OCWEN FINANCIAL CORP
Form 10-Q
May 07, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2009

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: 1-13219

Ocwen Financial Corporation

(Exact name of registrant as specified in its charter)

Florida	**65-0039856**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1661 Worthington Road, Suite 100, West Palm Beach, Florida 33409

(Address of principal executive offices) (Zip Code)

(561) 682-8000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

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

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

Number of shares of Common Stock, $0.01 par value, outstanding as of May 1, 2009: 67,434,998 shares.

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FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to the following:

- assumptions related to the sources of liquidity, our ability to fund advances and the adequacy of financial resources;
- estimates regarding prepayment speeds, float balances, delinquency rates, advances and other servicing portfolio characteristics;
- projections as to the performance of our fee-based loan processing business and our asset management vehicles;
- assumptions about our ability to grow our business;
- our plans to continue to sell our non-core assets;
- our ability to establish additional asset management vehicles;
- our ability to reduce our cost structure;
- our analysis in support of the decision to spin Ocwen Solutions as a separate company;
- our continued ability to successfully modify delinquent loans and sell foreclosed properties;
- estimates regarding our reserves, valuations and anticipated realization on assets; and
- expectations as to the effect of resolution of pending legal proceedings on our financial condition.

Forward-looking statements are not guarantees of future performance and involve a number of assumptions, risks and uncertainties that could cause actual results to differ materially. Important factors that could cause actual results to differ include, but are not limited to, the risks discussed in Risk Factors below and the following:

- availability of adequate and timely sources of liquidity;
- delinquencies, advances and availability of servicing;
- general economic and market conditions;
- uncertainty related to government programs, regulations and policies; and
- uncertainty related to dispute resolution and litigation.

Further information on the risks specific to our business are detailed within this report and our other reports and filings with the Securities and Exchange Commission, including our Annual report on Form 10-K for the year ended December 31, 2008, our quarterly reports on Form 10-Q and our current reports on Form 8-K. Forward-looking statements speak only as of the date they are made and should not be relied upon. Ocwen Financial Corporation undertakes no obligation to update or revise forward-looking statements.

PART I FINANCIAL INFORMATION
ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	March 31, 2009	December 31, 2008 (As Adjusted)
Assets		
Cash	$ 158,855	$ 201,025
Trading securities, at fair value		
Investment grade auction rate	238,161	239,301
Subordinates and residuals	4,028	4,369
Loans held for resale, at lower of cost or fair value	44,670	49,918
Advances	172,459	102,085
Match funded advances	881,244	1,100,555
Mortgage servicing rights	140,603	139,500
Receivables, net	49,433	42,798
Deferred tax assets, net	167,913	175,145
Intangibles, including goodwill of $9,836	45,589	46,227
Premises and equipment, net	11,799	12,926
Investments in unconsolidated entities	22,115	25,663
Other assets	92,647	97,588
Total assets	$ 2,029,516	$ 2,237,100
Liabilities and Equity		
Liabilities		
Match funded liabilities	$ 790,300	$ 961,939
Lines of credit and other secured borrowings	144,065	116,870
Investment line	186,568	200,719
Servicer liabilities	90,365	135,751
Debt securities	108,843	133,367
Other liabilities	82,697	78,813
Total liabilities	1,402,838	1,627,459
Commitments and Contingencies (Note 20)		
Equity		
Ocwen Financial Corporation stockholders equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 62,963,498 and 62,716,530 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	630	627
Additional paid-in capital	205,262	203,195
Retained earnings	418,646	403,537
Accumulated other comprehensive income, net of income taxes	1,836	1,876
Total Ocwen Financial Corporation stockholders equity	626,374	609,235
Minority interest in subsidiaries	304	406
Total equity	626,678	609,641
Total liabilities and equity	$ 2,029,516	$ 2,237,100

The accompanying notes are an integral part of these consolidated financial statements.

