PHH CORP
Form 10-Q
November 08, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from to

Commission File Number: 1-7797

PHH CORPORATION

(Exact name of registrant as specified in its charter)

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

As of October 22, 2012, 56,701,439 shares of PHH common stock were outstanding.

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Except as expressly indicated or unless the context otherwise requires, the Company, PHH, we, our or us means PHH Corporation, a Maryl corporation, and its subsidiaries.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

- the impact of the adoption of recently issued accounting pronouncements on our financial statements;
- future origination volumes and loan margins in the mortgage industry;
- our belief that sources of liquidity will be adequate to fund operations;
- our expectations regarding our ability to achieve our liquidity plans;
- mortgage repurchase and indemnification requests and associated reserves and provisions; and
- our assessment of legal proceedings and associated reserves and provisions.

Actual results, performance or achievements may differ materially from those expressed or implied in forward-looking statements due to a variety of factors, including but not limited to the factors listed and discussed in Part I Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011, Part II Item 1A. Risk Factors in this Form 10-Q and those factors described below:

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

- the effects of any further declines in the volume of U.S. home sales and home prices, due to adverse economic changes or otherwise, on our Mortgage Production and Mortgage Servicing segments;

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

- our decisions regarding the use of derivatives related to mortgage servicing rights, if any, and the resulting potential volatility of the results of operations of our Mortgage Servicing segment;

- the impact of the failure to maintain our credit ratings, including the impact on our cost of capital and ability to incur new indebtedness or refinance our existing indebtedness, as well as our current or potential customers assessment of our counterparty credit risk;

- the effects of continued elevated volumes or increases in our actual and projected repurchases of, indemnification given in respect of, or related losses associated with, sold mortgage loans for which we have provided representations and warranties or other contractual recourse to purchasers and insurers of such loans, including increases in our loss severity and reserves associated with such loans;

- the effects of reinsurance claims in excess of projected levels and in excess of reinsurance premiums we are entitled to receive or amounts currently held in trust to pay such claims;

- the effects of any significant adverse changes in the underwriting criteria or existence or programs of government-sponsored entities, including Fannie Mae and Freddie Mac, including any changes caused by the Dodd-Frank Wall Street Reform and Consumer Protection Act or other actions of the federal government;

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- the effects of any inquiries and investigations by attorneys general of certain states and the U.S. Department of Justice, the Bureau of Consumer Financial Protection or other state or federal regulatory agencies related to foreclosure procedures or other mortgage origination or servicing activities, any litigation related to our mortgage origination or servicing activities, or any related fines, penalties and increased costs;

- the ability to maintain our status as a government sponsored entity-approved seller and servicer, including the ability to continue to comply with the respective selling and servicing guides, including any changes caused by the Dodd-Frank Act;

- changes in laws and regulations, including changes in mortgage- and real estate-related laws and regulations (including changes caused by the Dodd-Frank Act) status of government sponsored-entities and state, federal and foreign tax laws and accounting standards;

- the effects of the insolvency of any of the counterparties to our significant customer contracts or financing arrangements or the inability or unwillingness of such counterparties to perform their respective obligations under, or to renew on terms favorable to us, such contracts, or our ability to continue to comply with the terms of our significant customer contracts, including service level agreements;

- the effects of competition in our existing and potential future lines of business, including the impact of consolidation within the industries in which we operate and competitors with greater financial resources and broader product lines;

- the ability to obtain financing (including refinancing and extending existing indebtedness) on acceptable terms, if at all, to finance our operations or growth strategy, to operate within the limitations imposed by our financing arrangements and to maintain the amount of cash required to service our indebtedness;

- the ability to maintain our relationships with our existing clients and to establish relationships with new clients;

- 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 law and our contractual obligations;

- the ability to attract and retain key employees;

- a deterioration in the performance of assets held as collateral for secured borrowings;

