OCWEN FINANCIAL CORP
Form 10-Q
May 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from: ______________________to ______________________

Commission File Number: 1-13219

Ocwen Financial Corporation

(Exact name of registrant as specified in its charter)

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

2002 Summit Boulevard, 6th Floor, Atlanta, Georgia 30319

(Address of principal executive offices) (Zip Code)

(561) 682-8000

(Registrant's telephone number, including area code)

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

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

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

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

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

Number of shares of Common Stock, $0.01 par value, outstanding as of May 3, 2013: 135,643,647 shares.

OCWEN FINANCIAL CORPORATION

FORM 10-Q

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Forward-Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact included in this report, including, without limitation, statements regarding our financial position, business strategy and other plans and objectives for our future operations, are forward-looking statements.

These statements include declarations regarding our management's beliefs and current expectations. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "could", "intend," "consider," "expec "intend," "plan," "anticipate," "believe," "estimate," "predict" or "continue" or the negative of such terms or other comparable terminology. Such statements are not guarantees of future performance and involve a number of assumptions, risks and uncertainties that could cause actual results to differ materially from expected results. Important factors that could cause actual results to differ include, but are not limited to, the risks discussed in "Risk Factors" and the following:

- the adequacy of our financial resources, including our sources of liquidity and ability to fund and recover advances, repay borrowings and comply with debt covenants;
- the characteristics of our servicing portfolio, including prepayment speeds along with delinquency and advance rates;
- our ability to grow and adapt our business, including the availability of new loan servicing and other accretive business opportunities;
- our ability to contain and reduce our operating costs;
- our ability to successfully modify delinquent loans, manage foreclosures and sell foreclosed properties;
- our reserves, valuations, provisions and anticipated realization on assets;
- our ability to effectively manage our exposure to interest rate changes and foreign exchange fluctuations;
- our credit and servicer ratings and other actions from various rating agencies;
- uncertainty related to general economic and market conditions, delinquency rates, home prices and disposition timelines on foreclosed properties;
- uncertainty related to the actions of loan owners, including mortgage-backed securities investors and government sponsored entities (GSEs), regarding loan put-backs, penalties and legal actions;
- uncertainty related to the processes for judicial and non-judicial foreclosure proceedings, including potential additional costs or delays or moratoria in the future or claims pertaining to past practices;
- uncertainty related to claims, litigation and investigations brought by private parties and government agencies regarding our servicing, foreclosure, modification and other practices;
- uncertainty related to legislation, regulations, regulatory agency actions, government programs and policies, industry initiatives and evolving best servicing practices; and
- uncertainty related to acquisitions, including our ability to integrate the systems, procedures and personnel of acquired companies.

Further information on the risks specific to our business is detailed within this report and our other reports and filings with the Securities and Exchange Commission (SEC) including our Annual Report on Form 10-K for the year ended December 31, 2012 and our current reports on Form 8-K. Forward-looking statements speak only as of the date they were made and except for our ongoing obligations under the U.S. federal securities laws, we undertake no obligation

to update or revise forward-looking statements whether as a result of new information, future events or otherwise.

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PART I - FINANCIAL INFORMATION
ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 2013	December 31, 2012
Assets		
Cash	$663,405	$220,130
Loans held for sale, at fair value	295,514	426,480
Advances	530,172	184,463
Match funded advances	3,436,083	3,049,244
Mortgage servicing rights, at amortized cost	1,052,168	676,712
Mortgage servicing rights, at fair value	84,534	85,213
Receivables, net	155,558	167,459
Deferred tax assets, net	95,137	92,136
Goodwill	503,617	371,083
Premises and equipment, net	58,863	37,536
Debt service accounts	134,157	88,748
Other assets	238,807	272,678
Total assets	$7,248,015	$5,671,882
Liabilities, Mezzanine Equity and Stockholders' Equity		
Liabilities		
Match funded liabilities	$2,982,984	$2,532,745
Other borrowings	1,987,894	1,096,679
Other liabilities	471,007	277,664
Total liabilities	5,441,885	3,907,088
Commitments and Contingencies (Note 24)		
Mezzanine Equity		
Series A Perpetual Convertible Preferred stock, $.01 par value; 200,000 shares authorized; 162,000 shares issued and outstanding at March 31, 2013 and December 31, 2012; redemption value $162,000 plus accrued and unpaid dividends	154,458	153,372
Stockholders' Equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 135,643,647 and 135,637,932 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	1,356	1,356
Additional paid-in capital	913,295	911,942
Retained earnings	747,141	704,565
Accumulated other comprehensive loss, net of income taxes	(10,120)	(6,441)
Total stockholders' equity	1,651,672	1,611,422

Total liabilities, mezzanine equity and stockholders' equity	$7,248,015	$5,671,882

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

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OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(Dollars in thousands, except per share data)

Three Months Ended March 31,	2013	2012
Revenue		
Servicing and subservicing fees	$369,309	$155,103
Gain on loans held for sale, net	6,749	—
Other revenues	30,601	9,443
Total revenue	406,659	164,546
Operating expenses		
Compensation and benefits	94,626	30,783
Amortization of servicing rights	47,883	14,314
Servicing and origination	23,913	3,287
Technology and communications	30,012	9,349
Professional services	14,065	8,559
Occupancy and equipment	18,249	15,305
Other operating expenses	14,778	4,530
Total operating expenses	243,526	86,127
Income from operations	163,133	78,419
Other income (expense)		
Interest income	5,185	2,312
Interest expense	(93,416)	(46,924)
Loss on debt redemption	(17,030)	—
Other, net	(6,537)	(3,688)
Other expense, net	(111,798)	(48,300)
Income before income taxes	51,335	30,119
Income tax expense	6,188	10,770
Net income	45,147	19,349
Preferred stock dividends	(1,485)	—
Deemed dividend related to beneficial conversion feature of preferred stock	(1,086)	—
Net income attributable to Ocwen common stockholders	$42,576	$19,349
Earnings per share attributable to Ocwen common stockholders		
Basic	$0.31	$0.15
Diluted	$0.31	$0.14
Weighted average common shares outstanding		
Basic	135,638,567	130,649,595
Diluted	139,559,157	138,046,270

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(unaudited)
(Dollars in thousands unless otherwise indicated)

Three Months Ended March 31,	2013	2012
Net income	$45,147	$19,349
Other comprehensive income (loss), net of income taxes:		
Unrealized foreign currency translation income (loss) arising during the period	37	1
Change in deferred loss on cash flow hedges arising during the period (1)	(4,126)	(1,187)
Reclassification adjustment for losses on cash flow hedges included in net income (2)	408	4,259
Net change in deferred loss on cash flow hedges	(3,718)	3,072
Other	2	1
Total other comprehensive income, net of income taxes	(3,679)	3,074
Comprehensive income	$41,468	$22,423

(1) Net of income tax benefit (expense) of $2.8 million and $0.7 million for the three months ended March 31, 2013 and 2012, respectively.

(2) Net of income tax benefit (expense) of $(0.2) million and $(2.4) million for the three months ended March 31, 2013 and 2012, respectively.

