

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

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-7797

PHH CORPORATION  
(Exact name of registrant as specified in its charter)

|   |  |
|---|--|
| MARYLAND<br>(State or other jurisdiction of<br>incorporation or organization) | 52-0551284<br>(I.R.S. Employer<br>Identification Number) |
|---|--|

|  |                     |
|--|---------------------|
| 3000 LEADENHALL ROAD<br>MT. LAUREL, NEW JERSEY<br>(Address of principal executive offices) | 08054<br>(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  No

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

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

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

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<br>Ended<br>September 30,<br>2016 |          | Nine Months<br>Ended<br>September 30,<br>2015 |          |
|--|--|----------|---|----------|
| <b>REVENUES</b>  |  |          |   |          |
| 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      |
| <b>EXPENSES</b>  |  |          |   |          |
| 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<br>Months<br>Ended<br>September<br>30,<br>2016 |        | Nine<br>Months<br>Ended<br>September<br>30,<br>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,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| 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 <sup>(1)</sup>  | \$ 3,446              | \$ 3,642             |
| <b>LIABILITIES</b>   |                       |                      |
| 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 <sup>(1)</sup>   | 2,186                 | 2,294                |
| Commitments and contingencies (Note 10)  |                       |                      |
| <b>EQUITY</b>  |                       |                      |
| Preferred stock, \$0.01 par value; 1,090,000 shares authorized;<br>none issued or outstanding  | —                     | —                    |
| Common stock, \$0.01 par value; 273,910,000 shares authorized;<br>53,585,565 shares issued and outstanding at September 30, 2016;<br>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 <sup>(2)</sup>  | (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)

The Condensed Consolidated Balance Sheets include assets and liabilities of variable interest entities. The assets (1) 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,<br>2016 | December 31,<br>2015 |
|---------------------------------------|-----------------------|----------------------|
| <b>ASSETS</b>                         |                       |                      |
| 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               |
| <b>LIABILITIES</b>                    |                       |                      |
| Accounts payable and accrued expenses | \$ 15                 | \$ 14                |
| Debt                                  | 486                   | 456                  |
| Other liabilities                     | 6                     | 6                    |
| Total liabilities                     | \$ 507                | \$ 476               |

Includes amounts recorded related to the Company's defined benefit pension plan, net of income tax benefits of \$6 (2) 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                         | Additional |                    | Retained | Other                             | Noncontrolling | Total   |
|   | Shares                               | Amount     | Paid-In<br>Capital | Earnings | Comprehensive<br>Income<br>(Loss) | Interest       | Equity  |
| <b>Nine Months Ended September 30, 2016</b>   |                                      |            |                    |          |                                   |                |         |
| 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 |
| <b>Nine Months Ended September 30, 2015</b>   |                                      |            |                    |          |                                   |                |         |
| 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<br>September 30,<br>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 servicer.

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                             |            | Nine Months Ended |            |
|--|--|------------|-------------------|------------|
|  | September 30,                                  |            | 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     | 53,578,059                                     | 59,830,544 | 53,616,461        | 61,078,072 |
| 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 |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30,      |           | September 30,     |           |
|  | 2016               | 2015      | 2016              | 2015      |
| Outstanding stock-based compensation awards <sup>(1)</sup> | 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 MSR's. In addition, as of September 30, 2016, 27% of the capitalized MSR's 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 MSR's to third parties and will have continuing involvement as a subservicer. As of September 30, 2016, the Company had commitments to sell MSR's 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 MSR's 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 MSR's, 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 MSR's 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 MSR's 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         |      | Nine      |       |
|---|---------------|------|-----------|-------|
|   | Months        |      | Months    |       |
|   | Ended         |      | Ended     |       |
|   | September     |      | September |       |
|   | 30,           |      | 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 MSR's 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 MSR's.

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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<br>Ended<br>September 30,<br>2016 2015<br>(In millions) |          |
|--|---|----------|
| Proceeds from new loan sales or securitizations          | \$4,647   | \$7,267  |
| Servicing fees from capitalized portfolio <sup>(1)</sup> | 204   | 228      |
| Purchases of previously sold loans <sup>(2)</sup>        | (232 )  | (124 )   |
| Servicing advances <sup>(3)</sup>                        | (1,217 )  | (1,576 ) |
| Repayment of servicing advances <sup>(3)</sup>           | 1,241   | 1,527    |

<sup>(1)</sup> Excludes late fees and other ancillary servicing revenue.

<sup>(2)</sup> Includes purchases of repurchase eligible loans and excludes indemnification payments to investors and insurers of the related mortgage loans.

Outstanding servicing advance receivables are presented in Servicing advances, net in the Condensed Consolidated

<sup>(3)</sup> 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,<br>2016 | September 30,<br>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 Paid     | Collateral | Net Amount |
|   | (In millions)      |                        |               |            |            |
| <b>ASSETS</b>                               |                    |                        |               |            |            |
| 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 Received | Collateral | Net Amount |
| <b>LIABILITIES</b>                          |                    |                        |               |            |            |
| 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 Received | Collateral | Net Amount |
|   | (In millions)     |                        |               |            |            |
| <b>ASSETS</b>                               |                   |                        |               |            |            |
| Subject to master netting arrangements:     |                   |                        |               |            |            |
| Forward delivery commitments                | \$2               | \$ (2 )                | \$ —          |            | \$ —       |
| MSR-related agreements                      | 27                | —                      | (23 )         | 4          | 4          |
| Derivative assets subject to netting        | 29                | (2 )                   | (23 )         | 4          | 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 Received | Collateral | Net Amount |
| <b>LIABILITIES</b>                          |                   |                        |               |            |            |
| 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<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine Months<br>Ended<br>September<br>30,<br>2015 |       |
|--|--|-------|--|-------|
|  | 2015   | 2016  | 2015   | 2016  |
|  | (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:<br>MSR-related agreements | (4 )   | 50    | 139  | 54    |

## 5. Other Assets

Other assets consisted of:

|  | September 30,<br>2016 |        | December 31,<br>2015 |      |
|--|-----------------------|--------|----------------------|------|
|  | 2016                  | 2015   | 2015                 | 2016 |
|  | (In millions)         |        |                      |      |
| Derivatives                              | \$ 70                 | \$ 26  |                      |      |
| Repurchase eligible loans <sup>(1)</sup> | 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 |                      |      |

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,<br>2016 |        | December 31,<br>2015 |      |
|--|-----------------------|--------|----------------------|------|
|  | 2016                  | 2015   | 2015                 | 2016 |
|  | (In millions)         |        |                      |      |
| Legal and regulatory matters (Note 10)     | \$ 121                | \$ 105 |                      |      |
| Pension and other post-employment benefits | 10                    | 11     |                      |      |



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|                          |        |        |
|--------------------------|--------|--------|
| 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,<br>2015 |
|---------------------------------------|--------------------|---------------------------------|--------------------------------------|----------------------|
|                                       | Balance            | Interest<br>Rate <sup>(1)</sup> | Available<br>Capacity <sup>(2)</sup> | 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 <sup>(3)</sup> | 272                | 7.375 %                         | n/a                                  | 271                  |
| Term notes due in 2021 <sup>(3)</sup> | 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<br>Facilities | Servicing<br>Advance<br>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<br>Facilities | Servicing<br>Advance<br>Facility <sup>(1)</sup> | Unsecured<br>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 | —                       | —   | —                 | —     |

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|                             |       |       |        |         |
|-----------------------------|-------|-------|--------|---------|
| 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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## 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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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following tables summarize certain information regarding the total loan servicing portfolio, which includes loans associated with the capitalized mortgage servicing rights as well as loans subserviced for others:

|                                      | September 30,<br>2016 | December 31,<br>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,<br>2016 | December 31,<br>2015 |        |
|--|-----------------------|----------------------|--------|
|  | Number of<br>Loans    | Unpaid<br>Balance    |        |
|  | Number of<br>Loans    | Unpaid<br>Balance    |        |
| Portfolio Delinquency <sup>(1)</sup>         |                       |                      |        |
| 30 days                                      | 2.13 %                | 1.47 %               | 2.22 % |
| 60 days                                      | 0.42                  | 0.28                 | 0.44   |
| 90 or more days                              | 0.67                  | 0.49                 | 0.82   |
| Total  | 3.22 %                | 2.24 %               | 3.48 % |
| Foreclosure/real estate owned <sup>(2)</sup> | 1.62 %                | 1.35 %               | 1.74 % |

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

<sup>(2)</sup> 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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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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,<br>2016 | December 31,<br>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                |

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|   |       |       |
|---|-------|-------|
| 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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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.