- any failure to comply with covenants under our financing arrangements; and

- 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.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PHH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In millions, except per share data)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
REVENUES				
Mortgage fees	$ 91	$ 68	$ 254	$ 210
Fleet management fees	45	42	137	128
Net fee income	136	110	391	338
Fleet lease income	340	370	1,014	1,050
Gain on mortgage loans, net	257	203	695	381
Mortgage interest income	24	24	70	82
Mortgage interest expense	(54)	(48)	(162)	(150)
Mortgage net finance expense	(30)	(24)	(92)	(68)
Loan servicing income	112	112	333	337
Change in fair value of mortgage servicing rights	(225)	(410)	(451)	(601)
Net derivative gain related to mortgage servicing rights	8	1	5	1
Valuation adjustments related to mortgage servicing rights, net	(217)	(409)	(446)	(600)
Net loan servicing loss	(105)	(297)	(113)	(263)
Other income	26	22	65	127
Net revenues	624	384	1,960	1,565
EXPENSES				
Salaries and related expenses	159	124	438	375
Occupancy and other office expenses	15	14	43	44
Depreciation on operating leases	304	307	908	922
Fleet interest expense	18	19	52	60
Other depreciation and amortization	7	7	19	19
Other operating expenses	177	155	512	368
Total expenses	680	626	1,972	1,788
Loss before income taxes	(56)	(242)	(12)	(223)
Income tax benefit	(33)	(104)	(32)	(100)
Net (loss) income	(23)	(138)	20	(123)
Less: net income attributable to noncontrolling interest	19	10	44	17
Net loss attributable to PHH Corporation	$ (42)	$ (148)	$ (24)	$ (140)
Basic loss per share attributable to PHH Corporation	$ (0.74)	$ (2.62)	$ (0.42)	$ (2.48)
Diluted loss per share attributable to PHH Corporation	$ (0.74)	$ (2.62)	$ (0.42)	$ (2.48)

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In millions)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net (loss) income	$ (23)	$ (138)	$ 20	$ (123)
Other comprehensive income (loss), net of tax:				
Currency translation adjustment	7	(16)	7	(10)
Change in unrealized gains on available-for-sale securities, net			(1)	1
Change in unfunded pension liability, net		1	1	1
Total other comprehensive income (loss), net of tax	7	(15)	7	(8)
Total comprehensive (loss) income	(16)	(153)	27	(131)
Less: comprehensive income attributable to noncontrolling interest	19	10	44	17
Comprehensive loss attributable to PHH Corporation	$ (35)	$ (163)	$ (17)	$ (148)

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In millions, except share data)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$ 677	$ 414
Restricted cash, cash equivalents and investments (including $126 and $226 of available-for-sale securities at fair value)	435	574
Mortgage loans held for sale	1,953	2,658
Accounts receivable, net of allowance for doubtful accounts of $4 and $2	742	700
Net investment in fleet leases	3,653	3,515
Mortgage servicing rights	1,002	1,209
Property, plant and equipment, net	68	64
Goodwill	25	25
Other assets	691	618
Total assets (1)	$ 9,246	$ 9,777
LIABILITIES AND EQUITY		
Accounts payable and accrued expenses	$ 516	$ 504
Debt	6,318	6,914
Deferred taxes	604	626
Other liabilities	309	272
Total liabilities (1)	7,747	8,316
Commitments and contingencies (Note 10)		
EQUITY		
Preferred stock, $0.01 par value; 1,090,000 shares authorized; none issued or outstanding		
Common stock, $0.01 par value; 273,910,000 shares authorized; 56,695,730 shares issued and outstanding at September 30, 2012; 56,361,155 shares issued and outstanding at December 31, 2011	1	1
Additional paid-in capital	1,120	1,082
Retained earnings	314	338
Accumulated other comprehensive income	28	21
Total PHH Corporation stockholders equity	1,463	1,442
Noncontrolling interest	36	19
Total equity	1,499	1,461
Total liabilities and equity	$ 9,246	$ 9,777

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

(Unaudited)
(In millions)

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(1) The Condensed Consolidated Balance Sheets include assets of variable interest entities which can be used only to settle their obligations and liabilities of variable interest entities which creditors or beneficial interest holders do not have recourse to PHH Corporation and subsidiaries as follows:

	September 30, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$ 63	$ 57
Restricted cash, cash equivalents and investments	236	313
Mortgage loans held for sale	722	484
Accounts receivable, net	96	79
Net investment in fleet leases	3,547	3,390
Property, plant and equipment, net	2	1
Other assets	49	66
Total assets	$ 4,715	$ 4,390
LIABILITIES		
Accounts payable and accrued expenses	$ 35	$ 36
Debt	4,025	3,549
Other liabilities	22	9
Total liabilities	$ 4,082	$ 3,594

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited)

(In millions, except share data)