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(unaudited)
FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(Dollars in thousands)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Loss,	
	Shares	Amount	Capital	Earnings	Net of Taxes	Total
Balance at December 31, 2012	135,637,932	$ 1,356	$ 911,942	$ 704,565	$ (6,441)	$ 1,611,422
Net income	—	—	—	45,147	—	45,147
Preferred stock dividends ($9.17 per share	—	—	—	(1,485)	—	(1,485)
Deemed dividend related to beneficial conversion feature of preferred stock	—	—	—	(1,086)	—	(1,086)
Issuance of employee stock award	5,715	—	—	—	—	—
Equity-based compensation	—	—	1,353	—	—	1,353
Other comprehensive income, net of income taxes	—	—	—	—	(3,679)	(3,679)
Balance at March 31, 2013	135,643,647	$ 1,356	$ 913,295	$ 747,141	$ (10,120)	$ 1,651,672
Balance at December 31, 2011	129,899,288	$ 1,299	$ 826,121	$ 523,787	$ (7,896)	$ 1,343,311
Net income	—	—	—	19,349	—	19,349
Conversion of 3.25% Convertible Notes	4,635,159	46	56,364	—	—	56,410
Exercise of common stock options	313,028	3	1,016	—	—	1,019
Equity-based compensation	—	—	2,850	—	—	2,850
Other comprehensive income, net of income taxes	—	—	—	—	3,074	3,074
Balance at March 31, 2012	134,847,475	$ 1,348	$ 886,351	$ 543,136	$ (4,822)	$ 1,426,013

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

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

The Three Months Ended March 31,	2013	2012
Cash flows from operating activities		
Net income	$45,147	$19,349
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of mortgage servicing rights	47,883	14,314
Amortization of debt discount	424	745
Amortization of debt issuance costs – senior secured term loans	894	920
Depreciation	4,513	833
Loss on sales of loans	1,081	—
Realized and unrealized losses on derivative financial instruments, net	5,736	3,262
Loss on extinguishment of debt	17,030	—
Increase in deferred tax assets, net	(98)	(112)
Origination and purchase of loans held for sale	(2,515,084)	—
Proceeds from sale and collection of loans held for sale	2,629,152	241
Changes in assets and liabilities:		
Decrease in advances and match funded advances	186,420	318,386
Decrease (increase) in receivables and other assets, net	(47,860)	15,055
Increase in servicer liabilities	6,472	2,444
Increase (decrease) in other liabilities	12,511	(6,273)
Other, net	7,720	3,846
Net cash provided by operating activities	401,941	373,010
Cash flows from investing activities		
Cash paid to acquire ResCap Servicing Operations (a component of Residential Capital, LLC)	(2,097,821)	—
Purchase of mortgage servicing rights, net	(971)	—
Proceeds from sale of advance financing subsidiary and special purpose entity	—	87,303
Proceeds from sale of match funded advances	713,582	—
Proceeds from sale of subsidiaries	86,950	—
Net cash acquired in step acquisition of Correspondent One S.A.	22,108	—
Distributions of capital from unconsolidated entities	1,300	1,688
Additions to premises and equipment	(4,201)	(10,661)
Other	—	1,508
Net cash (used in) provided by investing activities	(1,279,053)	79,838
Cash flows from financing activities		
Net proceeds from match funded liabilities	450,239	79,707
Net proceeds from other borrowings	3,778,876	—
Repayment of other borrowings	(2,985,417)	(52,169)
Payment of debt issuance costs – senior secured term loan	(24,048)	—
Proceeds from sale of mortgage servicing rights accounted for as a financing	100,737	62,495
Redemption of 10.875% Capital Securities	—	(25)
Exercise of common stock options	—	1,023
Other	—	(4,167)
Net cash provided by financing activities	1,320,387	86,864

Net increase in cash	443,275	539,712
Cash at beginning of period	220,130	144,234
Cash at end of period	$663,405	$683,946

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

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

For the three months ended March 31,	2013	2012
Supplemental non-cash investing and financing activities		
Conversion of 3.25% Convertible Notes to common stock	$—	$56,410
Supplemental business acquisition information		
Fair value of assets acquired		
Advances	$(1,622,348)	$—
Mortgage servicing rights	(393,891)	—
Premises and equipment	(22,398)	—
Goodwill	(204,743)	—
Receivables and other assets	(2,989)	—
	(2,246,369)	—
Fair value of liabilities assumed		
Accrued expenses and other liabilities	74,340	—
Total consideration	(2,172,029)	—
Amount due to seller for purchase price adjustments	74,208	—
Cash paid	(2,097,821)	—
Less cash acquired	—	—
Net cash paid	$(2,097,821)	$

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013

(Dollars in thousands, except per share data or if otherwise indicated)

Note 1 Summary of Significant Accounting Policies
Organization

Ocwen Financial Corporation (NYSE: OCN) (Ocwen, OCN, "we", or "us") is a financial services holding company which, through its subsidiaries, is engaged in the servicing and origination of mortgage loans. Ocwen is headquartered in Atlanta, Georgia with offices in Florida, New Jersey, Pennsylvania, Texas, United States Virgin Islands (USVI) and Washington, DC and support operations in India and Uruguay. Ocwen is a Florida corporation organized in February 1988. Ocwen Loan Servicing, LLC (OLS), a wholly-owned subsidiary, is licensed to service mortgage loans in all fifty states, the District of Columbia and two U.S. territories. Homeward Residential, Inc. (Homeward), a wholly-owned subsidiary, is licensed to originate mortgage loans in 47 U.S. jurisdictions, including the District of Columbia and Puerto Rico.

At March 31, 2013, Ocwen directly or indirectly owned all of the outstanding stock of its primary operating subsidiaries: Homeward, OLS, Ocwen Financial Solutions Private Limited and Ocwen Mortgage Servicing, Inc. (OMS).

On February 15, 2013, OLS completed the acquisition of certain assets and operations of Residential Capital, LLC (ResCap), an indirect subsidiary of Ally Financial, Inc. (Ally), in connection with the asset sale by ResCap and certain of its subsidiaries pursuant to a plan under Chapter 11 of the Bankruptcy Code (the ResCap Acquisition). We purchased mortgage servicing rights (MSRs) related to "private label", Federal Home Loan Mortgage Corporation (Freddie Mac) and Government National Mortgage Association (Ginnie Mae) residential mortgage loans and master and sub-servicing agreements. The ResCap Acquisition included the related advances and related elements of the servicing platform for the MSRs and advances. This transaction did not involve the transfer of ownership of any legal entities.

On December 27, 2012, Ocwen completed the merger by and among Ocwen, O&H Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Ocwen, Homeward Residential Holdings, Inc. (Homeward Holding) and WL Ross & Co. LLC, a Delaware limited liability company as shareholder representative, pursuant to which O&H Acquisition Corp. merged with and into Homeward Holding with Homeward Holding continuing as the surviving corporation and becoming a wholly-owned subsidiary of Ocwen (the Homeward Acquisition). Homeward engages in the servicing of residential mortgage loans, the majority of which are nonprime, and also originates prime loans.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in conformity with the instructions of the Securities and Exchange Commission (SEC) to Form 10-Q and SEC Regulation S-X, Article 10, Rule 10-01 for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. In our opinion, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. The results of operations and other data for the three months ended March 31, 2013 are not necessarily indicative of the results that may be

expected for any other interim period or for the year ending December 31, 2013. The unaudited interim consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The preparation of financial statements in conformity with GAAP requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Material estimates that are particularly significant in the near or medium term relate to fair value measurements, the provision for potential losses that may arise from litigation proceedings, the amortization of MSRs and the valuation of goodwill and deferred tax assets.

