenses for legal and regulatory matters and in 2015, for premiums paid to exchange the Convertible

notes due in 2017. See Note 8, 'Income Taxes' in the accompanying Notes to Condensed Consolidated Financial Statements.

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Revenues

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Origination and other loan fees	$75	$75	$215	$220
Gain on loans held for sale, net	87	69	212	237
Loan servicing income	89	94	271	298
Change in fair value of mortgage servicing rights, net of related derivatives	(50)	(65)	(133)	(69)
Net interest expense	(7)	(7)	(23)	(36)
Other income	3	3	8	17
Net revenues	$197	$169	$550	$667

Origination and other loan fees in the third quarter of 2016 was consistent with the third quarter of 2015 due to operating benefits from amendments to our private label agreements being fully offset by declines in overall origination volumes as compared to the third quarter of 2015.

Gain on loans held for sale, net from our Mortgage Production segment, increased by $18 million during the third quarter of 2016 resulting from a 69 basis point increase in average total loan margins, as interest rates declined during the quarter. The exit from wholesale/correspondent lending during the second quarter of 2016 resulted in a lower cost to acquire loans, which had a positive impact on Gain on loans. The increase in margins was partially offset by a 31% decline in IRLCs expected to close, reflecting the increased mix of fee-based closings (where we do not enter into an IRLC).

Loan servicing income for the third quarter of 2016 was lower by $5 million compared to the prior year quarter, primarily due to a 12% decrease in the average capitalized portfolio.

During the third quarter of 2016, we experienced $13 million of unfavorable MSR market-related fair value adjustments, net of related derivatives, driven by a flattening of the yield curve, while in the third quarter of 2015, we experienced $22 million of unfavorable net MSR hedge results, driven by a 28 basis point decrease in the modeled primary mortgage rate. Change in fair value of MSRs, net of related derivatives also included a $6 million favorable change in MSR valuation changes from actual prepayments of the underlying mortgage loans and actual receipts of recurring cash flows due to a decrease in the value of payoffs in our capitalized servicing portfolio and a lower average capitalized servicing rate as compared to the prior year quarter.

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Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Salaries and related expenses	$86	$79	$268	$251
Commissions	19	19	49	65
Loan origination expenses	18	23	52	72
Foreclosure and repossession expenses	10	11	26	41
Professional and third-party service fees	35	39	111	126
Technology equipment and software expenses	10	9	30	28
Occupancy and other office expenses	11	15	35	39
Depreciation and amortization	4	4	13	13
Other operating expenses:				
Legal and regulatory reserves	11	44	16	78
Loss on early debt retirement	—	—	—	30
Other	22	13	48	54
Total expenses	$226	$256	$648	$797

Salaries and related expenses for the third quarter of 2016 increased by $7 million compared to the third quarter of 2015, primarily due to higher management incentive compensation.

Loan origination expenses decreased by $5 million, or 22%, compared to the third quarter of 2015, primarily driven by an 11% decrease in retail closing units.

We recorded a provision for legal and regulatory matters of $11 million, compared to a $44 million increase to our provisions in the third quarter of 2015. As discussed in "—Executive Summary", we are currently managing through several regulatory investigations, examinations and inquiries related to our historical mortgage servicing practices and our reserves are based on currently available information. For more information regarding legal proceedings, see Note 10, 'Commitments and Contingencies' in the accompanying Notes to Condensed Consolidated Financial Statements.

Other expenses increased by $9 million from the third quarter of 2015 primarily due to an $8 million increase in Repurchase and foreclosure-related charges, primarily driven by exposure for legacy repurchase claims from certain private investors and by an increase in estimated defect rates for loans where we do not intend to file an insurance claim.

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Mortgage Production Segment

Strategic Review

Retail—Private Label. In November 2016, as an outcome of our strategic review process, we announced our intentions to exit our Private Label Solutions ("PLS") business. For the nine months ended September 30, 2016, the PLS business represented 78% of our total closing volume (based on dollars) and was 60% of our Net revenues for the Mortgage Production segment. Our strategic review process and the factors driving this decision are discussed in more depth in "—Executive Summary". At this time, we believe we will be in a position to substantially exit the PLS business by the first quarter of 2018, subject to certain transition support requirements.