	PHH Corporation Stockholders Equity						
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
Nine Months Ended September 30, 2012							
Balance at December 31, 2011	**56,361,155**	**$ 1**	**$ 1,082**	**$ 338**	**$ 21**	**$ 19**	**$ 1,461**
Total comprehensive (loss) income				(24)	7	44	27
Distributions to noncontrolling interest						(27)	(27)
Stock compensation expense			3				3
Stock issued under share-based payment plans	334,575		(1)				(1)
Conversion option related to Convertible note issuance, net (Note 7)			33				33
Recognition of deferred taxes related to Convertible notes			3				3
Balance at September 30, 2012	**56,695,730**	**$ 1**	**$ 1,120**	**$ 314**	**$ 28**	**$ 36**	**$ 1,499**
Nine Months Ended September 30, 2011							
Balance at December 31, 2010	**55,699,218**	**$ 1**	**$ 1,069**	**$ 465**	**$ 29**	**$ 14**	**$ 1,578**
Total comprehensive (loss) income				(140)	(8)	17	(131)
Distributions to noncontrolling interest						(16)	(16)
Stock compensation expense			5				5
Stock issued under share-based payment plans	641,495		6				6
Balance at September 30, 2011	**56,340,713**	**$ 1**	**$ 1,080**	**$ 325**	**$ 21**	**$ 15**	**$ 1,442**

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In millions)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash flows from operating activities:		
Net income (loss)	$ 20	$ (123)
Adjustments to reconcile Net income (loss) to net cash provided by operating activities:		
Capitalization of originated mortgage servicing rights	(244)	(357)
Net unrealized loss on mortgage servicing rights and related derivatives	446	600
Vehicle depreciation	908	922
Other depreciation and amortization	19	19
Origination of mortgage loans held for sale	(28,230)	(27,013)
Proceeds on sale of and payments from mortgage loans held for sale	29,655	29,131
Net gain on interest rate lock commitments, mortgage loans held for sale and related derivatives	(746)	(321)
Deferred income tax benefit	(42)	(109)
Other adjustments and changes in other assets and liabilities, net	16	(410)
Net cash provided by operating activities	1,802	2,339
Cash flows from investing activities:		
Investment in vehicles	(1,282)	(1,190)
Proceeds on sale of investment vehicles	227	280
Net cash received (paid) on derivatives related to mortgage servicing rights	7	(1)
Purchases of property, plant and equipment	(18)	(16)
Purchases of restricted investments	(151)	(185)
Proceeds from sales and maturities of restricted investments	187	204
Decrease (increase) in restricted cash and cash equivalents	105	(15)
Other, net	21	24
Net cash used in investing activities	(904)	(899)
Cash flows from financing activities:		
Proceeds from secured borrowings	48,063	42,065
Principal payments on secured borrowings	(48,472)	(43,668)
Proceeds from unsecured borrowings	518	610
Principal payments on unsecured borrowings	(671)	(530)
Issuances of common stock	1	8
Cash paid for debt issuance costs	(43)	(20)
Other, net	(31)	(15)
Net cash used in financing activities	(635)	(1,550)
Effect of changes in exchange rates on Cash and cash equivalents		(1)
Net increase (decrease) in Cash and cash equivalents	263	(111)
Cash and cash equivalents at beginning of period	414	195
Cash and cash equivalents at end of period	$ 677	$ 84

See accompanying Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

BASIS OF PRESENTATION

PHH Corporation and subsidiaries (collectively, PHH or the Company) is a leading outsource provider of mortgage and fleet management services operating in the following business segments:

- **Mortgage Production** provides mortgage loan origination services and sells mortgage loans.
- **Mortgage Servicing** performs servicing activities for originated and purchased loans.
- **Fleet Management Services** provides commercial fleet management services.

The Condensed Consolidated Financial Statements include the accounts and transactions of PHH and its subsidiaries, as well as entities in which the Company directly or indirectly has a controlling interest and variable interest entities of which the Company is the primary beneficiary. PHH Home Loans, LLC and its subsidiaries are consolidated within the Condensed Consolidated Financial Statements, and Realogy Corporation s ownership interest is presented as a noncontrolling interest. Intercompany balances and transactions have been eliminated from the Condensed Consolidated Financial Statements.

The Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States, which is commonly referred to as 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 Annual Report on Form 10-K for the year ended December 31, 2011.

On March 31, 2011, the Company sold 50.1% of the equity interests in its appraisal services business, Speedy Title and Appraisal Review Services, (STARS) to CoreLogic, Inc. for a total purchase price of $35 million. For the nine months ended September 30, 2011, a $68 million gain on the sale of the 50.1% equity interest was recorded within Other income. Subsequent to March 31, 2011, the Company participates in the appraisal services business through its 49.9% ownership interest in STARS, and is entitled to its proportionate share of STARS earnings.