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## 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)      |           |             |                                   |
| <b>ASSETS</b>                             |                    |           |             |                                   |
| 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                                |
| <b>LIABILITIES</b>                        |                    |           |             |                                   |
| 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)     |           |             |                                   |
| <b>ASSETS</b>                   |                   |           |             |                                   |
| 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 | \$ | <del>\$</del> 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 MSR:

|   | Nine Months Ended September 30, 2016 |  | September 30, 2015 |  |
|---|--------------------------------------|--|--------------------|--|
| Initial capitalization rate of additions to MSR | 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 MSR were as follows (in annual rates):

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|   | 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 MSR from adverse changes in the significant assumptions:

|  | September 30, 2016                          |   |
|--|---|---|
|  | Weighted-<br>Average<br>Prepayment<br>Speed | Weighted-<br>Option<br>Adjusted<br>Spread<br>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 MSR 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 |         |            |
|---|---------------------------------------|--------|------------|---------------------------------------|---------|------------|
|   | MLH                                   | MSRs   | IRLCs, net | MLH                                   | 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  |         |            |
|   | MLH                                   | MSRs   | IRLCs, net | MLH                                   | 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<br>Months<br>Ended<br>September<br>30,<br>2016 | Three<br>Months<br>Ended<br>September<br>30,<br>2015 | Nine<br>Months<br>Ended<br>September<br>30,<br>2016 | Nine<br>Months<br>Ended<br>September<br>30,<br>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,<br>2016                               |      | December 31, 2015                                   |      |
|------------------------------|---|------|---|------|
|                              | Servicing<br>PHH Home<br>Loans Receivables<br>Trust |      | Servicing<br>PHH Home<br>Loans Receivables<br>Trust |      |
|                              | (In millions)                                       |      |   |      |
| <b>ASSETS</b>                |   |      |   |      |
| 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   | —    |

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|                           |       |        |        |        |
|---------------------------|-------|--------|--------|--------|
| 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 <sup>(1)</sup>      | \$409 | \$ 98 | \$ 365 | \$ 111 |

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(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 servicer 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, | December 31, |
|                             | 2016          | 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         |       | Nine      |       |
|                             | Months        |       | Months    |       |
|                             | Ended         |       | Ended     |       |
|                             | September     |       | September |       |
|                             | 30,           | 30,   | 30,       | 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) <sup>(2)</sup>  |        |                                      |         |
|-----------------------------|---------------------------------------|--------|--------------------------------------|---------|
|                             | Three Months Ended September 30, 2016 |        | Nine Months Ended September 30, 2015 |         |
|                             | 2016                                  | 2015   | 2016                                 | 2015    |
|                             | (In millions)                         |        |                                      |         |
| Mortgage Production segment | \$22                                  | \$(10) | \$9                                  | \$(26)  |
| Mortgage Servicing segment  | (52)                                  | (77)   | (106)                                | (66)    |
| Other <sup>(1)</sup>        | (5)                                   | (3)    | (10)                                 | (49)    |
| Total                       | \$(35)                                | \$(90) | \$(107)                              | \$(141) |

(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, 2016 |        | Nine Months Ended September 30, 2015 |         |
|--|---------------------------------------|--------|--------------------------------------|---------|
|  | 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 servicer 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 servicer.

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 servicer 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<br>Ended<br>September 30,<br>2016 |          | Nine Months<br>Ended<br>September 30,<br>2015 |          |
|--|--|----------|---|----------|
|  | 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<br>Months<br>Ended<br>September<br>30,<br>2016 2015 |       | Nine Months<br>Ended<br>September<br>30,<br>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<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |       |
|--|--|-------|---|-------|
|  | 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<br>Ended<br>September 30,<br>2016 2015 |          | Nine Months<br>Ended<br>September 30,<br>2016 2015 |          |
|--|---|----------|--|----------|
|  | (\$ In millions)                                    |          |  |          |
| <b>Closings:</b>                             |   |          |  |          |
| 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 |
| <b>Purchase</b>                              |   |          |  |          |
| Refinance                                    | \$4,421   | \$5,920  | \$12,748   | \$15,843 |
| Total  | \$5,596   | \$4,417  | \$15,596   | \$15,919 |
| Total  | \$10,017  | \$10,337 | \$28,344   | \$31,762 |
| <b>Retail - PLS</b>                          |   |          |  |          |
| Retail - Real Estate                         | \$7,853   | \$7,600  | \$22,161   | \$23,536 |
| Total retail                                 | 2,137   | 2,296    | 5,598  | 7,118    |
| Wholesale/correspondent                      | 9,990   | 9,896    | 27,759   | 30,654   |
| Total  | 27  | 441      | 585  | 1,108    |
| Total  | \$10,017  | \$10,337 | \$28,344   | \$31,762 |
| <b>Retail - PLS (units)</b>                  |   |          |  |          |
| Retail - Real Estate (units)                 | 13,590  | 14,956   | 38,718   | 45,239   |
| Total retail (units)                         | 7,379   | 8,485    | 19,928   | 26,269   |
| Wholesale/correspondent (units)              | 20,969  | 23,441   | 58,646   | 71,508   |
| Total (units)                                | 107   | 1,942    | 2,298  | 4,881    |
| Total (units)                                | 21,076  | 25,383   | 60,944   | 76,389   |
| <b>Applications:</b>                         |   |          |  |          |
| Saleable to investors                        | \$4,136   | \$4,169  | \$11,580   | \$14,982 |
| Fee-based                                    | 8,217   | 8,058    | 25,720   | 26,440   |
| Total  | \$12,353  | \$12,227 | \$37,300   | \$41,422 |
| <b>Retail - PLS</b>                          |   |          |  |          |
| Retail - Real Estate                         | \$9,743   | \$9,266  | \$29,193   | \$30,690 |
| Total retail                                 | 2,610   | 2,433    | 7,416  | 8,999    |
| Wholesale/correspondent                      | 12,353  | 11,699   | 36,609   | 39,689   |
| Total  | —   | 528      | 691  | 1,733    |
| Total  | \$12,353  | \$12,227 | \$37,300   | \$41,422 |
| <b>Retail - PLS (units)</b>                  |   |          |  |          |
| Retail - Real Estate (units)                 | 18,234  | 19,074   | 53,011   | 60,856   |
| Total retail (units)                         | 8,879   | 9,215    | 26,052   | 33,271   |
| Wholesale/correspondent (units)              | 27,113  | 28,289   | 79,063   | 94,127   |
| Total (units)                                | —   | 2,373    | 2,649  | 7,547    |
| Total (units)                                | 27,113  | 30,662   | 81,712   | 101,674  |
| <b>Other:</b>                                |   |          |  |          |
| IRLCs expected to close                      | \$1,199   | \$1,732  | \$3,685  | \$6,025  |
| Total loan margin on IRLCs (in basis points) | 388   | 319      | 342  | 310      |
| Loans sold                                   | \$2,954   | \$4,234  | \$7,804  | \$11,002 |



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## Segment Results:

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |        | Nine Months<br>Ended<br>September<br>30,<br>2015 |         |
|--|--|--------|--|---------|
|  | 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     |
| Net interest income (expense):                           |  |        |  |         |
| Interest income  | 8  | 12     | 24   | 32      |
| Secured interest expense                                 | (5 )   | (7 )   | (16 )  | (19 )   |
| Unsecured interest expense                               | —  | (3 )   | —  | (18 )   |
| Net interest income (expense)                            | 3  | 2      | 8  | (5 )    |
| Other income   | 3  | 3      | 8  | 8       |
| Net revenues   | 168  | 149    | 443  | 460     |
| Salaries and related expenses                            | 53   | 52     | 167  | 164     |
| Commissions  | 19   | 19     | 49   | 65      |
| Loan origination expenses                                | 18   | 23     | 52   | 72      |
| Professional and third-party service fees                | 6  | 9      | 17   | 25      |
| Technology equipment and software expenses               | 1  | 1      | 3  | 3       |
| Occupancy and other office expenses                      | 6  | 10     | 20   | 24      |
| Depreciation and amortization                            | 2  | 3      | 7  | 9       |
| Other operating expenses                                 | 35   | 39     | 110  | 113     |
| Total expenses   | 140  | 156    | 425  | 475     |
| Income (loss) before income taxes                        | 28   | (7 )   | 18   | (15 )   |
| Less: net income attributable to noncontrolling interest | 6  | 3      | 9  | 11      |
| Segment profit (loss)                                    | \$22   | \$(10) | \$9  | \$(26 ) |

Quarterly Comparison: Mortgage Production segment profit was \$22 million during the third quarter of 2016 compared to a segment loss of \$10 million during the third quarter of 2015. Net revenues increased to \$168 million, up \$19 million, or 13%, compared to the prior year quarter driven by higher margins on IRLCs and operating benefits from amendments to our private label agreements. The dollar volume of closings in the third quarter of 2016 declined modestly when compared to the third quarter of 2015, primarily due to the decline in the wholesale/correspondent channel, which we exited in the second quarter of 2016. Total expenses decreased to \$140 million, down \$16 million compared with the third quarter of 2015, primarily driven by the decline in Loan origination expenses from lower closing unit volume as well as a reduction in Professional and third-party service fees, Occupancy and other office expenses, and Corporate overhead allocation.

Net revenues. Origination and other loan fees were \$75 million, which was consistent with the prior year quarter. Origination assistance fees increased by \$4 million, which was primarily driven by operating benefits from amendments to our private label agreements, partially offset by a 9% decrease in private label closing units compared to the prior year quarter. This increase was offset by a \$4 million decrease in appraisal income and application and other closing fees primarily driven by an 11% decrease in total retail closing units.

Gain on loans held for sale, net was \$87 million during the third quarter of 2016, increasing 26% as compared to \$69 million for the prior year quarter. This increase was primarily related to 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% decrease in IRLCs expected to close, reflecting the increased mix of fee-based closings (where we do not enter into an IRLC).

Interest income was \$8 million during the third quarter of 2016, down \$4 million or 33%, as compared to the third quarter of 2015, primarily due to the decline in average mortgage loans held for sale from the decline in saleable volume. Secured interest expense was \$5 million during the third quarter of 2016, down \$2 million or 29%, as compared to the third quarter



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of 2015, primarily due to the decline in average mortgage warehouse debt from reduced borrowing needs for mortgage loans held for sale.