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands)

	For the three months ended March 31,	
	2009	2008
		(As Adjusted)
Revenue		
Servicing and subservicing fees	$ 78,810	$ 98,214
Process management fees	33,692	26,950
Other revenues	2,088	3,087
Total revenue	114,590	128,251
Operating expenses		
Compensation and benefits	28,545	30,086
Amortization of servicing rights	10,041	14,014
Servicing and origination	12,638	14,411
Technology and communications	4,808	5,270
Professional services	7,186	14,749
Occupancy and equipment	6,046	6,533
Other operating expenses	3,002	3,012
Total operating expenses	72,266	88,075
Income from operations	42,324	40,176
Other income (expense)		
Interest income	2,165	4,813
Interest expense	(16,663)	(26,070)
Loss on trading securities	(380)	(12,023)
Gain on debt repurchases	534	
Loss on loans held for resale, net	(4,554)	(4,509)
Equity in earnings of unconsolidated entities	27	6,955
Other, net	(189)	(925)
Other expense, net	(19,060)	(31,759)
Income from continuing operations before income taxes	23,264	8,417
Income tax expense	8,037	2,939
Income from continuing operations	15,227	5,478
Loss from discontinued operations, net of income taxes	(188)	(204)
Net income	15,039	5,274
Net loss (income) attributable to minority interest in subsidiaries	70	(2)
Net income attributable to Ocwen Financial Corporation (OCN)	$ 15,109	$ 5,272
Basic earnings per share		

Income from continuing operations attributable to OCN common shareholders	$	0.24	$	0.09
Loss from discontinued operations attributable to OCN common shareholders				(0.01)
Net income attributable to OCN common shareholders	$	0.24	$	0.08
Diluted earnings per share				
Income from continuing operations attributable to OCN common shareholders	$	0.24	$	0.09
Loss from discontinued operations attributable to OCN common shareholders				(0.01)
Net income attributable to OCN common shareholders	$	0.24	$	0.08
Weighted average common shares outstanding				
Basic		62,750,010		62,567,972
Diluted		67,871,466		62,814,449

The accompanying notes are an integral part of these consolidated financial statements.

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)

	For the three months ended March 31,	
	2009	2008
		(As Adjusted)
Net income	$ 15,039	$ 5,274
Other comprehensive income, net of taxes:		
Change in unrealized foreign currency translation adjustment (1)	(40)	714
Change in deferred loss on cash flow hedge arising during the period (2)		(194)
Less: Reclassification adjustment for loss on cash flow hedge included in net income (3)		345
Net change in deferred loss on cash flow hedge		151
	(40)	865
Comprehensive income	14,999	6,139
Comprehensive loss (income) attributable to minority interest in subsidiaries	102	(92)
Comprehensive income attributable to OCN	$ 15,101	$ 6,047

(1) Net of tax benefit (expense) of $23 and $(420) for the three months ended March 31, 2009 and 2008, respectively.

(2) Net of tax benefit of $114 for the three months ended March 31, 2008.

(3) Net of tax expense of $202 for the three months ended March 31, 2008.

The accompanying notes are an integral part of these consolidated financial statements.

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2009
(Dollars in thousands, except share data)

	OCN Shareholders						
	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income,	Minority interest in	
	Shares	Amount	Capital	Earnings	Net of Taxes	subsidiaries	Total
Balance at December 31, 2008 (As Adjusted See Note 2)	62,716,530	$ 627	$ 203,195	$ 403,537	$ 1,876	$ 406	$ 609,641
Net income				15,109		(70)	15,039
Repurchase of 3.25% Convertible Notes			(3)				(3)
Issuance of common stock awards to employees	29,907		(138)				(138)
Exercise of common stock options	217,061	3	1,477				1,480
Excess tax benefits related to share-based awards			186				186
Employee compensation Share-based awards			522				522
Director s compensation Common stock			23				23
Other comprehensive loss, net of income taxes					(40)	(32)	(72)
Balance at March 31, 2009	62,963,498	$ 630	$ 205,262	$ 418,646	$ 1,836	$ 304	$ 626,678

The accompanying notes are an integral part of these consolidated financial statements.