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, other financial instruments and goodwill, the estimation of liabilities for mortgage loan repurchases and indemnifications and reinsurance losses, and the determination of 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CHANGES IN ACCOUNTING POLICIES

Comprehensive Income. In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income . Subsequently in December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 . The updates to comprehensive income guidance require all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The Company adopted the new accounting guidance effective January 1, 2012, and applied it retrospectively. The adoption added the Condensed Consolidated Statements of Comprehensive Income but did not impact the Company s results of operations, financial position, or cash flows.

Fair Value Measurement. In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards . This update to fair value measurement guidance addresses changes to concepts regarding performing fair value measurements including: (i) the application of the highest and best use and valuation premise; (ii) the valuation of an instrument classified in the reporting entity s shareholders equity; (iii) the valuation of financial instruments that are managed within a portfolio; and (iv) the application of premiums and discounts. This update also enhances disclosure requirements about fair value measurements, including providing information regarding Level 3 measurements such as quantitative information about unobservable inputs, further discussion of the valuation processes used and assumption sensitivity analysis. The Company adopted the new accounting guidance effective January 1, 2012. The updated disclosures are included in Note 12, Fair Value Measurements .

Transfers and Servicing. In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements . This update to transfers and servicing guidance removes from the assessment of effective control the criterion relating to the transferor s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. This update also eliminates the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. The Company adopted the new accounting guidance effective beginning January 1, 2012 and the guidance will be applied prospectively to new transactions or modifications of existing transactions. The adoption of this update did not have an impact on the Company s financial statements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Intangibles. In July 2012, the FASB issued ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment. This update amends the current guidance on testing indefinite-lived intangibles for impairment and allows for the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangibles are impaired. If it is more likely than not that the indefinite-lived intangibles are impaired, the entity is required to determine the fair value of the indefinite-lived intangibles and perform the quantitative impairment test by comparing the fair value with the carrying amount. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 with early adoption permitted. The Company does not anticipate the adoption of this update will have a material impact on its financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Earnings Per Share

Basic loss per share attributable to PHH Corporation was computed by dividing Net loss attributable to PHH Corporation for the period by the weighted-average number of shares outstanding during the period. Diluted loss per share attributable to PHH Corporation was computed by dividing Net loss attributable to PHH Corporation for the period by the weighted-average number of shares outstanding during the period, assuming all potentially dilutive common shares were issued.

The weighted-average computation of the dilutive effect of potentially issuable shares of Common stock under the treasury stock method excludes the effect of any contingently issuable securities where the contingency has not been met and the effect of securities that would be anti-dilutive, which may include:

- outstanding stock-based compensation awards representing shares from restricted stock units and stock options;
- stock assumed to be issued related to convertible notes;
- purchased options and sold warrants related to the assumed conversion of the 2012 Convertible notes; and
- sold warrants related to the Company s 2014 Convertible notes.

The computation also excludes the assumed issuance of the 2014 Convertible notes and related purchased options as they are currently to be settled only in cash. Shares associated with anti-dilutive securities are outlined in the table below.

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions, except share and per share data)			
Net loss attributable to PHH Corporation	$ (42)	$ (148)	$ (24)	$ (140)
Weighted-average common shares outstanding basic and diluted(1)	56,842,323	56,436,649	56,768,027	56,297,629
Basic and diluted loss per share attributable to PHH Corporation	$ (0.74)	$ (2.62)	$ (0.42)	$ (2.48)

Anti-dilutive securities excluded from the computation of dilutive securities:				
Outstanding stock-based compensation awards	2,356,488	2,062,302	2,356,488	2,062,302
Assumed conversion of debt securities	5,494,884		3,750,848	594,876

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(1) Due to the net loss recognized for the three and nine months ended September 30, 2012 and 2011, there were no potentially dilutive securities included in the calculations of diluted earnings per share, as their inclusion would have been antidilutive.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Restricted Cash, Cash Equivalents and Investments

The following table summarizes Restricted cash, cash equivalents and investment balances:

	September 30, 2012		December 31, 2011	
	(In millions)			
Restricted cash and cash equivalents	$	309	$	348
Restricted investments, at fair value		126		226
Total	$	435	$	574

The restricted cash related to our reinsurance activities is invested in certain debt securities as permitted under the reinsurance agreements. The restricted investments are classified as available-for-sale securities and remain in trust for capital fund requirements and potential reinsurance losses. In 2012, the Company terminated one of its reinsurance agreements. As a result, the restricted cash and investments held in trust to pay future losses were released and the remaining liability was settled with the primary mortgage insurer. See Note 9, Credit Risk for information regarding the termination.