Allocated unsecured interest expense was zero in the third quarter of 2016, as compared to \$3 million for the third quarter of 2015, driven by updates to our interest allocation methodology in 2016 compared to 2015. We evaluate the capital structure of each segment on an annual basis and have not allocated unsecured interest expense during 2016 to Mortgage Production as the segment's capital structure has been fully supported by existing cash and the secured warehouse debt facilities for 2016.

Total expenses. Loan origination expenses were down \$5 million, or 22%, compared to the prior year quarter, primarily due to an 11% decrease in retail closing units.

Professional and third-party service fees declined \$3 million, or 33%, primarily due to reduced consulting expenses on compliance activities and our efforts to re-engineer the business in the third quarter of 2016 as compared to the third quarter of 2015.

Occupancy and other office expenses declined \$4 million, or 40%, primarily due to one-time expenses and lower rent from consolidating Mt. Laurel facilities in the third quarter of 2015.

See “—Other” for a discussion of the costs that are allocated through the Corporate overhead allocation.

Year-to-Date Comparison: Mortgage Production segment profit was \$9 million during the nine months ended September 30, 2016 compared to a loss of \$26 million during the prior year. Net revenues decreased to \$443 million, down \$17 million, or 4%, compared to the prior year driven by lower volumes of IRLCs and closings, partially offset by lower allocated unsecured interest expense. The lower volume of closings was a result of reduced purchase originations in the real estate channel, reduced private label volume, and our exit of the wholesale/correspondent channel in the second quarter of 2016. Total expenses decreased to \$425 million, down \$50 million, or 11%, compared with the prior year, primarily driven by the declines in origination volume, which resulted in lower Loan origination expenses and Commissions.

Net revenues. Origination and other loan fees were \$215 million, down \$5 million, or 2%, compared to the prior year, which was primarily due to a \$15 million decrease in appraisal income and application and other closing fees primarily driven by an 18% decrease in total retail closing units. This was partially offset by an increase in origination assistance fees of \$10 million primarily driven by operating benefits from amendments to our private label agreements that were partially offset by a 14% decrease in private label closing units compared to the prior year.

Gain on loans held for sale, net was \$212 million during the nine months ended September 30, 2016, declining 11% as compared to \$237 million for the prior year, which was primarily related to a 39% decrease in IRLCs expected to close, reflecting the increased mix of fee-based closings (where we do not enter into an IRLC). This was partially offset by a 32 basis point increase in average total loan margins.

Interest income was \$24 million during the nine months ended September 30, 2016, down \$8 million or 25%, as compared to the prior year, primarily due to the decline in average mortgage loans held for sale from the decline in saleable volume. Secured interest expense was \$16 million during the nine months ended September 30, 2016, down \$3 million or 16%, as compared to the prior year, primarily due to the decline in average mortgage warehouse debt from reduced borrowing needs for mortgage loans held for sale.

Allocated unsecured interest expense was zero in the nine months ended September 30, 2016, as compared to \$18 million for the nine months ended September 30, 2015, driven by updates to our interest allocation methodology in

2016 compared to 2015. We evaluate the capital structure of each segment on an annual basis and have not allocated unsecured interest expense during 2016 to Mortgage Production as the segment's capital structure has been fully supported by existing cash and the secured warehouse debt facilities for 2016.

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Total expenses. Commissions were down \$16 million, or 25%, primarily driven by a 21% decrease in closing volume from our real estate channel. Loan origination expenses were down \$20 million, or 28%, compared to the prior year primarily due to an 18% decrease in retail closing units, as well as the termination of our trademark and licensing agreements with Realogy in 2015.

Professional and third-party service fees declined \$8 million, or 32%, primarily due to reduced consulting expenses on compliance activities and our efforts to re-engineer the business in the nine months ended September 30, 2016 compared to the prior year.

Occupancy and other office expenses declined \$4 million, or 17%, primarily due to one-time expenses and lower rent from consolidating Mt. Laurel facilities in the nine months ended September 30, 2015.

See “—Other” for a discussion of the costs that are allocated through the Corporate overhead allocation.

## Selected Income Statement Data:

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |      | Nine Months<br>Ended<br>September<br>30,<br>2015 |       |
|--|--|------|--|-------|
|  | 2016   | 2015 | 2016   | 2015  |
|  | (In millions)  |      |  |       |
| Gain on loans held for sale, net:  |  |      |  |       |
| Gain on loans  | \$75   | \$58 | \$181  | \$205 |
| Change in fair value of Scratch and Dent and certain non-conforming mortgage loans | —  | —    | (3)  | (1)   |
| Economic hedge results   | 12   | 11   | 34   | 33    |
| Total change in fair value of mortgage loans and related derivatives               | 12   | 11   | 31   | 32    |
| Total  | \$87   | \$69 | \$212  | \$237 |
| Salaries and related expenses:   |  |      |  |       |
| Salaries, benefits and incentives  | \$48   | \$49 | \$153  | \$152 |
| Contract labor and overtime  | 5  | 3    | 14   | 12    |
| Total  | \$53   | \$52 | \$167  | \$164 |
| Other operating expenses:  |  |      |  |       |
| Corporate overhead allocation  | \$28   | \$32 | \$92   | \$95  |
| Other expenses   | 7  | 7    | 18   | 18    |
| Total  | \$35   | \$39 | \$110  | \$113 |

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### Mortgage Servicing Segment

Our Mortgage Servicing segment has experienced, and may continue to experience, high degrees of earnings volatility due to significant exposure to changes in interest rates and the related impact on our modeled MSR cash flows, high delinquent GNMA servicing costs and other market risks. These factors can be impacted by, among other factors, conditions in the housing market, general economic factors, including higher unemployment rates, policies of the Federal Reserve, and global economic changes. As of September 30, 2016, we have observed a 68 basis point decline in the 10-year Treasury yield since the end of the fourth quarter, which has contributed to a 27% decline in the value of our MSR asset during that period. In 2016, we have maintained a high MSR hedge coverage ratio, and for the nine months ended September 30, 2016, hedge gains have offset 80% of the \$174 million negative market-related change in MSR value.

In recent years, the residential mortgage industry has been under heightened scrutiny from federal, state and local regulators which has resulted in, and may result in, higher costs and enhanced regulatory, compliance and vendor oversight requirements. The results of servicing our owned, or capitalized, portfolio have been negatively impacted by the persistent low interest rate environment and increasing costs to comply with regulations, while the compensation for servicers has remained constant. We expect that costs to service may continue to exceed revenue from the capitalized portfolio in the short term. In recent years, we sold a significant amount of newly created MSRs through our flow sale agreements; however, we have reduced the volume of sales under our MSR flow sale arrangements, as sales were 17% of our MSR additions during the nine months ended September 30, 2016, compared to 43% during the prior year (in each case based on UPB). Further, in November 2016, we signed an agreement to sell substantially all of our GNMA MSR portfolio, consisting of \$14.8 billion of UPB and \$104 million in fair value. We are continuing to evaluate possible additional sales of our remaining MSR portfolio and will provide further updates when appropriate.

We have previously announced expected declines in our subservicing portfolio:

During the third quarter of 2016, HSBC Bank USA, NA ("HSBC") agreed to sell the mortgage servicing rights for a significant portion of the mortgage loans currently subserviced by us. HSBC advised us that the purchaser of the mortgage servicing rights does not intend to retain us as subservicer, and we expect to transfer the loans in the fourth quarter of 2016.

This reduction is in addition to the previously announced intent of Merrill Lynch Home Loans, a division of Bank of America, National Association, to insource their entire subservicing portfolio no later than December 31, 2016.

As a result of these actions, we expect total subservicing units to decline by approximately 222,000, or 47% of the total subservicing units as of September 30, 2016. We estimate the combined actions represent a reduction in pre-tax earnings of approximately \$20 million on an annualized basis, exclusive of any offsetting management actions. In light of these developments, we are taking the necessary actions to realign our direct operating costs, including actions to re-engineer facilities and overhead costs.

There can be no assurances that our subservicing agreements or relationships will not be subject to further change. The terms of a substantial portion of our subservicing agreements allow the owners of the servicing to terminate the subservicing agreement without cause with respect to some or all of the subserviced loans and, in some cases, without payment of any termination fee. For information, see "—Risk Management—Counterparty and Concentration Risk" and "Part II—Item 1A. Risk Factors—Risks Related to Our Business—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 more information about our continuing evaluation of strategic alternatives for our business and our sale of MSRs, see "—Overview—Executive Summary".