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	For the three months ended March 31,	
	2009	2008
		(As Adjusted)
Cash flows from operating activities		
Net income	$ 15,039	$ 5,274
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Amortization of mortgage servicing rights	10,041	14,014
Premium amortization and discount accretion	754	1,018
Depreciation and other amortization	2,444	3,144
Provision for bad debts	328	(97)
Loss on trading securities	380	12,023
Loss on loans held for resale, net	4,554	4,509
Equity in earnings of unconsolidated entities	(27)	(6,955)
Gain on repurchase of debt securities	(534)	
Excess tax benefits related to share-based awards	(186)	
Net cash provided (used) by trading activities	1,100	(286,640)
Net cash provided by loans held for resale activities	1,137	1,303
Decrease (increase) in advances and match funded advances	148,509	(30,761)
Decrease in deferred tax asset	7,232	496
Increase in receivables and other assets, net	(4,735)	(7,223)
Decrease in servicer liabilities	(45,386)	(15,029)
Decrease in other liabilities, net	(12,382)	(4,346)
Other	1,826	2,324
Net cash provided (used) by operating activities	130,094	(306,946)
Cash flows from investing activities		
Purchase of mortgage servicing rights	(10,241)	(3,626)
Distributions from Ocwen Structured Investments, LLC and Ocwen Nonperforming Loans, LLC and related entities	3,246	3,875
Investment in Ocwen Nonperforming Loans, LLC and related entities		(1,250)
Additions to premises and equipment	(849)	(940)
Proceeds from sales of real estate	1,196	1,967
Other		136
Net cash provided (used) by investing activities	(6,648)	162
Cash flows from financing activities		
Proceeds from (repayment of) match funded liabilities, net	(170,797)	63,843
Proceeds from lines of credit and other secured borrowings, net	41,822	19,546
Proceeds from investment line		299,964
Repayment of investment line	(14,151)	(16,128)
Repurchase of debt securities	(24,602)	
Exercise of common stock options	1,202	
Excess tax benefits related to share-based awards	186	
Proceeds from sale of mortgage servicing rights accounted for as a financing	724	
Net cash provided (used) by financing activities	(165,616)	367,225

Net increase (decrease) in cash		(42,170)		60,441
Cash at beginning of period		201,025		114,243
Cash at end of period	$	158,855	$	174,684

The accompanying notes are an integral part of these consolidated financial statements.

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(Dollars in thousands, except share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Ocwen Financial Corporation (NYSE:OCN), through its subsidiaries, is a leading asset manager and business process solutions provider specializing in loan servicing, special servicing, mortgage loan due diligence and receivables management services. At March 31, 2009, OCN owned all of the outstanding stock of its primary subsidiaries: Ocwen Loan Servicing, LLC (OLS); Ocwen Financial Solutions, Private Limited (OFSPL); Investors Mortgage Insurance Holding Company; and NCI Holdings, Inc. (NCI). OCN owns 70% of Global Servicing Solutions, LLC (GSS) with the remaining 30% minority interest held by ML IBK Positions, Inc.

OCN also holds a 45% interest in BMS Holdings, Inc. (BMS Holdings), a 25% interest in Ocwen Structured Investments, LLC (OSI) and approximately a 25% interest in Ocwen Nonperforming Loans, LLC (ONL) and Ocwen REO, LLC (OREO).

On November 12, 2008 our Board of Directors authorized management to pursue a plan to separate, through a tax-free spin-off, into a newly formed publicly-traded company, all of our operations included within our Ocwen Solutions line of business except for BMS Holdings and GSS (the Separation). The ownership interest in this new company will be distributed to OCN s existing shareholders in the form of a pro rata stock distribution. Each OCN shareholder will receive one share of Ocwen Solutions common stock for every three shares of OCN common stock held as of the close of business on the record date of the distribution.