The following tables summarize Restricted investments, at fair value:

	September 30, 2012								
	Amortized Cost		Fair Value		Unrealized Gains (In millions)		Unrealized Losses		Weighted-average remaining maturity
Corporate securities	$	30	$	31	$	1	$		26 mos.
Agency securities (1)		22		22					36 mos.
Government securities		72		73		1			18 mos.
Total	$	124	$	126	$	2	$		23 mos.

	December 31, 2011								
	Amortized Cost		Fair Value		Unrealized Gains (In millions)		Unrealized Losses		Weighted-average remaining maturity
Corporate securities	$	53	$	54	$	1	$		28 mos.
Agency securities (1)		118		119		1			19 mos.
Government securities		52		53		1			34 mos.
Total	$	223	$	226	$	3	$		25 mos.

(1) Represents bonds and notes issued by various agencies including, but not limited to, Fannie Mae, Freddie Mac and Federal Home Loan Banks.

During the three months ended September 30, 2012, the amount of realized gains and losses from the sale of available-for-sale securities was not significant. During the nine months ended September 30, 2012 and the three and nine months ended September 30, 2011, realized gains of $1 million from the sale of available-for-sale securities were recorded and realized losses were not significant.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Transfers and Servicing of Mortgage Loans

Residential mortgage loans are sold through one of the following methods: (i) sales to or pursuant to programs sponsored by Fannie Mae, Freddie Mac and Ginnie Mae, or (ii) sales to private investors. The Company may have continuing involvement in mortgage loans sold by retaining one or more of the following: servicing rights and servicing obligations, recourse obligations and/or beneficial interests (such as interest-only strips, principal-only strips, or subordinated interests). See Note 9, Credit Risk for a further description of recourse obligations.

The total servicing portfolio consists of loans associated with capitalized mortgage servicing rights, loans held for sale, and the servicing portfolio associated with loans subserviced for others. The total servicing portfolio, including loans subserviced for others was $185.1 billion and $182.4 billion as of September 30, 2012 and December 31, 2011, respectively. Mortgage servicing rights (MSRs) recorded in the Condensed Consolidated Balance Sheets are related to the capitalized servicing portfolio, and are created either through the direct purchase of servicing from a third party or through the sale of an originated loan.

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

	Nine Months Ended September 30, 2012	2011
	(In millions)	
Balance, beginning of period	$ 147,088	$ 134,753
Additions	24,794	26,502
Payoffs, sales and curtailments	(27,102)	(16,980)
Balance, end of period	$ 144,780	$ 144,275

The activity in capitalized MSRs consisted of:

	Nine Months Ended September 30, 2012	2011
	(In millions)	
Balance, beginning of period	$ 1,209	$ 1,442
Additions	244	357
Changes in fair value due to:		
Realization of expected cash flows	(199)	(146)
Changes in market inputs or assumptions used in the valuation model	(252)	(455)
Balance, end of period	$ 1,002	$ 1,198

The value of MSRs is driven by the net positive cash flows associated with servicing activities. These cash flows include contractually specified servicing fees, late fees and other ancillary servicing revenue and were recorded within Loan servicing income as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Servicing fees from capitalized portfolio	$ 106	$ 111	$ 329	$ 327
Late fees	5	5	15	15
Other ancillary servicing revenue	10	11	30	30

As of September 30, 2012 and December 31, 2011, the MSRs had a weighted-average life of approximately 4.1 years and 4.2 years, respectively. See Note 12, Fair Value Measurements for additional information regarding the valuation of MSRs.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth information regarding cash flows relating to loan sales in which the Company has continuing involvement:

	Nine Months Ended September 30,	
	2012	2011
	(In millions)	
Proceeds from new loan sales or securitizations	$ 25,895	$ 26,984
Servicing fees from capitalized portfolio(1)	329	327
Other cash flows on retained interests (2)	5	
Purchases of delinquent or foreclosed loans (3)	(70)	(32)
Servicing advances (4)	(975)	(1,296)
Repayment of servicing advances	942	1,253

(1) Excludes late fees and other ancillary servicing revenue.

(2) Represents cash flows received on retained interests other than servicing fees.

(3) Excludes indemnification payments to investors and insurers of the related mortgage loans.

(4) As of September 30, 2012 and December 31, 2011, outstanding servicing advance receivables of $278 million and $247 million, respectively, were included in Accounts receivable, net.