Principles of Consolidation

Our financial statements include the accounts of Ocwen, its majority-owned subsidiaries and any variable interest entity (VIE) where we have determined that we are the primary beneficiary. We apply the equity method of accounting to investments when the entity is not a VIE, and we are able to exercise significant influence, but not control, over the policies and procedures of the entity but own 50% or less of the voting securities. We have eliminated intercompany accounts and transactions in consolidation.

Variable Interest Entities

We evaluate each special purpose entity (SPE) for classification as a VIE. When a SPE meets the definition of a VIE and we determine that Ocwen is the primary beneficiary, we include the SPE in our consolidated financial statements.

We have determined that the SPEs created in connection with our match funded financing facilities are VIEs of which we are the primary beneficiary. We also determined that we were the primary beneficiary for four residential mortgage loan securitization trusts.

Securitizations and Asset Backed Financing Arrangements

We securitize, sell and service residential mortgage loans and regularly transfer financial assets in connection with asset-backed financing arrangements. We have aggregated these securitizations and asset-backed financing arrangements into two groups: (1) securitizations of residential mortgage loans and (2) financings of advances on loans serviced for others.

Securitizations of Residential Mortgage Loans. Currently, we securitize and sell residential mortgage loans involving Ginnie Mae, Freddie Mac and Federal National Mortgage Association (Fannie Mae). We retain the right to service these loans and receive servicing fees based upon the securitized loan balances and certain ancillary fees, all of which are reported in servicing and subservicing fees on the Consolidated Statements of Operations. In prior years, we securitized residential mortgage loans through "private label" securitization trusts. We continued to be involved with the securitization trusts, typically by acting as the servicer or sub-servicer for the loans held by the trust and by retaining a beneficial ownership interest in the securitization trust. The beneficial interests that we held consisted of both subordinate and residual securities that were either retained at the time of the securitization or subsequently acquired. We held beneficial interests in five of these trusts. We also acquired residual and subordinated interests in six additional trusts where we were not the transferor but were the servicer.

In December 2012, we sold the beneficial interests that we held in the four consolidated securitization trusts and deconsolidated these securitization trusts. We also sold our retained interests in two of the seven unconsolidated securitization trusts. The beneficial interests that we hold in the five remaining unconsolidated securitization trusts have no value and no potential for significant cash flows in the future. In addition, at March 31, 2013, we had no other significant assets in our unaudited interim consolidated financial statements related to these securitization trusts. We have no obligation to provide financial support to unconsolidated securitization trusts and have provided no such support. The beneficial owners of the trusts can look only to the assets of the securitization trusts for satisfaction of the debt issued by the securitization trusts and have no recourse against the assets of Ocwen. The general creditors of Ocwen have no claim on the assets of the trusts.

Financings of Advances on Loans Serviced for Others. Match funded advances on loans serviced for others result from our transfers of residential loan servicing advances to SPEs in exchange for cash. We consolidate these SPEs because the transfers do not qualify for sales accounting treatment or because Ocwen is the primary beneficiary of the SPE.

These SPEs issue debt supported by collections on the transferred advances. We made these transfers under the terms of our advance facility agreements. We classify the transferred advances on our Consolidated Balance Sheet as Match funded advances and the related liabilities as Match funded liabilities. The SPEs use collections of the pledged advances to repay principal and interest and to pay the expenses of the SPE. Holders of the debt issued by these entities can look only to the assets of the SPE for satisfaction of the debt and have no recourse against Ocwen. The assets and liabilities of the advance financing SPEs are comprised solely of Match funded advances, Debt service accounts, Match funded liabilities and amounts due to affiliates. Amounts due to affiliates are eliminated in consolidation.

See Note 8 – Match Funded Advances, Note 12 – Debt Service Accounts and Note 14 – Match Funded Liabilities for additional information.

Reclassification

Within in the revenue section of the Consolidated Statement of Operations for the three months ended March 31, 2012, reclassified Process management fees of $8.8 million to Other revenues.

Within in the Other income (expense) section of the Consolidated Statement of Operations for the three months ended March 31 2012, we reclassified Loss on loans held for resale, net, of $(0.4) million and Equity in earnings of unconsolidated entities of $0.3 million to Other, net.

Within the operating activities section of the Consolidated Statement of Cash Flows for the three months ended March 31, 2012, we reclassified Provision for valuation allowance on mortgage servicing assets of $0.2 million, Loss on loans held for resale, net, of $0.4 million and Equity in earnings of unconsolidated entities of $(0.3) million to Other, net. Within the investing activities section we reclassified Proceeds from sales of real estate of $0.5 million, Decrease in restricted cash – for securitization investors of $42 thousand and Principal payments received on loans – restricted for securitization investors of $1.0 million to Other. Within the financing activities section we reclassified Repayment of secured borrowings – owed to securitization investors of $(1.7) million to Other.

Note 2 Recent Accounting Pronouncements

Accounting Standards Update (ASU) 2011-11, (Accounting Standards Codification (ASC) 210, Balance Sheet): Disclosures about Offsetting Assets and Liabilities. The amendments in this ASU require an entity to disclose information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. The disclosures relate to financial instruments and derivative instruments that are either (1) offset on the balance sheet under existing accounting guidance or (2) subject to an enforceable master netting arrangement or similar agreement. The Financial Accounting Standards Board (FASB) subsequently issued *ASU 2013-01*: *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,* on January 31, 2013 to clarify the scope of transactions that are subject to the disclosures about offsetting. ASU 2013-01 clarifies that ordinary trade receivables and payables are not in the scope of ASU 2011-11. Specifically, the amendments clarify that ASU 2011-11 applies to derivatives accounted for in accordance with ASC 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with ASC 210 or ASC 815 or subject to an enforceable master netting arrangement or similar agreement. Retrospective application is required for all comparative periods presented. Our adoption of these standards on January 1, 2013 did not have a material impact on our unaudited interim consolidated financial statements, as the requirements relate to disclosures only.

ASU 2013-02 (ASC 220, Comprehensive Income): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. On February 5, 2013, the FASB issued ASU 2013-02, which requires entities to disclose the following additional information about items reclassified out of accumulated other comprehensive income (AOCI):

- Changes in AOCI balances by component (e.g., unrealized gains or losses on available-for sale securities or foreign-currency items). Both before-tax and net-of-tax presentations of the information are acceptable as long as an entity presents the income tax benefit or expense attributed to each component of OCI and reclassification adjustments in either the financial statements or the notes to the financial statements.
- Significant items reclassified out of AOCI by component either on the face of the income statement or as a separate footnote to the financial statements.