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## Segment Metrics:

|  | September 30,      |           |                   |           |
|--|--------------------|-----------|-------------------|-----------|
|  | 2016               | 2015      |                   |           |
|  | (\$ In millions)   |           |                   |           |
| Total Loan Servicing Portfolio:                  |                    |           |                   |           |
| Unpaid Principal Balance                         | \$227,883          | \$226,949 |                   |           |
| Number of loans in owned portfolio (units)       | 588,700            | 658,051   |                   |           |
| Number of subserviced loans (units)              | 475,877            | 449,209   |                   |           |
| Total number of loans serviced (units)           | 1,064,577          | 1,107,260 |                   |           |
| Capitalized Servicing Portfolio:                 |                    |           |                   |           |
| Unpaid Principal Balance                         | \$88,622           | \$101,838 |                   |           |
| Capitalized servicing rate                       | 0.73               | % 0.91    | % %               |           |
| Capitalized servicing multiple                   | 2.6                | 3.2       |                   |           |
| Weighted-average servicing fee (in basis points) | 28                 | 29        |                   |           |
|  | Three Months Ended |           | Nine Months Ended |           |
|  | September 30,      |           | September 30,     |           |
|  | 2016               | 2015      | 2016              | 2015      |
|  | (In millions)      |           |                   |           |
| Total Loan Servicing Portfolio:                  |                    |           |                   |           |
| Average Portfolio UPB                            | \$229,969          | \$226,051 | \$230,479         | \$225,501 |
| Capitalized Servicing Portfolio:                 |                    |           |                   |           |
| Average Portfolio UPB                            | \$90,655           | \$103,207 | \$94,213          | \$106,953 |
| Payoffs and principal curtailments               | 5,335              | 4,888     | 14,102            | 14,854    |
| Sales  | 246                | 742       | 742               | 3,080     |

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## Segment Results:

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |        | Nine Months<br>Ended<br>September 30,<br>2015 |        |
|---|--|--------|---|--------|
|   | 2016   | 2015   | 2016  | 2015   |
|   | (In millions)  |        |   |        |
| 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 MSRs        | (4 )   | 50     | 139   | 54     |
| Net loan servicing income                         | 39   | 29     | 138   | 229    |
| Net interest expense:                             |  |        |   |        |
| Interest income                                   | 3  | 1      | 8   | 3      |
| Secured interest expense                          | (3 )   | (2 )   | (8 )  | (8 )   |
| Unsecured interest expense                        | (10 )  | (8 )   | (31 )   | (26 )  |
| Net interest expense                              | (10 )  | (9 )   | (31 )   | (31 )  |
| Other income                                      | —  | —      | —   | 3      |
| Net revenues                                      | 29   | 20     | 107   | 201    |
| Salaries and related expenses                     | 17   | 14     | 54  | 44     |
| Foreclosure and repossession expenses             | 10   | 11     | 26  | 41     |
| Professional and third-party service fees         | 9  | 5      | 27  | 19     |
| Technology equipment and software expenses        | 4  | 4      | 12  | 12     |
| Occupancy and other office expenses               | 4  | 5      | 13  | 13     |
| Depreciation and amortization                     | —  | —      | 2   | 1      |
| Other operating expenses                          | 37   | 58     | 79  | 137    |
| Total expenses                                    | 81   | 97     | 213   | 267    |
| Segment loss                                      | \$(52)   | \$(77) | \$(106)                                       | \$(66) |

Quarterly Comparison: Mortgage Servicing segment loss was \$52 million during the third quarter of 2016 compared to a loss of \$77 million during the prior year quarter. Net revenues increased to \$29 million, up \$9 million, or 45%, compared to the prior year quarter primarily driven by favorable changes in our MSR market-related fair value adjustments, net of related derivatives. Total expenses decreased to \$81 million, down \$16 million, or 16%, compared with the third quarter of 2015 primarily driven by a lower provision for legal and regulatory matters that was partially offset by an increase in Repurchase and foreclosure-related charges.

Net revenues. In recent periods, we have experienced a decline in our capitalized loan servicing portfolio from a persistent low interest rate environment leading to high prepayment activity and our execution of sales of MSRs under flow sale arrangements. As a result, Servicing fees from our capitalized portfolio decreased to \$67 million, down \$5 million, or 7%, compared to the prior year quarter driven by a 12% decrease in our average capitalized loan servicing portfolio.

MSR valuation changes from actual prepayments of the underlying mortgage loans decreased by \$3 million, or 9%, primarily due to a 20 basis point decrease in the value of actual prepayments that was partially offset by a 15% increase in payoffs in our capitalized servicing portfolio compared to the prior year quarter. MSR valuation changes from actual receipts of recurring cash flows decreased by \$3 million, or 33%, primarily due to a lower average capitalized servicing rate and a smaller portfolio size in the third quarter of 2016 compared to the prior year quarter.

During the third quarter of 2016, Market-related fair value adjustments decreased the value of our MSR's by \$9 million and net losses on MSR derivatives were \$4 million. The \$9 million unfavorable Market-related fair value adjustments during the third quarter of 2016 was primarily due to a flattening of the yield curve. The \$4 million of net losses on MSR derivatives was primarily attributable to changes in interest rates.

During the third quarter of 2015, Market-related fair value adjustments decreased the value of our MSR's by \$72 million, which was partially offset by \$50 million of net gains on MSR derivatives primarily related to a decrease in interest rates. The \$72 million negative Market-related fair value adjustments during the third quarter of 2015 is primarily attributable to a 28 basis point decrease in the modeled primary mortgage rate.



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Total expenses. Salaries and related expenses increased by \$3 million, or 21%, compared to the prior year quarter that was primarily attributable to higher management incentive compensation and an increased allocation of shared service employees to the Mortgage Servicing segment.

Professional and third-party service fees increased by \$4 million, or 80%, compared to the prior year quarter primarily driven by expenses incurred during 2016 related to compliance activities.

Repurchase and foreclosure-related charges increased by \$8 million from the prior year quarter primarily due to exposure for legacy repurchase claims from certain private investors and higher expenses not reimbursed pursuant to government mortgage insurance programs from an increase in estimated defect rates.

During the third quarter of 2016, we recorded an \$11 million provision for legal and regulatory matters, as compared to a \$44 million provision during the third quarter of 2015, due to various legal proceedings and regulatory investigations, examinations and inquiries that are still ongoing related to our legacy mortgage servicing practices.

See “—Other” for a more detailed discussion of expenses included in the Corporate overhead allocation.

Year-to-Date Comparison: Mortgage Servicing segment loss was \$106 million during the nine months ended September 30, 2016 compared to a loss of \$66 million during the prior year. Net revenues decreased to \$107 million, down \$94 million, or 47%, compared to the prior year primarily driven by unfavorable comparisons in our MSR market-related fair value adjustments, net of related derivatives. Total expenses decreased to \$213 million, down \$54 million, or 20%, compared with the prior year primarily driven by a lower provision for legal and regulatory matters and lower Foreclosure and repossession expenses that were partially offset by higher Salaries and related expenses and higher Professional and third-party service fees.

Net revenues. Servicing fees from our capitalized portfolio decreased to \$204 million, down \$24 million, or 11%, compared to the prior year driven by a 12% decrease in our average capitalized loan servicing portfolio. Late fees and other ancillary servicing revenue decreased by \$5 million, or 17% compared to the prior year, which was primarily driven by a loss on the sale of delinquent FNMA servicing in 2016 and higher repurchase activity related to Ginnie Mae buyout eligible loans as compared to the prior year.

MSR valuation changes from actual prepayments of the underlying mortgage loans decreased by \$23 million, or 23%, due to a 6% decrease in payoffs in our capitalized servicing portfolio and a 16 basis point decrease in the value of actual prepayments compared to the prior year. MSR valuation changes from actual receipts of recurring cash flows decreased by \$11 million, or 37%, due to a lower average capitalized servicing rate in the nine months ended September 30, 2016 compared to the prior year, as well as a favorable impact from the MSR value changes of Ginnie Mae buyout eligible loan transactions.

During the nine months ended September 30, 2016, Market-related fair value adjustments decreased the value of our MSRs by \$174 million which was partially offset by \$139 million of net gains on MSR derivatives from changes in interest rates. This activity was primarily due to a 57 basis point decline in the modeled primary mortgage rate and a flattening of the yield curve.

During the nine months ended September 30, 2015, Market-related fair value adjustments increased the value of our MSRs by \$9 million, and we recorded net gains on MSR derivatives of \$54 million from changes in interest rates. The \$9 million positive Market-related fair value adjustments during the nine months ended September 30, 2015 reflects favorable adjustments associated with updates to our prepayment model to align modeled and actual prepayments and changes from market data calibration that was partially offset by a 4 basis point decline in the modeled primary mortgage rate and model updates to reflect increased servicing costs and foreclosure losses.

Total expenses. Salaries and related expenses increased by \$10 million, or 23%, compared to the prior year and included \$2 million of severance costs incurred during 2016. The remaining \$8 million increase was attributable to \$5 million associated with an increased allocation of shared service employees to the Mortgage Servicing segment, \$2 million from higher management incentive compensation, and \$1 million from higher temporary contract labor to assist with short-term customer service projects.

Foreclosure and repossession expenses decreased by \$15 million from the prior year primarily driven by lower foreclosure activity and improved delinquencies that were partially the result of sales of MSRMs with respect to delinquent government loans.

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Professional and third-party service fees increased by \$8 million compared to the prior year primarily driven by expenses incurred during 2016 related to compliance activities.

Repurchase and foreclosure-related charges increased by \$5 million from the prior year primarily due to exposure for legacy repurchase claims from certain private investors.

During the nine months ended September 30, 2016, we recorded a \$16 million provision for legal and regulatory matters, as compared to a \$78 million provision in the prior year. We have continued to be subject to various legal proceedings and regulatory investigations, examinations and inquiries related to our legacy mortgage servicing practices.

Other expenses decreased by \$9 million from the prior year primarily due to a \$6 million provision for certain non-recoverable fees associated with foreclosure activities incurred during 2015 in which the reimbursement of fees to borrowers was completed in 2016.

Corporate overhead allocations increased by \$8 million compared to the prior year primarily due to an increased allocation of expenses to the Mortgage Servicing segment in 2016. See “—Other” for a more detailed discussion of the expenses included in the Corporate overhead allocation.