We are currently moving forward with our efforts to address the legal and regulatory requirements related to the Separation with the goal of effecting the transaction in the third quarter of 2009. These efforts include filing a registration statement with the Securities and Exchange Commission for the proposed transaction in the second quarter of 2009. A vote of OCN shareholders is not required in connection with the Separation.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in conformity with the instructions of the Securities and Exchange Commission (SEC) to Form 10-Q and SEC Regulation S-X, Article 10, Rule 10-01 for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. In our opinion, the accompanying unaudited financial statements contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. The results of operations and other data for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for any other interim period or for the entire year ending December 31, 2009. The unaudited interim consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008.

The preparation of financial statements in conformity with GAAP requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly significant in the near or medium term relate to our determination of the valuation of securities, loans held for resale, mortgage servicing rights (MSRs), intangibles and the deferred tax asset.

Certain amounts included in our 2008 consolidated financial statements have been reclassified to conform to the 2009 presentation, including retrospective application of new accounting pronouncements adopted in the period and the reclassification of charge-offs of loans held for resale. These charge-offs, totaling $3,464 for the three months ended March 31, 2008, were reclassified from other operating expenses to loss on loans held for resale, net, in the consolidated statements of operations. See Note 2 for information regarding our adoption of recent accounting pronouncements.

Principles of Consolidation

Securitizations or Asset Backed Financing Arrangements

Ocwen or its subsidiaries have been the transferor in connection with a number of securitizations or asset-backed financing arrangements over the years. As of March 31, 2009, we have continuing involvement with the financial assets of eleven of these securitizations or asset-backed financing arrangements. We have aggregated these securitizations or asset-backed financing arrangements into two groups: (1)

securitizations of residential mortgage loans that were accounted for as sales and (2) financings of advances on loans serviced for others that were accounted for as secured borrowings.

Securitizations of Residential Mortgage Loans

The following table provides information regarding seven securitization trusts where we have continuing involvement with the transferred assets. Our continuing involvement typically includes acting as servicer or sub-servicer for the mortgage loans held by the trust and holding beneficial interests in the trust. The beneficial interests held consist of both subordinate and residual securities that were either retained at the time of the securitization transaction or were acquired subsequent to the securitization. Because each of the securitization trusts is a qualifying special purpose entity (QSPE), we exclude the trusts from our consolidated financial statements. Summary information for these trusts is provided below.

	For the three months ended March 31,	
	2009	2008
Total cash received on beneficial interests held	$ 489	$ 1,314
Total servicing and subservicing fee revenues	1,346	1,447

	As of	
	March 31, 2009	December 31, 2008
Total collateral balance	$ 697,357	$ 740,477
Non-performing collateral (1)	212,944	219,613
Total certificate balance	696,723	740,121
Total servicing advances	23,605	30,683
Total beneficial interests held at fair market value	1,861	2,216
Total mortgage servicing rights at amortized cost	1,984	2,066

(1) Non-performing collateral includes loans past due 90 days or more, loans in foreclosure, loans in bankruptcy and foreclosed real estate.

We have no obligation to provide financial support to the trusts and have provided no such support. Our exposure to loss as a result of our continuing involvement in the trusts is limited to the carrying values of our investments in the residual and subordinate securities of the trusts, our mortgage servicing rights that are related to the trusts and our advances to the trusts. We consider the probability of loss arising from our advances to be remote because of their position ahead of most of the other liabilities of the trusts. See Notes 5, 6, 7 and 8 for additional information regarding trading securities, advances, match funded advances and mortgage servicing rights.