The ASU does not change the current GAAP requirements for interim financial statement reporting of comprehensive income. That is, a total for comprehensive income must be reported in condensed interim financial statements in either (1) a single continuous statement or (2) two separate but consecutive statements. However, entities would also need to include information about (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI in their interim reporting periods. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The amendments in the ASU should be applied prospectively. Our adoption of these standards on January 1, 2013 did not have a material impact on our unaudited interim consolidated financial statements, as the requirements relate to disclosures only. However, we are required to disclose on the face of our statement of operations or in footnotes thereto the line items affected by any significant items reclassified from accumulated other comprehensive income to earnings and the before tax amount and the related effect on income tax expense of the reclassification.

ASU 2013-04 (ASC 405, Liabilities): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date, a consensus of the FASB Emerging Issues Task Force (EITF). On February 28, 2013, the FASB issued ASU 2013-04, which is based on a consensus reached by the EITF. The ASU requires entities to "measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following:

a. The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors
b. Any additional amount the reporting entity expects to pay on behalf of its co-obligors."

Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. The ASU permits entities to aggregate disclosures (as opposed to providing separate disclosures for each joint-and-several obligation). These disclosure requirements are incremental to the existing related-party disclosure requirements in ASC 850. The ASU is effective for all prior periods in fiscal years beginning on or after December 15, 2013 (and interim reporting periods within those years). The ASU should be applied retrospectively to obligations with joint-and-several liabilities existing at the beginning of an entity's fiscal year of adoption. Entities that elect to use hindsight in measuring their obligations during the comparative periods must disclose that fact. Early adoption is permitted. We are currently evaluating the effect of adopting this standard effective January 1, 2014, but we do not anticipate that our adoption will have a material impact on our consolidated financial statements.

ASU 2013-05 (ASC 830, Foreign Currency Matters): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity, a consensus of the FASB Emerging Issues Task Force. On March 4, 2013, the FASB issued ASU 2013-05, which indicates that the entire amount of a cumulative translation adjustment (CTA) related to an entity's investment in a foreign entity should be released when there has been a:

- sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in the foreign entity,
- loss of a controlling financial interest in an investment in a foreign entity (i.e., the foreign entity is deconsolidated) or
- step acquisition for a foreign entity (i.e., when an entity has changed from applying the equity method for an investment in a foreign entity to consolidating the foreign entity).

The ASU does not change the requirement to release a pro rata portion of the CTA of the foreign entity into earnings for a partial sale of an equity method investment in a foreign entity. The ASU is effective for fiscal years (and interim periods within those fiscal years) beginning on or after December 15, 2013. The ASU should be applied prospectively from the beginning of the fiscal year of adoption. We are currently evaluating the effect of adopting this standard effective January 1, 2014, but we do not anticipate that our adoption will have a material impact on our consolidated financial statements.

Note 3 Business Acquisitions

We completed the acquisitions of ResCap and Homeward as part of our ongoing strategy to expand our residential servicing business. We accounted for these transactions using the acquisition method which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. In a business combination, the initial allocation of the purchase price is considered preliminary and therefore subject to change until the end of the measurement period (up to one year from the acquisition date). Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the expected revenue and cost synergies of the combined business.

The pro forma consolidated results presented below for each business acquisition are not indicative of what our consolidated net earnings would have been had we completed the acquisitions on the dates indicated because of differences in servicing practices and cost structure between Ocwen and the acquiree. In addition, the pro forma consolidated results do not purport to project our combined future results nor do they reflect the expected realization of any cost savings associated with the acquisitions.

The acquisition of ResCap is treated as an asset acquisition for U.S. tax purposes. We expect the opening tax basis for the acquired assets and liabilities to be the fair value as shown in the purchase price allocation tables below. We expect the MSRs and goodwill to be treated as intangible assets acquired in connection with the purchase of a trade or business and as such, amortized over 15 years for U.S. tax purposes. The acquisition of Homeward was treated as a stock purchase for U.S. tax purposes.

Preliminary Purchase Price Allocation

The following table summarizes the fair values of assets acquired and liabilities assumed as part of the ResCap and Homeward Acquisitions:

Purchase Price Allocation	ResCap	Homeward
Cash	$—	$79,511
Loans held for sale (1)	—	558,721
Mortgage servicing rights (1)	393,891	358,119
Advances and match funded advances (1)	1,622,348	2,266,882
Deferred tax assets (1)	—	47,346
Premises and equipment (1)	22,398	16,803
Debt service accounts	—	69,287
Investment in unconsolidated entities (1)	—	5,485
Receivables and other assets (1)	2,989	56,886
Match funded liabilities	—	(1,997,459)
Other borrowings	—	(864,969)
Accrued bonuses	—	(35,201)
Checks held for escheat (1)	—	(16,418)
Other liabilities (1)	(74,340)	(80,112)
Total identifiable net assets	1,967,286	464,881
Goodwill (1)	204,743	300,843
Total consideration	$2,172,029	$765,724

(1) Initial fair value estimate

The estimated fair values of the assets acquired and liabilities assumed at the acquisition date, as set forth in the table above, includes some amounts based on preliminary fair value estimates. The following factors led to certain balances having preliminary fair value estimates:

- The complex nature of certain acquired assets and liabilities prevented us from completing our valuations and reconciliations;
- We engaged a third party specialist to assist in valuing certain assets and liabilities and this work is not yet complete; and
- Underlying information such as UPB and other loan level details have not yet been boarded and reconciled onto our servicing platform, and therefore, we have not been able to fully validate and reconcile certain asset and liability balances correlated with UPB data.

ResCap Acquisition

We completed the ResCap Acquisition on February 15, 2013. We acquired MSRs to “private label”, Freddie Mac and Ginnie Mae loans with an unpaid principal balance (UPB) of $107.3 billion and master servicing agreements with a UPB of $42.1 billion. We also assumed subservicing contracts with a UPB of $25.9 billion. In addition, until certain consents and court approvals are obtained, we will subservice MSRs with a UPB of $9.0 billion on behalf of ResCap. When such consents and approvals are obtained, we will purchase these MSRs and assume the subservicing contracts from ResCap. We also acquired certain diversified fee-based business operations that include recovery, title and closing services.

To finance the ResCap Acquisition, we deployed $840.0 million of net additional capital from the proceeds of a new $1.3 billion senior secured term loan (SSTL) facility and borrowed $1.2 billion pursuant to two new servicing advance facilities and one existing facility.

Our purchase agreement with ResCap allows us to fully assess the valuation of the assets acquired and liabilities assumed during the 120 days following the closing. Any measurement period adjustments that we determine to be material will be applied retrospectively to the period of acquisition, and depending on the nature of the adjustments, other periods subsequent to the period of acquisition could also be affected.

Ocwen assumed certain limited liabilities as part of the transaction, including certain employee liabilities and certain business payables outstanding at the closing date. Under the agreement with ResCap, Ocwen generally did not assume any contingent obligations, including pending or threatened litigation, financial obligations in connection with any settlements, orders, or similar agreements entered into by ResCap or obligations in connection with any representations or warranties associated with loans previously sold by ResCap except litigation that may arise in the ordinary course of servicing mortgage loans relating to servicing agreements assumed by Ocwen. Ocwen assumed all liabilities related to servicing loans that are guaranteed by Ginnie Mae, whether arising prior to or after the closing date.