## Selected Income Statement Data:

|   | Three Months<br>Ended<br>September<br>30,<br>2016 |         | Nine Months<br>Ended<br>September 30,<br>2015 |         |
|---|---|---------|---|---------|
|   | 2016  | 2015    | 2016  | 2015    |
|   | (In millions)                                     |         |   |         |
| Loan servicing income:                              |   |         |   |         |
| Servicing fees from capitalized portfolio           | \$67  | \$72    | \$204   | \$228   |
| Subservicing fees                                   | 17  | 18      | 53  | 52      |
| Late fees and other ancillary servicing revenue     | 9   | 8       | 25  | 30      |
| Curtailment interest paid to investors              | (4 )  | (4 )    | (11 )   | (12 )   |
| Total   | \$89  | \$94    | \$271   | \$298   |
| Changes in fair value of mortgage servicing rights: |   |         |   |         |
| Actual prepayments of the underlying mortgage loans | \$(31)  | \$(34 ) | \$(79 )                                       | \$(102) |
| Actual receipts of recurring cash flows             | (6 )  | (9 )    | (19 )   | (30 )   |
| Market-related fair value adjustments               | (9 )  | (72 )   | (174 )  | 9       |
| Total   | \$(46)  | \$(115) | \$(272)                                       | \$(123) |
| Other operating expenses:                           |   |         |   |         |
| Corporate overhead allocation                       | \$13  | \$11    | \$40  | \$32    |
| Repurchase and foreclosure-related charges          | 7   | (1 )    | 10  | 5       |
| Legal and regulatory reserves                       | 11  | 44      | 16  | 78      |
| Other expenses                                      | 6   | 4       | 13  | 22      |
| Total   | \$37  | \$58    | \$79  | \$137   |



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## Other

We leverage a centralized corporate platform to provide shared services for general and administrative functions to our reportable segments. These shared services include support associated with, among other functions, information technology, enterprise risk management, internal audit, human resources, accounting and finance and communications. The costs associated with these shared general and administrative functions, in addition to the cost of managing the overall corporate function, are recorded within Other and allocated to our reportable segments through a corporate overhead allocation. The Corporate overhead allocation to each segment is determined based upon the actual and estimated usage by function or expense category. In January 2016, we evaluated the overhead allocation rate to each segment based upon their current revenues, expenses, headcount and usage, which resulted in an increase in the rate of allocation to our Mortgage Servicing segment with a corresponding decrease to our Mortgage Production segment for 2016 as compared to 2015.

## Results:

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |       | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |        |
|--|--|-------|---|--------|
|  | 2016   | 2015  | 2016  | 2015   |
|  | (In millions)  |       |   |        |
| Net revenues                               | \$—  | \$—   | \$—   | \$6    |
| Salaries and related expenses              | 16   | 13    | 47  | 43     |
| Professional and third-party service fees  | 20   | 25    | 67  | 82     |
| Technology equipment and software expenses | 5  | 4     | 15  | 13     |
| Occupancy and other office expenses        | 1  | —     | 2   | 2      |
| Depreciation and amortization              | 2  | 1     | 4   | 3      |
| Other operating expenses:                  |  |       |   |        |
| Loss on early debt retirement              | —  | —     | —   | 30     |
| Other                                      | 2  | 3     | 7   | 9      |
| Total expenses before allocation           | 46   | 46    | 142   | 182    |
| Corporate overhead allocation:             |  |       |   |        |
| Mortgage Production segment                | (28)   | (32)  | (92)  | (95)   |
| Mortgage Servicing segment                 | (13)   | (11)  | (40)  | (32)   |
| Total expenses                             | 5  | 3     | 10  | 55     |
| Net loss before income taxes               | \$(5)  | \$(3) | \$(10)  | \$(49) |

Quarterly Comparison: Net loss before income taxes was \$5 million during the third quarter of 2016, compared to a loss of \$3 million during the prior year quarter.

Total expenses. Total expenses before allocations remained consistent at \$46 million, compared to the prior year quarter. Salaries and related expenses increased to \$16 million, up \$3 million, or 23%, compared to the prior year quarter primarily from increased management incentive compensation. Professional and third-party service fees decreased to \$20 million, down \$5 million, or 20%, compared to the prior year quarter primarily from the increased costs in 2015 resulting from actions taken to separate our information technology systems from the Fleet business that was partially offset by increased costs in 2016 associated with our strategic review.

Year-to-Date Comparison: Net loss before income taxes was \$10 million during the nine months ended September 30, 2016, compared to a loss of \$49 million during the prior year.

Net revenues. There were no Net revenues during the nine months ended September 30, 2016 since the transition services agreement related to the sale of the Fleet business was substantially complete at the end of the second quarter of 2015. Net revenues from the transition service agreement during the nine months ended September 30, 2015 were \$6 million.

Total expenses. Total expenses before allocations decreased to \$142 million, down \$40 million, or 22%, compared to the prior year. Loss on early debt retirement during the nine months ended September 30, 2015 was due to a \$30 million loss associated with the exchange of the Convertible notes due in 2017. Salaries and related expenses increased to \$47 million, up \$4 million, or 9%, compared to the prior year quarter primarily from increased management incentive compensation. Professional and third-party service fees decreased to \$67 million, down \$15 million, or 18%, compared to the prior year primarily from the increased costs in 2015 resulting from actions taken to separate our information technology systems from the Fleet business that was partially offset by increased costs in 2016 associated with our strategic review.

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## RISK MANAGEMENT

We are exposed to various business risks which may significantly impact our financial results including, but not limited to: (i) interest rate risk; (ii) consumer credit risk; (iii) counterparty and concentration risk; (iv) liquidity risk; and (v) operational risk.

During the nine months ended September 30, 2016, there have been no significant changes to our liquidity risk. In addition, as of September 30, 2016, there were no significant concentrations of credit risk with any individual counterparty or group of counterparties with respect to our derivative transactions.

## Interest Rate Risk

Our principal market exposure is to interest rate risk, specifically long-term Treasury and mortgage interest rates due to their impact on mortgage-related assets and commitments. Additionally, our escrow earnings on our mortgage servicing rights are sensitive to changes in short-term interest rates such as LIBOR. We are also exposed to changes in short-term interest rates on certain variable rate borrowings related to mortgage warehouse debt. We anticipate that such interest rates will remain our primary benchmark for market risk for the foreseeable future.

Refer to “—Item 3. Quantitative and Qualitative Disclosures About Market Risk” for an analysis of the impact of changes in interest rates on the valuation of assets and liabilities that are sensitive to interest rates.

## Consumer Credit Risk

We are not subject to the majority of the credit-related risks inherent in maintaining a mortgage loan portfolio because loans are not held for investment purposes. Our exposure to consumer credit risk primarily relates to loan repurchase and indemnification obligations from breaches of representation and warranty provisions of our loan sale or servicing agreements, which result in indemnification payments or exposure to loan defaults and foreclosures.

We have established a loan repurchase and indemnification liability for our estimate of exposure to losses related to our obligation to repurchase or indemnify investors for loans sold. 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 approximately \$35 million which relates to our estimate of repurchase and foreclosure-related charges that may not be reimbursed pursuant to government mortgage insurance programs or in the event we do not file insurance claims.

Repurchase and foreclosure-related reserves consist of the following:

|   | September 30, 2016 |       | December 31, 2015 |      |
|---|--------------------|-------|-------------------|------|
|   | 2016               | 2015  | 2016              | 2015 |
|   | (In millions)      |       |                   |      |
| Loan repurchase and indemnification liability | \$ 65              | \$ 62 |                   |      |
| Adjustment to value for real estate owned     | 13                 | 17    |                   |      |
| Allowance for probable foreclosure losses     | 9                  | 10    |                   |      |
| Total   | \$ 87              | \$ 89 |                   |      |

During the nine months ended September 30, 2016, we received 298 new repurchase and indemnification requests. We subject the population of repurchase and indemnification requests received to a review and appeal process to establish the validity of the claim and corresponding obligation. As of September 30, 2016, we had \$41 million in unpaid principal balance of unresolved requests. Based on the last twelve months ended September 30, 2016, we

appealed approximately 70% of claims received and reviewed, and we were successful in refuting approximately 90% of claims appealed. See Note 9, 'Credit Risk' in the accompanying Notes to Condensed Consolidated Financial Statements for additional information regarding loan repurchase and indemnification requests and our repurchase and foreclosure-related reserves.



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### Counterparty and Concentration Risk

Production. For the nine months ended September 30, 2016, our mortgage loan originations were derived from our relationships with significant counterparties as follows:

27% through our PLS relationship with Merrill Lynch;

21% through our PLS relationship with Morgan Stanley Private Bank, N.A.;

20% through the Real Estate channel, from our relationships with Realogy and its affiliates; and

10% through our PLS relationship with HSBC Bank USA.

In November 2016, as an outcome of our strategic review process, we announced our intentions to exit our PLS business, which represented 78% of our total closing volume (based on dollars) for the nine months ended September 30, 2016. As a result of this transition, our remaining mortgage loan origination business and the operations of our Mortgage Production segment will be substantially dependent upon the Real Estate channel and our relationship with Realogy. Under the PHH Home Loans Operating Agreement, Realogy has the right at any time to give us two years notice of its intent to terminate its interest in PHH Home Loans, which subjects us to termination risk with respect to this relationship. We are continuing to explore our strategic options to identify the best course of action related to this channel. There can be no assurances that our closing volumes, agreements or relationships will not be subject to further change.

For further discussion, see "—Executive Summary" and "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.