Match Funded Advances on Loans Serviced for Others

Match funded advances on loans serviced for others result from our transfers of residential loan servicing advances to special purpose entities (SPEs) in exchange for cash. These four SPEs issue debt supported by collections on the transferred advances. We made these transfers under the terms of four advance facility agreements. These transfers do not qualify for sales accounting because we retain control over the transferred assets. As a result, we account for these transfers as financings and classify the transferred advances on our balance sheet as match funded advances and the related liabilities as match funded liabilities. Collections on the advances pledged to the special purpose entities are used to repay principal and interest and to pay the expenses of the entity. Generally, holders of the debt issued by these entities can look only to the assets of the entities themselves for satisfaction of the debt and have no recourse against OCN. However, OLS has guaranteed the payment by one of the entities, Ocwen Servicer Advance Funding (Wachovia), LLC (OSAFW), of its obligations under the securitization documents. The maximum amount payable under the guarantee is limited to 10% of the notes outstanding at the end of the facility s revolving period in April 2009. As of March 31, 2009, OSAFW had notes outstanding of $198,516. The following table summarizes the assets and liabilities of the four special purpose entities formed in connection with our match funded advance facilities:

	March 31, 2009	December 31, 2008
Total assets	$ 909,642	$ 1,122,404
Match funded advances	881,244	1,100,555
Total liabilities	834,440	994,244
Match funded liabilities	790,300	961,939

Variable Interest Entities

We evaluate each SPE for classification as a QSPE. We do not consolidate QSPEs in our financial statements. Where we determine that an SPE is not classified as a QSPE, we further evaluate it for classification as a variable interest entity (VIE). When an SPE meets the definition of a VIE, and we determine that OCN is the primary beneficiary, we include the SPE in our consolidated financial statements.

We have determined that the special purpose entities created in connection with the match funded financing facilities that are discussed above are VIEs and that we are the primary beneficiary of those VIEs. The accounts of those special purpose entities are included in our consolidated financial statements.

We apply the equity method of accounting to investments in which we have less than 50% of the voting securities, yet we are able to exercise significant influence over the policies and procedures of the entity. We have eliminated all material intercompany accounts and transactions in consolidation.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, *Effective Date of FASB Statement No. 157.* This FSP deferred the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in an entity s financial statements on a recurring basis (at least annually). The adoption of FSP FAS 157-2 on January 1, 2009 did not have an impact on our consolidated financial statements. Fair value measurements of non-financial assets will require the tabular disclosure prescribed by SFAS No. 157 as well as disclosures with respect to the methodologies and assumptions utilized to determine fair value.

In April 2009, the FASB issued FASB FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.* This FSP provides additional guidance for estimating fair value when the level of activity for the asset or liability has significantly decreased. The FSP is effective for interim and annual reporting periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. We plan to adopt the FSP during the second quarter of 2009 and do not anticipate that the initial adoption of this FSP will have a significant impact on our consolidated financial statements.

SFAS No. 141 (R), Business Combination a replacement of FASB Statement No. 141. SFAS No. 141(R) modifies certain elements of the acquisition method of accounting used for all business combinations. The statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at the full amounts of their fair values, with limited exceptions specified in the statement. If the business combination is achieved in stages (a step acquisition), an acquirer is also required to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values. The statement requires the acquirer to recognize restructuring and acquisition costs separately from the business combination. The statement also requires the disclosure of information necessary to understand the nature and effect of the business combination. The adoption of SFAS No. 141 (R) on January 1, 2009 did not have an impact on our consolidated balance sheets or statements of operations.

SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements-an Amendment of ARB No. 51. The FASB issued SFAS No. 160 on December 4, 2007. The statement establishes new accounting and reporting standards for a non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements separate from the parent s equity. The amount of net income attributable to the non-controlling interest is included in consolidated net income on the face of the income statement. The statement clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, when a subsidiary is deconsolidated, this statement requires that a parent recognize a gain or loss in net income based on the fair value of the entire entity, irrespective of any retained ownership, on the deconsolidation date. Such a gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. We adopted SFAS No. 160 on January 1, 2009. Because the outstanding non-controlling interests in consolidated subsidiaries are not significant, the implementation of SFAS No. 160 did not have a material impact on our consolidated balance sheets or statements of operations.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133. The FASB issued SFAS No. 161 in March 2008. This statement requires enhanced disclosures about an entity s derivative and hedging activities. Under this statement, entities are required to provide enhanced disclosures relating to: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedge items are accounted for; and (3) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. The adoption of SFAS No. 161 on January 1, 2009 did not have a material effect on our consolidated balance sheets or statements of operations.