Post-Acquisition Results of Operations

The following table presents the revenue and earnings of the ResCap Business operations that are included in our unaudited Consolidated Statement of Operations from the acquisition date of February 15, 2013 through March 31, 2013:

Revenues	$74,853
Net income	$14,879

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Pro Forma Results of Operations

The following table presents supplemental pro forma information for the three months ended March 31, 2013 and 2012 as if the ResCap Acquisition occurred on January 1, 2012. Pro forma adjustments include:

- conforming servicing revenues to the revenue recognition policies followed by Ocwen;
- conforming the accounting for MSRs to the valuation and amortization policies of Ocwen;
- adjusting interest expense to eliminate the pre-acquisition interest expense of ResCap and to recognize interest expense as if the acquisition-related debt of Ocwen had been outstanding at January 1, 2012; and
- reporting acquisition-related charges for professional services related to the acquisition as if they had been incurred in 2012 rather than 2013.

For Three Months Ended March 31:	2013	2012
Revenues	$529,250	$303,735
Net income (loss)	$51,180	$(6,197)

Through March 31, 2013, we incurred $1.8 million of fees for professional services related to the ResCap Acquisition that are included in Operating expenses.

Homeward Acquisition

We completed the Homeward Acquisition on December 27, 2012. We acquired the MSRs and subservicing for approximately 421,000 residential mortgage loans with a UPB of approximately $77.0 billion. We also acquired Homeward's loan origination platform and its diversified fee-based business that includes property valuation, REO management, title, closing and advisory services.

Our purchase agreement with Homeward allows us to fully assess the valuation of the assets and liabilities acquired during an evaluation period that extends beyond the date of these unaudited interim consolidated financial statements. Because the measurement period is still open, we expect that certain fair value estimates will change once we receive all information necessary to make a final fair value assessment. We expect that the measurement period will extend until at least June 30, 2013. Any measurement period adjustments that we determine to be material will be applied retrospectively to the period of acquisition in our consolidated financial statements and, depending on the nature of the adjustments, other periods subsequent to the period of acquisition could also be affected.

On March 29, 2013, Ocwen sold the Homeward diversified fee-based to Altisource Solutions S.à r.l. and Altisource Portfolio Solutions, Inc., wholly-owned subsidiaries of Altisource Portfolio Solutions S.A. (Altisource), for an aggregate purchase price of $87.0 million in cash. Ocwen sold its investment in two subsidiaries of Homeward, Beltline Road Insurance Agency, Inc. and Power Default Services, Inc. As part of this transaction, Ocwen also agreed to sell certain designated assets used or usable in the business conducted by another Homeward subsidiary, Power Valuation Services, Inc., as well as certain designated intellectual property and information technology assets that are used or usable in the business conducted by the acquired subsidiaries or by Powerline Valuation Services, Inc. Altisource also assumed certain liabilities of the diversified fee-based business. The carrying value of the net assets sold approximated the sales price. The assets sold consisted of receivables and other assets of $18.7 million. The liabilities assumed by Altisource of $4.0 million consisted principally of deferred revenue. At the time of the sale, we derecognized goodwill of $72.3 million associated with the sold business. The purchase price is subject to a working capital and net income adjustment to be determined within 90 days of the closing date. In connection with this transaction, Ocwen entered into amendments to certain of its services and intellectual property agreements with Altisource. See Note 22 – Related Party Transactions for a discussion of these amendments.

Pro Forma Results of Operations

The following table presents supplemental pro forma information for the three months ended March 31, 2012 as if the acquisition of Homeward occurred on January 1, 2011. Pro forma adjustments include:

- conforming servicing revenues to the revenue recognition policy followed by Ocwen;
- conforming the accounting for MSRs to the valuation and amortization policies of Ocwen;
- reversing depreciation recognized by Homeward and reporting depreciation based on the estimated fair values and remaining lives of the acquired premises and equipment at the date of acquisition;
- adjusting interest expense to eliminate the pre-acquisition interest expense of Homeward and to recognize interest expense as if the acquisition-related debt of Ocwen had been outstanding at January 1, 2011 and
- reporting acquisition-related charges for professional services related to the acquisition as if they had been incurred in 2011 rather than 2012.

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Revenues	$277,635
Net income	$22,928

Other

On March 31, 2013, we increased our ownership in Correspondent One S.A. (Correspondent One), an entity formed with Altisource in March 2011, from 49% to 100%. We acquired the shares of Correspondent One held by Altisource (49% interest) for $12.6 million and acquired the remaining shares held by an unrelated entity for $0.9 million. We accounted for this transaction as a step acquisition and recognized the assets acquired and liabilities assumed at their fair values as of the acquisition date. The acquired net assets were $26.3 million and consisted primarily of cash ($23.0 million) and residential mortgage loans ($1.1 million). We remeasured our previously held investment, which we accounted for using the equity method, at fair value and recognized a loss of $0.4 million. We also recognized goodwill of $0.1 million. We began including the accounts of Correspondent One in our consolidated financial statements effective on the date of acquisition and have eliminated our investment in consolidation. Correspondent One facilitates the purchase of conforming and government-guaranteed residential mortgages from approved mortgage originators and resells the mortgages to secondary market investors. Correspondent One is not material to our financial condition, results of operations or cash flows.

Note 4 Asset Sales and Financing

In order to efficiently finance our assets and operations, we periodically sell the right to receive servicing fees, excluding ancillary income, relating to certain of our mortgage servicing rights (Rights to MSRs) and related advances (collectively HLSS Transactions) to Home Loan Servicing Solutions, Ltd. and its wholly owned subsidiary, HLSS Holdings, LLC (collectively HLSS). To the extent applicable, HLSS may also acquire certain advance SPEs and the related match funded liabilities. During the three months ended March 31, 2013 and 2012, we completed HLSS Transactions relating to the Rights to MSRs for $15.9 billion and $15.2 billion of UPB, respectively.

As part of the HLSS Transactions, we retain legal ownership of the MSRs and continue to service the related mortgage loans. However, we service the loans for a reduced fee because HLSS has assumed the match funded liabilities as well as the obligation for future servicing advances related to the MSRs. We are obligated to transfer legal ownership of the MSRs to HLSS upon obtaining all required third party consents. At that time, we would subservice the MSRs pursuant to our subservicing agreement with HLSS which was executed on February 10, 2012. See Note 22 – Related Party Transactions for additional information.

The following table provides a summary of the assets and liabilities sold to HLSS in connection with the HLSS Transactions during the three months ended March 31:

	2013	2012
Sale of MSRs accounted for as a financing	$100,707	$62,458
Sale of match funded advances	703,206	—
Sale of advance SPEs:		
Match funded advances	—	413,374
Debt service account	—	14,786
Prepaid lender fees and debt issuance costs	—	5,422
Other prepaid expenses	—	1,928
Match funded liabilities	—	(358,335)
Accrued interest payable and other accrued expenses	—	(841)
Net assets of advance SPEs	—	76,334
Sales price, as adjusted	803,913	138,792
Amount due to HLSS for post-closing adjustments at March 31	10,406	11,006
Cash received	$814,319	$149,798

Because we retained legal title to the MSRs, the sales of Rights to MSRs are accounted for as financings. The related advance sales meet the requirements for sale accounting under GAAP. When HLSS acquired advance SPEs from Ocwen, we derecognized the consolidated assets and liabilities of the Advance SPEs at the time of the sale. To the extent that we obtain all third party consents, legal title will transfer to HLSS, at which point we will derecognize the related MSRs. Upon derecognition, any resulting gain or loss will be deferred and amortized over the expected life of the related subservicing agreement. Until such time, we continue to recognize the full amount of servicing revenue and amortization of the MSRs.