During the three and nine months ended September 30, 2012, pre-tax gains of $263 million and $689 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on mortgage loans, net in the Condensed Consolidated Statements of Operations.

During the three and nine months ended September 30, 2011, pre-tax gains of $123 million and $441 million, respectively, related to the sale or securitization of residential mortgage loans were recognized in Gain on mortgage loans, net in the Condensed Consolidated Statements of Operations.

5. Derivatives

Derivative instruments and the risks they manage are as follows:

- **Forward delivery commitments** Related to interest rate and price risk for Mortgage loans held for sale and interest rate lock commitments
- **Option contracts** Related to interest rate and price risk for interest rate lock commitments
- **MSR-related agreements** Related to interest rate risk for mortgage servicing rights
- **Interest rate contracts** Related to interest rate risk for variable-rate debt arrangements and fixed-rate leases
- **Convertible note-related agreements** Related to the issuance of the Convertible notes due in 2014
- **Foreign exchange contracts** Related to exposure to currency fluctuations that would impact our investment in, or borrowings related to, our Canadian operations

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2012			December 31, 2011		
	Asset	Liability	Notional	Asset	Liability	Notional
	(In millions)					
Interest rate lock commitments	$ 221	$	$ 5,713	$ 184	$	$ 7,095
Forward delivery commitments: (1)						
Not subject to master netting arrangements	5	25	2,795	6	27	3,897
Subject to master netting arrangements(2)	35	116	10,879	32	100	11,893
Option contracts:						
Not subject to master netting arrangements	1		715	1		715
Subject to master netting arrangements			250	1		130
MSR-related agreements:						
Subject to master netting arrangements(2)	27		3,915	6		1,100
Interest rate contracts	1		697	1	1	477
Convertible note-related agreements(3)	22	22		4	4	
Total, gross	312	163		235	132	
Netting adjustments:						
Offsetting receivables/payables	(116)	(116)		(32)	(32)	
Cash collateral paid/received	69	2		(6)	(54)	
Total, net	$ 265	$ 49		$ 197	$ 46	

(1) The net notional amount of Forward delivery commitments was $5.4 billion and $8.3 billion as of September 30, 2012 and December 31, 2011, respectively.

(2) Represents derivative instruments that are executed with the same counterparties and subject to master netting arrangements. Amounts subject to netting shown above were presented in the Condensed Consolidated Balance Sheets as follows:

	September 30, 2012		December 31, 2011	
	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
	(In millions)			
Forward delivery commitments:				
Other assets	$ 22	$ 83	$	$
Other liabilities	13	33	32	100
Option contracts:				
Other assets			1	
MSR-related agreements:				
Other assets	7		6	
Other liabilities	20			

(3) The notional amount of derivative instruments related to the issuance of the 2014 Convertible notes was 9.6881 million shares of the Company s Common stock as of September 30, 2012 and December 31, 2011.

As of September 30, 2012 and December 31, 2011, cash collateral posted for derivative agreements that did not qualify for net presentation was $7 million and $13 million, respectively, which was included in Other assets in the Condensed Consolidated Balance Sheets.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the gains (losses) recorded in the Condensed Consolidated Statements of Operations for derivative instruments:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Gain on mortgage loans, net:				
Interest rate lock commitments	$ 425	$ 509	$ 1,185	$ 942
Forward delivery commitments	(152)	(247)	(305)	(337)
Options contracts	(4)	(7)	(14)	(14)
Net derivative gain related to mortgage servicing rights:				
MSR-related agreements	8	1	5	1
Fleet interest expense:				
Interest rate contracts		(2)	(1)	(3)
Foreign exchange contracts	(2)	(1)	(1)	(6)

6. Vehicle Leasing Activities

The following table summarizes the components of Net investment in fleet leases:

	September 30, 2012	December 31, 2011
	(In millions)	
Operating Leases:		
Vehicles under open-end operating leases	$ 8,099	$ 8,058
Vehicles under closed-end operating leases	156	176
Vehicles under operating leases	8,255	8,234
Less: Accumulated depreciation	(4,869)	(5,097)
Net investment in operating leases	3,386	3,137
Direct Financing Leases:		
Lease payments receivable	112	81
Less: Unearned income	(1)	(1)
Net investment in direct financing leases	111	80
Off-Lease Vehicles:		
Vehicles not yet subject to a lease	150	290
Vehicles held for sale	11	16
Less: Accumulated depreciation	(5)	(8)
Net investment in off-lease vehicles	156	298
Total	$ 3,653	$ 3,515