Servicing. During the nine months ended September 30, 2016, there have been no significant changes to our servicing portfolio's geographic, delinquency, and agency concentration risks, as previously outlined in our 2015 Form 10-K. We have implemented a strategy to shift the mix of our servicing portfolio to a greater mix of subserviced loans. A substantial portion of our subservicing agreements allow the owners of the servicing to terminate the subservicing agreement without cause with respect to some or all of the subserviced loans and, in some cases, without payment of any termination fee.

As previously announced, during the third quarter of 2016, HSBC agreed to sell the mortgage servicing rights for a significant portion of the mortgage loans currently subserviced by us. HSBC advised us that the purchaser of the mortgage servicing rights does not intend to retain us as servicer. This reduction is in addition to the previously announced intent of Merrill Lynch to insource their subservicing portfolio no later than December 31, 2016. As a result of these actions, we expect total subservicing units to decline by approximately 222,000 units, or 47% of the total subservicing units as of September 30, 2016.

For our portfolio remaining after the expected HSBC and Merrill Lynch reductions, our top three clients represent 80% of the approximately 250,000 units. Our subservicing relationships may be negatively impacted by our planned exit of the PLS origination channel; two of our top three subservicing clients are currently PLS clients, and such clients may elect to transfer their subservicing relationships to other counterparties upon sourcing a new origination services provider.

There can be no assurances that our subservicing agreements or relationships will not be subject to further change. Market conditions, including interest rates and future economic projections, could impact investor demand to hold MSRs, which may result in our loss of additional subservicing relationships, or significantly decrease the number of loans under such relationships. Further, our ability to retain or attract subservicing clients may be negatively impacted by our ongoing strategic review. The termination of subservicing agreements on a material portion of our subservicing portfolio, or other significant reductions to our subservicing units, could adversely affect our business, financial condition, and results of operations.

For further discussion of concentration risks related to our subservicing agreements, see "Part I—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.

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### Operational Risk

Our business is subject to extensive regulation by federal, state and local government authorities, which require us to operate in accordance with various laws, regulations, and judicial and administrative decisions. While we are not a bank, our private label business subjects us to both direct and indirect banking supervision (including examinations by our private label clients' regulators), and each private label client requires a unique compliance model, which creates complexities and potential inefficiencies in our operations.

In recent years, there have been a number of developments in laws and regulations that have required, and will likely continue to require, widespread changes to our business. The frequent introduction of new rules, changes to the interpretation or application of existing rules, increased focus of regulators, and near-zero defect performance expectations have increased our operational risk related to compliance with laws and regulations. Further, in our mortgage origination and servicing activities, we are exposed to operational risk and events of non-compliance resulting from inadequate or failed internal processes or systems, human factors, or external events. We continually maintain and update our systems and procedures to comply with applicable laws and regulations and devote resources towards managing, assessing and reacting to developments, and we have enhanced our policies, procedures and controls framework to monitor and control this risk.

## LIQUIDITY AND CAPITAL RESOURCES

Our sources of liquidity include: unrestricted Cash and cash equivalents; proceeds from the sale or securitization of mortgage loans; secured borrowings, including mortgage warehouse and servicing advance facilities; cash flows from operations; the unsecured debt markets; asset sales; and equity and hybrid equity markets. Our primary operating funding needs arise from the origination and financing of mortgage loans and the retention of mortgage servicing rights. Our liquidity needs can also be significantly influenced by changes in interest rates due to collateral posting requirements from derivative agreements as well as the levels of repurchase and indemnification requests.

In the first quarter of 2016, we completed \$100 million of open market repurchases that started in November 2015, resulting in the retirement of 6.350 million shares at an average price per share of \$15.75. We have authorization from our Board of Directors to repurchase up to an additional \$150 million through December 31, 2016 under the open market repurchase program. As we currently intend to complete the final phase of our strategic review in January 2017, we do not expect to complete any further repurchases under the existing authorization. However, at that time, we expect to provide guidance with respect the amount and timing of any future shareholder distributions.

Given our expectation for business volumes, we believe that our sources of liquidity are adequate to fund our operations for at least the next 12 months.

### Cash Flows

Our total unrestricted cash position as of September 30, 2016 is \$996 million, which includes \$61 million of cash in variable interest entities. We will continue to maintain an excess unrestricted cash position to fund certain known or expected payments, to fund our working capital needs and to maintain cash reserves for contingencies. The following is a summary of certain key items that we considered in our analysis of cash requirements as of September 30, 2016:

\$355 million to \$405 million for identified contingencies, including amounts related to mortgage loan repurchases and legal and regulatory matters;

\$75 million to \$150 million cash reserves for mortgage-related interest rate risk management activities, including our current MSR hedge position; and

\$100 million to \$125 million for working capital needs.

After consideration of these total requirements of \$530 million to \$680 million, we have approximately \$255 million to \$405 million of excess cash available for operations, excluding cash in variable interest entities.

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The following table summarizes the changes in Cash and cash equivalents:

|  | Nine Months<br>Ended<br>September<br>30, |         |         |
|--|--|---------|---------|
|  | 2016                                     | 2015    | Change  |
|  | (In millions)                            |         |         |
| Cash provided by (used in):                          |  |         |         |
| Operating activities                                 | \$20                                     | \$59    | \$(39 ) |
| Investing activities                                 | 117                                      | 84      | 33      |
| Financing activities                                 | (47 )                                    | (420 )  | 373     |
| Net increase (decrease) in Cash and cash equivalents | \$90                                     | \$(277) | \$ 367  |

### Operating Activities

Our cash flows from operating activities reflect the net cash generated or used in our business operations and can be significantly impacted by the timing of mortgage loan originations and sales. The operating results of our businesses are impacted by significant non-cash activities which include: (i) the capitalization of mortgage servicing rights in our Mortgage Production segment and (ii) the change in fair value of mortgage servicing rights in our Mortgage Servicing segment.

During the nine months ended September 30, 2016, cash provided by our operating activities was \$20 million which was primarily driven by operating benefits from amendments to our private label and subservicing agreements that were partially offset by cash expenses related to re-engineering efforts and our strategic review.

During the nine months ended September 30, 2015, cash provided by our operating activities was \$59 million which was primarily driven by the impact of timing differences between the origination and sale of mortgages as Mortgage loans held for sale decreased by \$132 million between September 30, 2015 and December 31, 2014 that was partially offset by losses from operations related to the pricing levels and mix of closings of our private label agreements and cash investments related to our growth and re-engineering efforts.

### Investing Activities

Cash flows from investing activities include cash flows related to collateral postings or settlements of our MSR derivatives, proceeds on the sale of mortgage servicing rights, purchases of property and equipment and changes in the funding requirements of restricted cash.

During the nine months ended September 30, 2016, cash provided by our investing activities was \$117 million, which was driven by \$121 million of net cash received from MSR derivatives for cash collateral amounts and settlement activity due to changes in interest rates.

During the nine months ended September 30, 2015, cash provided by our investing activities was \$84 million, which was driven by \$49 million of net cash received from MSR derivatives related to the settlement of certain MSR-related instruments. In addition, cash provided by investing activities included \$45 million of cash received from proceeds from the sale of MSRs related to sales under our MSR flow sale arrangements and the sale of a population of highly delinquent government insured loans that was completed during the fourth quarter of 2014.

### Financing Activities

Our cash flows from financing activities include proceeds from and payments on borrowings under our mortgage warehouse facilities and our servicing advance facility. The fluctuations in the amount of borrowings within each period are due to working capital needs and the funding requirements for assets, including mortgage loans held for sale and mortgage servicing rights. The outstanding balances under our warehouse and servicing advance debt facilities vary daily based on our current funding needs for eligible collateral and our decisions regarding the use of excess available cash to fund assets. As of the end of each quarter, our financing activities and Condensed Consolidated Balance Sheets reflect our efforts to maximize secured borrowings against the available asset base, increasing the ending cash balance. Within each quarter, excess available cash is utilized to fund assets rather than using the asset-backed borrowing arrangements, given the relative borrowing costs and returns on invested cash.

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During the nine months ended September 30, 2016, cash used in our financing activities was \$47 million which primarily related to \$18 million of net payments on secured borrowings resulting from decreased funding requirements for servicing advances and mortgage loans held for sale and \$23 million used to retire shares in our open market share repurchase program.

During the nine months ended September 30, 2015, cash used in our financing activities was \$420 million which primarily related to \$275 million of cash paid to complete the exchange of the Convertible notes due in 2017 and \$133 million of net payments on secured borrowings primarily resulting from decreased funding requirements for Mortgage loans held for sale.

## Debt

The following table summarizes our Debt as of September 30, 2016:

|                            | Balance       | Collateral <sup>(1)</sup> |
|----------------------------|---------------|---------------------------|
|                            | (In millions) |                           |
| Warehouse facilities       | \$628         | \$ 664                    |
| Servicing advance facility | 97            | 168                       |
| Unsecured debt             | 607           | —                         |
| Total                      | \$1,332       | \$ 832                    |

<sup>(1)</sup> Assets held as collateral are not available to pay our general obligations.

See Note 7, 'Debt and Borrowing Arrangements' in the accompanying Notes to Condensed Consolidated Financial Statements for additional information regarding our debt covenants and other components of our debt.

## Warehouse Facilities

We utilize both committed and uncommitted warehouse facilities, and we evaluate our capacity need under these facilities based on forecasted volume of mortgage loan closings and sales. During the nine months ended September 30, 2016, we reduced the aggregate committed capacity of our facilities in response to our expected saleable production volume and to reduce expenses associated with the facilities.