Note 5 Fair Value of Financial Instruments

Fair value is estimated based on a hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs are inputs that reflect the assumptions that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy prioritizes the inputs to valuation techniques into three broad levels whereby the highest priority is given to Level 1 inputs and the lowest to Level 3 inputs.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs for the asset or liability.

We classify assets in their entirety based on the lowest level of input that is significant to the fair value measurement.

The carrying amounts and the estimated fair values of our financial instruments and our nonfinancial assets measured at fair value are as follows:

	Level	March 31, 2013		December 31, 2012	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:					
Loans held for sale, at fair value (1)	2	$295,514	$295,514	$426,480	$426,480
Loans held for sale, at lower of cost or fair value (2)	3	62,615	62,615	82,866	82,866
Advances and match funded advances (3)	3	3,966,255	3,966,255	3,233,707	3,233,707
Receivables, net (3)	3	155,558	155,558	167,459	167,459
Financial liabilities:					
Match funded liabilities (3)	3	$2,982,984	$2,982,984	$2,532,745	$2,533,278
Other borrowings (3)	3	1,987,894	1,989,104	1,096,679	1,101,504
Derivative financial instruments (1):					
Interest rate lock commitments (IRLCs)	2	$4,652	$4,652	$5,781	$5,781
Interest rate swaps	3	(18,758)	(18,758)	(10,836)	(10,836)
Forward MBS trades	1	(1,108)	(1,108)	(1,719)	(1,719)
U.S. Treasury futures	1	—	—	(1,258)	(1,258)
Interest rate caps	3	123	123	168	168
MSRs, at fair value (1)	3	$84,534	$84,534	$85,213	$85,213

(1) Measured at fair value on a recurring basis.

(2) Measured at fair value on a non-recurring basis.

(3) Financial instruments disclosed, but not carried, at fair value.

The following tables present a reconciliation of the changes in fair value of Level 3 assets that we measure at fair value on a recurring basis:

	Derivative Financial Instruments	MSRS at Fair Value	Total
Three Months Ended March 31, 2013:			
Beginning balance	$ (10,668)	$ 85,213	$74,545
Purchases, issuances, sales and settlements:			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	310	—	310
	310	—	310
Total realized and unrealized gains and (losses) (1):			

Included in Other, net	(1,353)	(679)	(2,032)
Included in Other comprehensive income (loss)	(6,924)	—	(6,924)
	(8,277)	(679)	(8,956)
Transfers in and / or out of Level 3	—	—	—
Ending balance	$ (18,635)	$ 84,534	$65,899

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	Derivative Financial Instruments	MSRS at Fair Value	Total
Three Months Ended March 31, 2012:			
Beginning balance	$ (16,676)	$ —	$ (16,676)
Purchases, issuances, sales and settlements:			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	2,357	—	2,357
	2,357	—	2,357
Total realized and unrealized gains and (losses) (2):			
Included in Other, net	3,468	—	3,468
Included in Other comprehensive income (loss)	(1,955)	—	(1,955)
	1,513	—	1,513
Transfers in and / or out of Level 3	—	—	—
Ending balance	$ (12,806)	$ —	$ (12,806)

(1) Total net gains (losses) attributable to derivative financial instruments still held at March 31, 2013 and 2012 were $(4.8) million and $(4.3) million, respectively.

The methodologies that we use and key assumptions that we make to estimate the fair value of financial instruments and other assets and liabilities measured at fair value on a recurring or non-recurring basis are described below:

Loans Held for Sale

We originate and purchase residential mortgage loans that we intend to sell to Freddie Mac and Fannie Mae (together with Ginnie Mae the GSEs). We also own residential mortgage loans that are not eligible to be sold to the GSEs due to delinquency or other issues. Residential mortgage loans that we intend to sell to the GSEs are carried at fair value as a result of a fair value election. Such loans are subject to changes in fair value due to fluctuations in interest rates from the closing date through the date of the sale of the loan into the secondary market. These loans are classified within Level 2 of the valuation hierarchy as the primary component of the price is obtained from observable values of mortgage forwards for loans of similar terms and characteristics. We have the ability to access this market, and it is the market into which conforming mortgage loans are typically sold.

We report all other loans held for sale at the lower of cost or fair value. Current market illiquidity has reduced the availability of observable pricing data for certain of these loans. When we enter into an agreement to sell a loan or pool of loans to an investor at a set price, we value the loan or loans at the commitment price. We base the fair value of uncommitted loans on the expected future cash flows discounted at a rate commensurate with the risk of the estimated cash flows. Assumptions used in the valuation of performing loans include historical default rates, re-performance rates on defaulted loans, loss severity on defaulted loans, average resolution timeline, average coupon rate; and a discount rate. Significant assumptions used in the valuation of nonperforming loans include the current market value of the underlying collateral based on third party sources such as appraisals or broker price opinions, resolution timeline, estimated foreclosure and disposition costs that are based on historical experience and a discount rate. The assumptions we used in the valuation of these performing and non-performing loans at March 31, 2013 have not changed significantly from those we used in the December 31, 2012 valuations.

We repurchase certain loans from Ginnie Mae guaranteed securitizations in connection with loan modifications and loan resolution activity as part of our servicing obligations. These are classified as loans held for sale (and carried at

the lower of cost or fair value), as we expect to redeliver (sell) the loans to new Ginnie Mae guaranteed securitizations in the case of modified loans. The fair value of these loans is estimated using published forward Ginnie Mae prices. Loans repurchased in connection with loan resolution activities are modified or otherwise remediated through loss mitigation activities or are reclassified to receivables. Because these loans are insured or guaranteed by the Federal Housing Administration (FHA) or U.S Department of Veterans Affairs (VA), the fair value of these loans represents the net recovery value taking into consideration the insured or guaranteed claim.

Mortgage Servicing Rights

Amortized Cost MSRs

We estimate the fair value of MSRs carried at amortized cost using a combination of internal models and data provided by third-party valuation experts. The most significant assumptions used in the valuation of MSRs are the speed at which mortgages prepay and delinquency experience. Other assumptions typically used in the valuation of MSRs are:

- Cost of servicing
- Discount rate
- Interest rate used for computing the cost of Servicing advances
- Interest rate used for computing float earnings
- Compensating interest expense
- Collection rate of other ancillary fees

The significant components of the estimated future cash inflows for MSRs include servicing fees, late fees, float earnings and other ancillary fees. Significant cash outflows include the cost of servicing, the cost of financing servicing advances and compensating interest payments.

We perform an impairment analysis based on the difference between the carrying amount and fair value after grouping our loans into the applicable strata. As a result of the Homeward and ResCap Acquisitions, management has re-evaluated the portfolio and determined the appropriate strata are Agency and Non-Agency. The Agency stratum includes all GSE MSRs. The Non-Agency stratum includes all “private label” primary and master MSRs.