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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, 2012		December 31, 2011	
	Balance	Wt. Avg- Interest Rate(1)	Balance	Wt. Avg- Interest Rate(1)
	(In millions)			
Term notes, in amortization	$ 529	2.1%	$ 1,196	2.1%
Term notes, in revolving period	993	1.2%	374	1.6%
Variable-funding notes	1,849	1.4%	1,516	1.4%
Other	26	5.1%	32	5.1%
Vehicle Management Asset-Backed Debt	3,397		3,118	
Secured Canadian Credit facility		%		%
Committed warehouse facilities	1,701	2.1%	2,313	2.0%
Uncommitted warehouse facilities		%	44	1.2%
Servicing advance facility	71	2.7%	79	2.8%
Mortgage Asset-Backed Debt	1,772		2,436	
Term notes	732	8.5%	879	8.2%
Convertible notes	417	5.0%	460	4.0%
Unsecured Credit facilities		%		%
Unsecured Debt	1,149		1,339	
Mortgage loan securitization debt certificates, at fair value		%	21	7.0%
Total	$ 6,318		$ 6,914	

(1) Represents the weighted-average stated interest rate of outstanding debt as of the respective date, which may be different from the effective rate due to the amortization of premiums, discounts and issuance costs. Facilities are variable-rate, except for the Unsecured Term notes, Convertible notes, and Mortgage loan securitization debt certificates which are fixed-rate.

Assets held as collateral for asset-backed borrowing arrangements that are not available to pay the Company s general obligations as of September 30, 2012 consisted of:

	Vehicle Asset-Backed Debt	Mortgage Asset-Backed Debt
	(In millions)	
Restricted cash and cash equivalents	$ 233	$ 5
Accounts receivable	65	88
Mortgage loans held for sale (unpaid principal balance)		1,755

Net investment in fleet leases		3,573		
Total	$	3,871	$	1,848

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table provides the contractual debt maturities as of September 30, 2012:

	Vehicle Asset-Backed Debt(1)	Mortgage Asset-Backed Debt	Unsecured Debt(2)	Total
		(In millions)		
Within one year	$ 764	$ 1,772	$	$ 2,536
Between one and two years	1,057		250	1,307
Between two and three years	878			878
Between three and four years	525		450	975
Between four and five years	161		250	411
Thereafter	14		283	297
	$ 3,399	$ 1,772	$ 1,233	$ 6,404

(1) Maturities of vehicle management asset-backed notes, a portion of which are amortizing in accordance with their terms, represent estimated payments based on the expected cash inflows related to the securitized vehicle leases and related assets.

(2) Maturities of convertible notes have been reflected based on the contractual maturity date. Under certain circumstances, the convertible notes may be converted prior to the earliest conversion date and the principal portion of the notes would be due in cash prior to the contractual maturity date.

Capacity under all borrowing agreements is dependent upon maintaining compliance with, or obtaining waivers of, the terms, conditions and covenants of the respective agreements. Available capacity under asset-backed funding arrangements may be further limited by asset eligibility requirements. Available capacity under committed borrowing arrangements as of September 30, 2012 consisted of:

	Capacity	Utilized Capacity	Available Capacity
		(In millions)	
Vehicle Management Asset-Backed Debt:			
Term notes, in revolving period	$ 993	$ 993	$
Variable-funding notes	2,330	1,849	481
Secured Canadian Credit facility(1)	127	4	123
Mortgage Asset-Backed Debt:			
Committed warehouse facilities	3,545	1,701	1,844
Servicing advance facility	120	71	49
Unsecured Credit facilities	305		305

(1) Utilized capacity reflects $4 million of letters of credit issued under the Secured Canadian Credit facility, which are not included in Debt in the Condensed Consolidated Balance Sheet.

Capacity for Mortgage asset-backed debt shown above excludes $2.0 billion not drawn under uncommitted facilities. See Note 12, Fair Value Measurements for the measurement of the fair value of Debt.

VEHICLE MANAGEMENT ASSET-BACKED DEBT

Term Notes

In the third quarter 2012, Chesapeake Funding LLC (Chesapeake) fully repaid the 2009-1 and 2009-4 Term notes using the available capacity of the variable-funding notes.

On May 17, 2012, Chesapeake issued $643 million of Series 2012-1 Term notes. Proceeds from the notes were used to pay down a portion of the Series 2010-1 Notes and Series 2011-1 Notes.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Variable-funding Notes

On August 31, 2012, the Fleet Leasing Receivables Trust (FLRT) 2010-2 Series was further amended to increase capacity to $830 million (C$816 million) and extend the maturity date to August 30, 2013.