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Mortgage warehouse facilities consisted of the following as of September 30, 2016:

|   | Balance       | Total Capacity | Available Capacity <sup>(1)</sup> | Maturity Date |
|---|---------------|----------------|-----------------------------------|---------------|
|   | (In millions) |                |                                   |               |
| Debt:                                     |               |                |                                   |               |
| Committed facilities:                     |               |                |                                   |               |
| Wells Fargo Bank, N.A.                    | \$ 329        | \$ 450         | \$ 121                            | 4/2/2017      |
| Bank of America, N.A.                     | 200           | 400            | 200                               | 12/16/2016    |
| Fannie Mae                                | —             | 300            | 300                               | 12/13/2016    |
| Barclays Bank PLC                         | 99            | 100            | 1                                 | 3/28/2017     |
| Committed warehouse facilities            | 628           | 1,250          | 622                               |               |
| Uncommitted facilities:                   |               |                |                                   |               |
| Fannie Mae                                | —             | 2,700          | 2,700                             | n/a           |
| Barclays Bank PLC                         | —             | 100            | 100                               | n/a           |
| Total                                     | \$ 628        | \$ 4,050       | \$ 3,422                          |               |
| Off-Balance Sheet Gestation Facilities:   |               |                |                                   |               |
| Uncommitted facilities:                   |               |                |                                   |               |
| JP Morgan Chase Bank, N.A. <sup>(2)</sup> | \$ 1          | \$ 250         | \$ 249                            | n/a           |

(1) Capacity is dependent upon maintaining compliance with the terms, conditions and covenants of the respective agreements and may be further limited by asset eligibility requirements.

(2) On October 10, 2016, we and JP Morgan Chase Bank, N.A. mutually agreed to reduce the total capacity to \$150 million.

#### Servicing Advance Funding Arrangements

As of September 30, 2016, there are \$668 million of Servicing advance receivables, net on our Condensed Consolidated Balance Sheets, including \$253 million funded from our capital, and the remainder funded as outlined below:

|                                     | Balance       | Total Capacity | Available Capacity <sup>(1)</sup> | Maturity Date          |
|-------------------------------------|---------------|----------------|-----------------------------------|------------------------|
|                                     | (In millions) |                |                                   |                        |
| Debt:                               |               |                |                                   |                        |
| Servicing Advance Receivables Trust | \$ 97         | \$ 155         | \$ 58                             | 6/15/18 <sup>(2)</sup> |
| Subservicing advance liabilities:   |               |                |                                   |                        |
| Client-funded amounts               | 318           | n/a            | n/a                               | n/a                    |
| Total                               | \$ 415        |                |                                   |                        |

(1) Capacity is dependent upon maintaining compliance with the terms, conditions and covenants of the respective agreements and may be further limited by asset eligibility requirements.

(2) The facility has a revolving period through June 15, 2017, after which the facility goes into amortization. The maturity date of June 15, 2018 presented above represents the final repayment date of the amortizing notes.

#### Unsecured Debt



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Unsecured borrowing arrangements consisted of the following as of September 30, 2016:

|                               | Balance       |          | Maturity  |
|-------------------------------|---------------|----------|-----------|
|                               | Balance at    |          | Date      |
|                               |               | Maturity |           |
|                               | (In millions) |          |           |
| 7.375% Term notes due in 2019 | \$ 272        | \$ 275   | 9/1/2019  |
| 6.375% Term notes due in 2021 | 335           | 340      | 8/15/2021 |
| Total                         | \$ 607        | \$ 615   | 0         |

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As of November 3, 2016, our credit ratings on our senior unsecured debt were as follows:

|                                   | Senior Short-Term |      |
|-----------------------------------|-------------------|------|
|                                   | Debt              | Debt |
| Moody's Investors Service         | B1                | NP   |
| Standard & Poor's Rating Services | B-                | N/A  |

In April 2016, following our announcements of a comprehensive review of all strategic options and origination reductions in the private label business, Standard & Poor's downgraded our senior unsecured rating from B+ to B. In October 2016, following announcements of Merrill Lynch terminating its private label origination services agreement and HSBC's August sale of a significant portion of their owned servicing rights to a purchaser who will not retain us as a servicer, Moody's downgraded our senior unsecured rating from Ba3 to B1 and assigned a Stable Outlook, while Standard & Poor's downgraded our issuer credit rating from B to B- and maintained a Negative Outlook.

A security rating is not a recommendation to buy, sell or hold securities, may not reflect all of the risks associated with an investment in our debt securities and is subject to revision or withdrawal by the assigning rating organization. Each rating should be evaluated independently of any other rating. Our senior unsecured long-term debt credit ratings are below investment grade, and as a result, our access to the public debt markets may be severely limited in comparison to the ability of investment grade issuers to access such markets. See further discussion at "Part I—Item 1A. Risk Factors—Liquidity Risks—We may be limited in our ability to obtain or renew financing in the unsecured credit markets on economically viable terms or at all, due to our senior unsecured long-term debt ratings being below investment grade and due to our history of reported losses from continuing operations since becoming a standalone mortgage company." in our 2015 Form 10-K.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have not been any significant changes to the critical accounting policies and estimates described under "Part II—Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates" in our 2015 Form 10-K.

#### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

For information regarding recently issued accounting pronouncements and the expected impact on our financial statements, see Note 1, 'Summary of Significant Accounting Policies' in the accompanying Notes to Condensed Consolidated Financial Statements.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

## Interest Rate Risk

Our principal market exposure is to interest rate risk, specifically long-term Treasury and mortgage interest rates due to their impact on mortgage-related assets and commitments. Additionally, our escrow earnings on our mortgage servicing rights are sensitive to changes in short-term interest rates such as LIBOR. We also are exposed to changes in short-term interest rates on certain variable rate borrowings including our mortgage warehouse debt and our servicing advance facility. The valuation of our Mortgage servicing rights is based, in part, on the realization of the forward yield curve due to the impact that expected future interest rates have on our expected cash flows. We anticipate that such interest rates will remain our primary benchmark for market risk for the foreseeable future.

We used September 30, 2016 market rates to perform a sensitivity analysis that measures the potential impact on fair values based on hypothetical changes (increases and decreases) in interest rates. The estimates assume instantaneous, parallel shifts in interest rate yield curves. These sensitivities are hypothetical and presented for illustrative purposes only. Changes in fair value based on variations in assumptions generally cannot be extrapolated because the relationship of the change in fair value may not be linear.

The following table summarizes the estimated change in the fair value of our Mortgage pipeline, Mortgage servicing rights and related derivatives and unsecured debt that are sensitive to interest rates as of September 30, 2016 given hypothetical instantaneous parallel shifts in the yield curve:

|   | Change in Fair Value |                |                |              |              |               |
|---|----------------------|----------------|----------------|--------------|--------------|---------------|
|   | Down<br>100 bps      | Down<br>50 bps | Down<br>25 bps | Up<br>25 bps | Up<br>50 bps | Up<br>100 bps |
|   | (In millions)        |                |                |              |              |               |
| Mortgage pipeline:                            |                      |                |                |              |              |               |
| Mortgage loans held for sale                  | \$6                  | \$5            | \$3            | \$(4)        | \$(8)        | \$(19)        |
| Interest rate lock commitments <sup>(1)</sup> | 12                   | 9              | 5              | (8)          | (17)         | (42)          |
| Forward loan sale commitments <sup>(1)</sup>  | (20)                 | (14)           | (8)            | 12           | 25           | 58            |
| Option contracts <sup>(1)</sup>               | —                    | —              | —              | —            | 1            | 3             |
| Total Mortgage pipeline                       | (2)                  | —              | —              | —            | 1            | —             |
| MSRs and related derivatives:                 |                      |                |                |              |              |               |
| Mortgage servicing rights                     | (19)                 | (104)          | (52)           | 50           | 98           | 182           |
| Derivatives related to MSRs <sup>(1)</sup>    | 218                  | 96             | 47             | (44)         | (87)         | (171)         |
| Total MSRs and related derivatives            | 20                   | (8)            | (5)            | 6            | 11           | 11            |
| Unsecured term debt                           | (21)                 | (10)           | (5)            | 5            | 10           | 20            |
| Total, net                                    | \$(3)                | \$(18)         | \$(10)         | \$11         | \$22         | \$31          |

<sup>(1)</sup> Included in Other assets or Other liabilities in the Condensed Consolidated Balance Sheets.

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Item 4. Controls and Procedures

DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this Report on Form 10-Q, management performed, with the participation of our Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures. Based on that evaluation, management concluded that our disclosure controls and procedures were effective as of September 30, 2016.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

For information regarding legal proceedings, see Note 10, 'Commitments and Contingencies' in the accompanying Notes to Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

This Item 1A. should be read in conjunction with "Part I—Item 1A. Risk Factors" in our 2015 Form 10-K. Other than with respect to the discussion below, there have been no material changes from the risk factors disclosed in our Form 10-K.

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.

On March 9, 2016, we announced that our board of directors and management team are undertaking a comprehensive review of all strategic options, including capital structure and deployment alternatives, to maximize value for shareholders. While we have announced certain conclusions reached and intended actions from this process to date, we are continuing our evaluation for the remainder of our business.

The process of exploring strategic options, and pursuing any related transactions, could cause distractions and disruptions in our business, and exposes us to risks including, but not limited to the following:

- We have diverted, and will continue to divert, significant management resources and attention in our effort to evaluate and execute strategic options, which could also negatively impact our business and results of operations.