We estimate fair value using internal models and with the assistance of third-party valuation experts. Our internal models calculate the present value of expected future cash flows utilizing assumptions that we believe are used by market participants. We derive prepayment speeds and delinquency assumptions from historical experience adjusted for prevailing market conditions. We utilize discount rates provided by third-party valuation experts and we consider external market-based assumptions in determining the interest rate for the cost of financing advances, the interest rate for float earnings and the cost of servicing.

Third-party valuation experts generally utilize: (a) transactions involving instruments with similar collateral and risk profiles, adjusted as necessary based on specific characteristics of the asset or liability being valued; and/or (b) industry-standard modeling, such as a discounted cash flow model in arriving at their estimate of fair value. The prices provided by the valuation experts reflect their observations and assumptions related to market activity, including risk premiums and liquidity adjustments. The models and related assumptions used by the valuation experts are owned and managed by them and, in many cases, the significant inputs used in the valuation techniques are not reasonably available to us. However, we have an understanding of the processes and assumptions used to develop the prices based on our ongoing due diligence, which includes regular discussions with the valuation experts. We believe that the procedures executed by the valuation experts, combined with our internal verification and analytical procedures, provide assurance that the prices used in our consolidated financial statements comply with the accounting guidance for fair value measurements and disclosures and reflect the assumptions that a market participant would use.

The more significant assumptions used in the March 31, 2013 valuation of our MSRs carried at amortized cost include:

- Prepayment speeds ranging from 2.45% to 24.67% (weighted average of 15.57%) depending on loan type;
- Delinquency rates ranging from 6.63% to 46.55% (weighted average of 16.25%) depending on loan type;
- Interest rate of 1-month LIBOR plus 4% for computing the cost of financing advances;
- Interest rate of 1-month LIBOR for computing float earnings; and
- Discount rates ranging from 12.23% to 20% (weighted average of 17.14%).

We perform an impairment analysis based on the difference between the carrying amount and fair value after grouping our loans into the applicable strata based on one or more of the predominant risk characteristics of the underlying loans. As a result of the Homeward and ResCap Acquisitions, management has re-evaluated the portfolio and determined the appropriate strata are Agency and Non-Agency. The Agency stratum includes all GSE MSRs. The Non-Agency stratum includes all “private label” primary and master MSRs.

Fair Value MSRs

MSRs carried at fair value are classified within Level 3 of the valuation hierarchy due to the use of third party valuation expert pricing without adjustment. The fair value of these MSRs is within the range of prices provided by the valuation experts, however, a change in the valuation inputs utilized by the valuation expert or a change in the best point price in the range might result in a significantly higher or lower fair value measurement.

The key assumptions (generally unobservable inputs) used in the valuation of these MSRs include:

- Mortgage prepayment speeds;
- Delinquency rates and
- Discount rates.

The primary assumptions used in the March 31, 2013 valuation include a 13.2% weighted average constant prepayment rate and a discount rate equal to 1-Month LIBOR plus a range of 7.5% to 9.35%.

Advances

We value advances that we make on loans that we service for others at their net realizable value which generally approximates fair value because advances have no stated maturity, generally are realized within a relatively short period of time and do not bear interest.

Receivables

The carrying value of receivables generally approximates fair value because of the relatively short period of time between their origination and realization.

Borrowings

The carrying value of match funded liabilities and secured borrowings that bear interest at a rate that is adjusted regularly based on a market index approximates fair value. For other match funded or secured borrowings that bear interest at a fixed rate, we determine fair value by discounting the future principal and interest repayments at a market rate commensurate with the risk of the estimated cash flows. We estimate principal repayments of match funded liabilities during the amortization period based on our historical advance collection rates and taking into consideration any plans to refinance the notes. At March 31, 2013, the interest on all borrowings under match funded facilities was based on a variable rate adjusted regularly using a market index and therefore the carrying value approximates fair value. For the SSTL, we used a discount rate of 5.16% and the repayment schedule specified in the loan agreement to determine fair value.

Derivative Financial Instruments

We use interest rate swaps to hedge against the effects of changes in interest rates on our borrowings under advance funding facilities. These derivatives are not exchange-traded and therefore quoted market prices or other observable inputs are not available. Fair value is based on information provided by third-party pricing sources. Third-party valuations are derived from proprietary models based on inputs that include yield curves and contractual terms such as fixed interest rates and payment dates. Although we have not adjusted the information obtained from the third-party pricing sources, we review this information to ensure that it provides a reasonable basis for estimating fair value. Our review is designed to identify information that appears stale, information that has changed significantly from the prior period and other indicators that the information may not be accurate. For interest rate contracts, significant increases or decreases in the unobservable portion of the yield curves in isolation will result in substantial changes in the fair value measurement.

In addition, we use interest rate caps to minimize future interest rate exposures on variable rate debt issued on servicing advance facilities from increases in one-month LIBOR interest rates. The fair value for interest rate caps is based on counterparty market prices and adjusted for counterparty credit risk.

We enter into forward trades to provide an economic hedge against changes in the fair value of loans held for sale carried at fair value. Forward trades are primarily used to fix the forward sales price that will be realized upon the sale of mortgage loans into the secondary market. Forward contracts are actively traded in the market, thus they are classified within Level 1 of the valuation hierarchy.

IRLCs represent an agreement to purchase loans from a third-party originator, or an agreement to extend credit to a mortgage applicant (locked pipeline), or an agreement to sell a loan to investors, whereby the interest rate is set prior to funding. IRLCs are classified within Level 2 of the valuation hierarchy as the primary component of the price is obtained from observable values of mortgage forwards for loans of similar terms and characteristics. Fair value amounts of IRLCs are adjusted for expected “fallout” (locked pipeline loans not expected to close), using models that consider cumulative historical fallout rates and other factors.

We enter into derivative contracts including interest rate swaps, U.S. Treasury futures and forward contracts to hedge against the effects of changes in the value of the MSRs which we carry at fair value. The fair value of interest rate swaps is based upon projected short-term interest rates and volatility based on published market based sources. Because futures and forward contracts are actively traded in the market, they are classified within Level 1 of the valuation hierarchy. Effective April 1, 2013, we modified our strategy for managing the risks of the underlying loan portfolios and no longer use derivative contracts to hedge against the effects of changes in the value of MSRs which we carry at fair value.

See Note 18 – Derivative Financial Instruments for additional information regarding derivative financial instruments.

Note 6 Loans Held For Sale, at fair value

Loans held for sale, at fair value represent mortgage loans originated or purchased and held until sold to secondary market investors, such as GSEs or other third party investors. The following table summarizes the activity in the balance of loans held for sale during the three months ended March 31, 2013:

Balance at December 31, 2012	$426,480
Originations and purchase of loans held for sale	2,462,531
Proceeds from sale	(2,563,247)
Loss on sale of loans	(29,786)
Decrease in fair value	(440)
Other	(24)
Balance at March 31, 2013	$295,514

The following table summarizes the activity in Gain on loans held for sale, net, during the three months ended March 31:

	2013	2012
Loss on sales of loans (1)	$(1,081)	$ —
Changes in fair value of IRLCs	(1,237)	—
Change in fair value of loans held for sale	(440)	—
Gain on hedge instruments	10,189	—
Provision for representations and warranties	(512)	—
Other	(170)	—
	$6,749	$ —

(1) Net of a gain of $28,705 representing the value assigned to MSRs retained on sales of loans.