Proposed amendment of SFAS No. 140 and FIN 46(R) and issuance of FSP No. FAS 140-4 and FIN 46(R)-8. In April 2008, the FASB voted to eliminate the QSPE concept from SFAS No. 140 and to remove the scope exception for QSPEs from FIN 46(R). During September 2008, the FASB issued three separate but related exposure drafts for public comment. The proposed FASB Statements address amendments to SFAS No. 140 and to FIN 46(R). The proposed changes will require an analysis of all QSPEs which are currently exempt from the consolidation provisions of FIN 46(R), to determine if consolidation as VIEs is required.

FSP FAS 140-4 and FIN 46(R)-8 was issued in December 2008 and requires improved disclosures by public entities until the pending amendments to SFAS No. 140 and FIN No. 46(R) are effective. This FSP amends SFAS No. 140 and FIN 46(R) to require enhanced disclosures by public entities about transfers of financial assets and interests in VIEs. Additionally, the FSP requires certain disclosures by a public entity that is (a) a sponsor that has a variable interest in a VIE (irrespective of the significance of the variable interest) and (b) an enterprise that holds a significant variable interest in a QSPE but was not the transferor of financial assets to the QSPE. The additional disclosures required by FSP FAS 140-4 and FIN 46(R)-8 are included in Note 1.

We have retained investments in certain subordinate and residual securities in connection with loan securitization transactions completed in prior years (primarily 2006). Our subordinate and residual securities at March 31, 2009 include retained interests with a fair value of $107.

FSP No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). This FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, *Accounting for Convertible Debt andDebt Issued with Stock Purchase Warrants*. Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon adoption of this FSP on January 1, 2009, we recognized a discount to reduce the carrying value of the 3.25% Convertible Notes and an offsetting increase to stockholders equity. The cumulative effect of adoption resulted in: (1) a reduction of retained earnings of $21,202 due to the retrospective accretion of the resulting debt discount to interest expense over the expected life of the notes; (2) adjustments to debt issue cost amortization and gains or losses recognized on previous redemptions; and (3) an increase in additional paid-in capital of $22,657. The adjustment to additional paid-in capital includes the recognized debt discount, adjusted for note redemptions, and the effect of deferred taxes. Interest expense for the quarter ended March 31, 2008 has been restated to include non-cash interest of $1,071. Prospectively, the consolidated statement of operations will recognize non-cash interest expense over the remaining estimated life of the notes.

FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), *Business Combinations*. The FSP eliminates the previous useful-life assessment criterion that precluded an entity from using its own assumptions where there is likely to be substantial cost or modification and replaces it with a requirement that an entity shall consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. We adopted FSP FAS 142-3 on January 1, 2009 without material effect on our consolidated financial statements.

Emerging Issues Task Force (EITF) Issue No. 08-6, Equity Method Investment Accounting Considerations (EITF 08-6). The Task Force considered the effects of the issuances of SFAS Nos. 141(R) and 160 on an entity s application of the equity method under APB Opinion No. 18. The Task Force reached a consensus that (1) an entity should determine the initial carrying value of an equity method investment by applying the cost accumulation model described in SFAS No. 141(R); (2) an entity should use the other-than-temporary impairment model of APB Opinion No. 18 when testing equity method investments for impairment; (3) share issuances by the investee should be accounted for as if the equity method investor had sold a proportionate share of its investment (i.e., any gain or loss is recognized in earnings); and (4) when an investment is no longer within the scope of equity method accounting the investor should prospectively apply the provisions of APB Opinion No. 18 or SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and use the current carrying amount of the investment as its initial cost. The adoption of EITF Issue No. 08-6 on January 1, 2009 did not have a material impact on our consolidated balance sheets or statements of operations.