The costs associated with the evaluation of strategic options could be significant, regardless of whether any transaction is consummated. While we assess and estimate the potential costs associated with each strategic alternative, our assessments and estimates may differ materially from actual costs and the value realized, if such alternatives are pursued. Factors that drive significant uncertainty around the total amount of costs include contractual complexities, tax outcomes, and timing, among other factors.

We may encounter difficulty in retaining key employees who may be concerned about their future roles with the Company. If such key employees leave the Company, we may encounter difficulty recruiting qualified replacements.

- Our unique business model and the specialized knowledge required to fulfill our operations exposes us to significant retention risk. If we are unsuccessful in retaining key employees, or attracting talent during our transition period, we may suffer increased costs to staff our business and potential contractual penalties or fees if we are unable to meet our obligations.

We need to maintain our overhead structure and re-engineer costs to an appropriate level to allow our continuing operations to be properly supported, to sustain our ongoing client relationships and to maintain compliance with all applicable legal, regulatory, and contractual requirements of our business. There can be no assurances that we will be able to reduce our overhead structure to a profitable scale, or that we will be successful in managing the risks of this effort.

Any disruptions in or uncertainty around our business could affect our relationships with customers and/or other counterparties, may have negative impacts on our credit rating and/or ability to obtain or renew financing, among other impacts.

All of the foregoing could materially and adversely affect our business and financial results.

There can be no assurances that any actions taken as a result of our strategic review will be beneficial to our shareholders. If a transaction is not successfully executed, the share price of our common stock may decline significantly to the extent that the current market price of our common stock reflects an expectation that a transaction

will be completed. In addition, with respect to our continuing evaluation, there is no assurance that any transaction will be consummated, and no assurances about the timing for the announcement or consummation of any such strategic transaction if pursued.

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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.

Our Company has historically differentiated itself in the market as an outsourced mortgage banking services provider to such financial institutions through our Private Label Solutions ("PLS") channel. This business represented 78% of our total loan closings for the nine months ended September 30, 2016. Despite having completed amendments to improve the economics of our PLS agreements in 2015, we have not been able to achieve profitable scale within this business for reasons including, but not limited to, the current regulatory environment for mortgage originations, increased regulatory related cost associated with being a Technology Services Provider under the Bank Services Company Act, increased regulatory scrutiny for our financial institution clients and related persistent high costs of compliance and contractual requirements to customize the business for each client. In addition, we have been faced with recent client contract terminations, which further negatively affects our ability to achieve profitable scale. For these reasons, as an outcome of our strategic review process, we announced in November 2016 that we intend to exit the PLS channel.

Risks specific to our plan to exit PLS include, but are not limited to:

• We may not complete the exit in our anticipated time frame;

• Our estimate of costs to exit the PLS business includes our forecast of the net loss of operating the business through the exit of the business, severance and retention costs, and facility and other costs. However, our actual costs incurred through this process may significantly exceed our current estimates. Factors that drive significant uncertainty around the total amount of costs include our ability to: negotiate terms of certain contracts, meet the timeline of the exit process, satisfy the contractual and regulatory requirements of the business during the wind-down period, and our expectations of origination volumes and costs during the exit period, among other factors; and

• Our need to maintain adequate staffing levels to fulfill our remaining obligations under the PLS agreements and satisfy associated compliance requirements.

All of the foregoing could materially and adversely affect our business and financial results.

Our evaluation of strategic alternatives for the PLS business included our assessment of the expected net present value of the estimated future operating losses of the business versus the costs we expect to realize to exit the business. Our decision to exit the business was reliant on the underlying estimates, and there can be no assurances that our exit of the PLS business will be as beneficial to shareholders as if we had not taken such action.

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.

For the nine months ended September 30, 2016, we originated 78% of our loan production through the PLS channel, 20% through the Real Estate channel and 2% through the Wholesale/correspondent channel. As a result of conclusions reached in our strategic review process, we completed the exit of the Wholesale/correspondent channel in the second quarter of 2016. Further, in November 2016, we announced our intentions to exit our PLS business. We are continuing to evaluate strategic options to identify the best course of action for our Real Estate channel, which consists of loans sourced through our joint venture with Realogy Corporation.

As a result of our strategic decisions related to our Mortgage Production origination channels, our remaining mortgage loan origination business is substantially dependent upon originations from the Real Estate channel and our relationship with Realogy.

**Relationship with Realogy.** We are party to a Strategic Relationship Agreement dated as of January 31, 2005 between PHH Mortgage, PHH Home Loans, PHH Broker Partner, Realogy Services Venture Partner Inc. and Cendant Corporation (now known as Avis Budget Group, Inc.). PHH Home Loans is a joint venture that was formed for the purpose of originating and selling mortgage loans that are primarily sourced from Realogy's owned real estate brokerage business. Under the Strategic Relationship Agreement, PHH Home Loans is the exclusive recommended provider of mortgage loans to the independent sales associates affiliated with the real estate brokerage business owned and operated by Realogy's affiliates and certain customers of Realogy.

Termination Rights. Unless terminated earlier, our relationship with Realogy continues until January 31, 2055. However, under the PHH Home Loans Operating Agreement, Realogy has the right at any time to give us two years notice of its intent to terminate its interest in PHH Home Loans.



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In addition, the Strategic Relationship Agreement and the PHH Home Loans Operating Agreement outline certain terms and events that would give Realogy the right to terminate the PHH Home Loans joint venture for cause. These terms and events include, but are not limited to, if:

We materially breach any representation, warranty, covenant or other agreement contained in the Strategic Relationship Agreement or certain other related agreements, including, without limitation to, our confidentiality obligations in the PHH Home Loans Operating Agreement, the PHH Home Loans Trademark License Agreement, and the Strategic Relationship Agreement, and our non-compete obligations in the Strategic Relationship Agreement that is not cured following any applicable notice or cure period;

We become subject to any regulatory order or governmental proceeding that prevents or materially impairs PHH Home Loans' ability to originate mortgage loans for any period of time (which order or proceeding is not generally applicable to companies in the mortgage lending business) in a manner that adversely affects the value of one or more of the quarterly distributions to be paid by PHH Home Loans pursuant to the PHH Home Loans Operating Agreement;

PHH Home Loans fails to make scheduled distributions pursuant to the PHH Home Loans Operating Agreement; or

- There is a change in control of us, PHH Broker Partner Corporation or any other affiliate of ours involving certain competitors or other specified parties.

Upon a termination of the PHH Home Loans joint venture by Realogy or its affiliates (whether for cause or upon two years notice without cause), Realogy will have the right either: (i) to require that we or certain of our affiliates purchase all of Realogy's interest in PHH Home Loans at the applicable purchase price set forth in the PHH Home Loans Operating Agreement; or (ii) to cause us to sell our interest in PHH Home Loans at the applicable sale price set forth in the PHH Home Loans Operating Agreement to an unaffiliated third party designated by certain of Realogy's affiliates. If we were required to purchase Realogy's interest in PHH Home Loans, such purchase could have a material adverse impact on our liquidity. Additionally, any termination of the PHH Home Loans joint venture will also result in a termination of the Strategic Relationship Agreement and our other agreements and arrangements with Realogy. Any such termination would likely result in the loss of most, if not all, of our mortgage loan originations and Net revenues derived from Realogy's affiliates, which would have a material adverse effect on our overall business and our consolidated financial position, results of operations, cash flows and liquidity.

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.

During 2016, we have previously disclosed expected reductions in our subservicing portfolio through Merrill Lynch's announced intent to insource their portfolio and HSBC's sale of a population of loans that we currently subservice. As a result of those actions, we currently expect that, by December 31, 2016, our subservicing portfolio will decline by approximately 222,000 units, or 47%, of our current total.

For our portfolio remaining after the expected HSBC and Merrill Lynch reductions, our top three clients represent 80% of the approximately 250,000 units. Our subservicing relationships may be negatively impacted by our intended exit of the PLS origination channel; two of our top three subservicing clients are currently PLS clients, and such clients may elect to transfer their subservicing relationships to other counterparties upon sourcing a new origination services provider.

Further, 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, without cause. Further terminations or material reductions in our subservicing portfolio could adversely affect our business, financial condition, and results of operations.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On June 26, 2014, our Board of Directors authorized up to \$250 million in open market purchases. We have \$150 million remaining under this authorization which extends through December 31, 2016. We did not complete any share repurchases during the third quarter of 2016.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Information in response to this Item is incorporated herein by reference to the Exhibit Index to this Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, on this 9<sup>th</sup> day of November, 2016.

PHH CORPORATION

By: /s/ Glen A. Messina  
Glen A. Messina  
President and Chief Executive Officer

By: /s/ Robert B. Crowl  
Robert B. Crowl  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

By: /s/ Michael R. Bogansky  
Michael R. Bogansky  
Senior Vice President, Controller  
(Principal Accounting Officer)

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## EXHIBIT INDEX

| Exhibit No. | Description   | Incorporation by Reference |
|-------------|---|----------------------------|
| 31.1        | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith.            |
| 31.2        | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith.            |
| 32.1        | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | Furnished herewith.        |
| 32.2        | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | Furnished herewith.        |
| 101.INS     | XBRL Instance Document.   | Filed herewith.            |
| 101.SCH     | XBRL Taxonomy Extension Schema Document.  | Filed herewith.            |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document.  | Filed herewith.            |
| 101.LAB     | XBRL Taxonomy Extension Labels Linkbase Document.   | Filed herewith.            |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document.   | Filed herewith.            |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document.   | Filed herewith.            |