Note 7 Advances

Advances, representing payments made on behalf of borrowers or on foreclosed properties, consisted of the following at the dates indicated:

	March 31, 2013	December 31, 2012
Servicing:		
Principal and interest	$ 162,341	$ 83,617
Taxes and insurance	342,216	51,447
Foreclosures, bankruptcy and other	17,475	41,296
	522,032	176,360
Corporate Items and Other	8,140	8,103
	$ 530,172	$ 184,463

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Note 8 Match Funded Advances

Match funded advances on residential mortgage loans that we service for others are comprised of the following at the dates indicated:

	March 31, 2013	December 31, 2012
Principal and interest	$1,716,624	$ 1,577,808
Taxes and insurance	1,215,431	1,148,486
Foreclosures, bankruptcy, real estate and other	504,028	322,950
	$3,436,083	$ 3,049,244

Note 9 Mortgage Servicing

Mortgage Servicing Rights – Amortization Method

The following table summarizes our activity related to MSRs for the three months ended March 31:

	2013	2012
Balance at December 31, 2012	$676,712	$293,152
Additions recognized in connection with purchase transactions (1)	394,862	—
Additions recognized on sale of residential mortgage loans	28,705	—
Servicing transfers, adjustments and other	(124)	(204)
Amortization (2)	(47,987)	(15,232)
Balance at March 31, 2013	$1,052,168	$277,716
Estimated fair value at March 31	$1,288,732	$316,078

(1) Includes $393.9 million acquired in the ResCap Acquisition. See Note 3 – Business Acquisitions for additional information.

(2) Amortization of mortgage servicing rights is reported net of the amortization of servicing liabilities and includes the amount of charges we recognized to increase servicing liability obligations.

As disclosed in Note 4 – Asset Sales and Financing, we sold certain Rights to MSRs during 2012 and in the first quarter of 2013 as part of the HLSS Transactions. The carrying value of the related MSRs which have not been derecognized at March 31, 2013 was $357.0 million.

Mortgage Servicing Rights—Fair Value Measurement Method

This portfolio comprises servicing rights for which we elected the fair value option and includes prime mortgage loans that were acquired by Homeward through asset or flow purchases or retained on loans originated and subsequently sold for which we hedged the related market risks. The following table summarizes our activity related to our fair value MSRs for the three months ended March 31, 2013:

Balance at December 31, 2012	$85,213
Changes in fair value:	
Due to changes in valuation assumptions	4,650
Realization of cash flows and other changes	(5,329)
Balance at March 31, 2013	$84,534

Because the mortgages underlying these MSRs permit the borrowers to prepay the loans, the value of the MSRs generally tends to diminish in periods of declining interest rates (as prepayments increase) and increase in periods of rising interest rates (as prepayments decrease). The following table summarizes the estimated change in the fair value of our MSRs as of March 31, 2013 given hypothetical instantaneous parallel shifts in the yield curve:

	Adverse change in fair value	
	10%	20%
Weighted average prepayment speeds	$ (5,164)	$ (9,912)
Discount rate (Option-adjusted spread)	$ (2,804)	$ (5,444)

The sensitivity analysis measures the potential impact on fair values based on hypothetical changes (increases and decreases) in interest rates.

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Servicing Revenue

The following table presents the components of servicing and subservicing fees for the three months ended March 31:

	2013	2012
Loan servicing and subservicing fees	$269,022	$112,589
Home Affordable Modification Program (HAMP) fees	40,147	12,684
Late charges	25,896	18,845
Loan collection fees	6,382	3,339
Float earnings	1,680	787
Other	26,182	6,859
	$369,309	$155,103

Portfolio of Assets Serviced

The following table presents the composition of our servicing and subservicing portfolios by type of property serviced as measured by UPB. The servicing portfolio represents loans for which we own the MSRs while subservicing represents all other loans.

	Residential	Commercial	Total
UPB at March 31, 2013			
Servicing (1)	$273,970,522	$ —	$273,970,522
Subservicing	195,484,010	392,584	195,876,594
	$469,454,532	$ 392,584	$469,847,116
UPB at December 31, 2012			
Servicing (1)	$175,762,161	$ —	$175,762,161
Subservicing	27,903,555	401,031	28,304,586
	$203,665,716	$ 401,031	$204,066,747

(1) Includes UPB of $92.5 billion and $79.4 billion at March 31, 2013 and December 31, 2012, respectively, for which the Rights to MSRs have been sold to HLSS.

Residential assets serviced consist principally of residential mortgage loans, but also include foreclosed real estate. Residential assets serviced also include small-balance commercial assets with a UPB of $2.0 billion and $2.1 billion at March 31, 2013 and December 31, 2012, respectively, that are managed using the REALServicing™ application. Commercial assets consist of large-balance foreclosed real estate. Assets serviced for others are not included on our unaudited Consolidated Balance Sheet.

Custodial accounts, which hold funds representing collections of principal and interest that we receive from borrowers, are held in escrow by an unaffiliated bank and are excluded from our unaudited Consolidated Balance Sheet. Custodial accounts amounted to $4.7 billion and $1.3 billion at March 31, 2013 and December 31, 2012, respectively.

Note 10 Receivables

Receivables consisted of the following:

March 31, 2013	Receivables	Allowance for Losses	Net
Servicing (1)	$ 74,820	$ (2,024)	$72,796
Income taxes receivable	52,593	—	52,593
Due from related parties (2)	28,048	—	28,048
Other	4,117	(1,996)	2,121

$ 159,578	$ (4,020)	$ 155,558

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December 31, 2012	Receivables	Allowance for Losses	Net
Servicing (1)	$ 84,870	$ (1,647)	$ 83,223
Income taxes receivable	55,292	—	55,292
Due from related parties (2)	12,361	—	12,361
Other	18,577	(1,994)	16,583
	$ 171,100	$ (3,641)	$ 167,459

(1) The balances arise from our Servicing business and primarily include reimbursable expenditures due from investors and amounts to be recovered from the custodial accounts of the trustees.

(2) See Note 22 – Related Party Transactions for additional information regarding transactions with Altisource and HLSS.

Receivable balances are evaluated individually for collectibility. The change in the allowance for credit losses for the three months ended March 31, 2013 and 2012 and the balance of the related receivables at those dates were as follows:

	March 31, 2013	March 31, 2012
Allowance for credit losses balance at beginning of the period	$ 1,994	$ 6,281
Charge offs	—	—
Provision	—	455
Other	2	(19)
Allowance for credit losses balance at end of the period	$ 1,996	$ 6,717
Receivables balance	$ 4,117	$ 8,416

Note 11 Goodwill

The following table provides a summary of activity in the carrying value of goodwill during the three months ended March 31, 2013:

	ResCap Acquisition	Homeward Acquisition	Litton Acquisition	HomEq Acquisition	Total
Balance at December 31, 2012	$ —	$ 300,843	$ 57,430	$ 12,810	$ 371,083
Derecognition of goodwill in connection with the sale of a business (1)	—	(72,309)	—	—	(72,309)
ResCap Acquisition (2)	204,743	—	&mda		