FSP No. FAS 115-2 and FAS 124-2 Recognition of Other-Than-Temporary-Impairments . This FSP amends the other-than-temporary impairment guidance for debt securities and improves the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. Because our current investments in debt securities are classified as trading securities and therefore measured at fair value on a recurring basis, we do not anticipate that this FSP will have a significant impact on our consolidated financial statements upon adoption during the second quarter 2009.

FSP FAS No. 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments. This FSP extends the annual disclosure requirements of SFAS No. 107 *Disclosure about Fair Value of Financial Instruments* to interim periods for all publicly traded companies. Interim disclosures are required to include the estimated fair value and carrying value of financial instruments, a description of the methods and inputs to estimate fair value as well as any changes in the methods and significant assumptions, if any, during the period. Consequently, our consolidated financial statements for the quarter ended June 30, 2009, will reflect the additional disclosures as required by this FSP.

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 157 establishes a fair value hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy prioritizes the inputs to valuation techniques into three broad levels whereby the highest priority is given to Level 1 inputs and the lowest to Level 3 inputs. The three broad categories are:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly for substantially the full term of the financial instrument.

Level 3: Unobservable inputs for the asset or liability.

Where available, we utilize quoted market prices or observable inputs rather than unobservable inputs to determine fair value. We classify assets in their entirety based on the lowest level of input that is significant to the fair value measurement. The following table sets forth assets and liabilities measured at fair value at March 31, 2009, categorized by input level within the fair value hierarchy:

	Carrying value	Level 1	Level 2	Level 3
Measured at fair value on a recurring basis:				
Trading securities (1):				
Investment grade auction rate	$ 238,161	$	$	$ 238,161
Subordinates and residuals	4,028			4,028
Derivative financial instruments, net (2)	8	(347)		355
Measured at fair value on a non-recurring basis:				
Loans held for resale (3)	44,670			44,670
Mortgage servicing rights (4)				
Lines of credit and other secured borrowings (5)	45,373			45,373

(1) Because our internal valuation model requires significant use of unobservable inputs, we classified these securities within Level 3 of the fair value hierarchy.

(2) Derivative financial instruments consist of interest rate caps that we use to protect against our exposure to rising interest rates on two of our match funded variable funding notes and foreign currency futures contracts that we use to hedge our net investment in Bankhaus Oswald Kruber GmbH & Co. KG (BOK), our wholly-owned German banking subsidiary, against adverse changes in the value of the Euro versus the U.S. Dollar. We classified the interest rate caps within Level 3 of the fair value hierarchy and the futures contracts within Level 1. See Note 18 for additional information on our derivative financial instruments.

(3) Loans held for resale are measured at fair value on a non-recurring basis. At March 31, 2009, the carrying value of loans held for resale is net of a valuation allowance of $18,166. Current market illiquidity has reduced the availability of observable pricing data. Consequently, we classify these loans within level 3 of the fair value hierarchy.

(4) The carrying value of MSRs at March 31, 2009 is net of a valuation allowance for impairment of $3,624 established during the third and fourth quarters of 2008. The valuation allowance, which relates exclusively to the high-loan-to-value stratum of our residential MSRs, reduced the carrying value of the stratum to zero. The estimated fair value exceeded amortized cost for all other strata. See Note 8 for additional information on MSRs.

(5) Lines of credit and other secured borrowings measured at fair value on a nonrecurring basis consist of a fixed-rate term note outstanding under the advance fee reimbursement facility. See Note 13 for more information on the facility.

The following table sets forth a reconciliation of the changes in fair value of our Level 3 assets that we measure at fair value on a recurring basis:

For the three months ended March 31, 2009:	Fair value at January 1	Purchases, collections and settlements, net (1)	Total realized and unrealized gains and (losses) (2)	Transfers in and/or out of Level 3	Fair value at March 31
Trading securities:					
Investment grade auction rate	$ 239,301	$ (1,100)	$ (40)	$	$ 238,161
Subordinates and residuals	4,369	(1)	(340)		4,028
Derivative financial instruments	193		162		355
For the three months ended March 31, 2008:					
Trading securities:					