In addition, we have previously announced changes specific to our private label relationship with Merrill Lynch Home Loans, a division of Bank of America, National Association ("Merrill Lynch"). Effective March 31, 2017, Merrill Lynch has exercised its right to terminate the private label origination services agreement without cause, and has a one year right to transition assistance. Including the agreement termination with Merrill Lynch, we currently have exit plans in place with clients representing approximately 50% of our PLS closing volume (based on closing dollars for the nine months ended September 30, 2016).

While we implement the exit from this business channel, we expect to incur operating losses in the Mortgage Production segment related to PLS of approximately $100 million, including maintaining the support and compliance infrastructure needed to comply with both regulatory and contractual requirements. Further, we estimate we may incur $75 million to $105 million of costs (pre-tax) over the next 18 months, which includes severance and retention programs, facility-related exit costs and other expected payments.

For discussion of risks related to the PLS exit, see “Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—Our decision to exit our Private Label client agreements will result in a decline in future revenues and will involve a significant amount of restructuring costs. Furthermore, there can be no assurances that such action will be as beneficial to shareholders as if we had not taken such action.” in this Form 10-Q.

Retail—Real Estate. We are continuing to evaluate strategic options to identify the best course of action for the Home Loans joint venture with Realogy Corporation, through which we originate loans in our Real Estate channel. The Real Estate channel represented 20% of our total closing volume (based on dollars) for the nine months ended September 30, 2016. For discussion of risks related to our remaining business, see “Part II—Item 1A. Risk Factors—Risks Related to Our Strategies—We have announced our intention to exit our Private Label Solutions business. Our remaining mortgage loan origination business is substantially dependent upon the Real Estate channel and our relationship with Realogy. The termination of our contractual agreements with Realogy would have a material adverse effect on our business, financial position, results of operations and cash flows.” in this Form 10-Q.

Wholesale/Correspondent. We had previously announced our exit of the Wholesale/correspondent lending channel, which represented 2% of our total closings volume (based on dollars) for the nine months ended September 30, 2016. In the second quarter of 2016, we completed the exit, and there were no significant costs recognized related to the exit. Refer to “—Overview—Executive Summary” for further discussion of our strategic review.

Industry Trends

In the third quarter of 2016, the origination environment experienced brief surge of refinance activity from a decline in interest rates in June. This occurred after a similar surge in the first half of 2015. However, the higher refinance activity in the third quarter of 2016 is expected to trail off during the fourth quarter of 2016 into the full year 2017, and the environment is expected to return to a lower volume, home purchase driven mortgage market. According to Fannie Mae's October 2016 Economic and Housing Outlook, total mortgage market closing volume is expected to increase modestly by 6% in 2016 as compared to 2015, driven by increased purchase originations, despite flat refinancing closings. Refinance closings are expected to represent 45% of total industry originations in 2016, as compared to 47% in 2015. Refinance closings as a percentage of total industry closings are expected to decline to approximately 35% in 2017.

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Segment Metrics:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	($ In millions)			
Closings:				
Saleable to investors	$2,759	$3,477	$7,594	$10,700
Fee-based	7,258	6,860	20,750	21,062
Total	$10,017	$10,337	$28,344	$31,762
Purchase	$4,421	$5,920	$12,748	$15,843
Refinance	5,596	4,417	15,596	15,919
Total	$10,017	$10,337	$28,344	$31,762
Retail - PLS	$7,853	$7,600	$22,161	$23,536
Retail - Real Estate	2,137	2,296	5,598	7,118
Total retail	9,990	9,896	27,759	30,654
Wholesale/correspondent	27	441	585	1,108
Total	$10,017	$10,337	$28,344	$31,762
Retail - PLS (units)	13,590	14,956	38,718	45,239
Retail - Real Estate (units)	7,379	8,485	19,928	26,269
Total retail (units)	20,969	23,441	58,646	71,508
Wholesale/correspondent (units)	107	1,942	2,298	4,881
Total (units)	21,076	25,383	60,944	76,389
Applications:				
Saleable to investors	$4,136	$4,169	$11,580	$14,982