On June 27, 2012, Chesapeake fully repaid its 2010-1 and 2011-1 Class B Notes and amended its Series 2010-1 Indenture Supplement and Series 2011-1 Indenture Supplement to, among other things, extend the revolving period of the 2010-1 and 2011-1 Variable-funding notes to June 26, 2013 and June 26, 2014, respectively. Upon expiration of the revolving periods, the 2010-1 and 2011-1 Variable-funding notes amortization period will commence.

SECURED CANADIAN CREDIT FACILITY

On September 25, 2012, PHH Vehicle Management Services Inc. (PHH VMS Canada), an indirect wholly-owned subsidiary, entered into a secured revolving credit facility with a group of lenders providing up to $127 million (C$125 million) of committed revolving capacity. Borrowings under the facility bear interest at a variable-rate, and the facility fee and interest rate margin is dependent on the Company s senior unsecured long-term debt ratings issued by certain credit rating agencies. The facility is scheduled to expire on August 2, 2015.

Among other things, this facility can be used to warehouse vehicle leases, vehicles not yet subject to lease and certain account receivables. PHH VMS Canada s obligations under the facility are guaranteed by PHH Corporation and are secured by a first-priority lien on all of PHH VMS Canada s present and future assets and property (and corresponding security in any jurisdiction), subject to exceptions for client self-funded leases and related vehicles, and the assets of certain excluded subsidiaries.

MORTGAGE ASSET-BACKED DEBT

Committed Facilities

During the nine months ended September 30, 2012, the committed variable-rate mortgage repurchase facilities with Credit Suisse First Boston Mortgage Capital LLC were extended to May 22, 2013, the committed variable-rate mortgage repurchase facility with The Royal Bank of Scotland plc was extended to June 21, 2013 and the committed variable-rate mortgage repurchase facility with Bank of America was extended to October 10, 2013.

On April 27, 2012, the Company s master agreement with Fannie Mae was renewed and certain other agreements with Fannie Mae were amended, including an amendment to the $1.0 billion committed early funding letter agreement. Pursuant to the committed early funding letter amendment, the termination event related to the Company s credit ratings was removed and other termination events were added, most of which are generally consistent with existing covenants under the Company s various other debt facilities. See the Debt Covenants section below for further information. Unless earlier terminated, the committed early funding agreement expires on December 15, 2012.

Servicing Advance Facility

On June 29, 2012, the committed facility with Fannie Mae that provides for the early reimbursement of certain servicing advances made on behalf of Fannie Mae was extended to June 30, 2013.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNSECURED DEBT

Term Notes

On August 23, 2012, the Company completed an offering of $275 million aggregate principal amount of 7.375% Senior Notes due 2019 under an existing indenture, dated as of January 17, 2012 with The Bank of New York Mellon Trust Company, N.A., as trustee. The Company realized net proceeds of $270 million from the issuance after deducting underwriting fees. The notes are senior unsecured and unsubordinated obligations of the Company and rank equally with all existing and future senior unsecured debt. The notes are redeemable by the Company prior to the maturity date at any time, based on a make-whole redemption price specified in the indenture. The Company used the net proceeds of this offering, along with cash on hand, to repurchase the outstanding aggregate principal amount of the Medium-term notes due 2013, as described below. Interest on the notes is payable semiannually in arrears on March 1 and September 1 of each year, beginning on March 1, 2013. The 2019 Notes will mature on September 1, 2019, unless previously redeemed in accordance with their terms.

During the nine months ended September 30, 2012, the Company paid the outstanding principal balance of the Medium-term notes due 2013 and recorded a pre-tax loss of $13 million in Other operating expenses in the Condensed Consolidated Statements of Operations.

Credit Facilities

On August 2, 2012, the Company amended and restated the existing unsecured Amended Credit Facility with an Amended and Restated Credit Agreement among PHH, a group of lenders and JPMorgan Chase Bank, N.A., as administrative agent (the Revolving Credit Facility). As a result of the amendment, the commitments of the facility were reduced from $525 million (scheduled to expire on February 29, 2013) to $300 million of aggregate commitments (scheduled to expire between July 1, 2014 and August 2, 2015), as discussed further below.

The Revolving Credit Facility consists of two tranches: (i) a $250 million revolving credit tranche (Tranche A) that is scheduled to expire on August 2, 2015 and (ii) a $50 million revolving credit tranche (Tranche B) that is scheduled to expire on July 1, 2014. No borrowing may be made under Tranche B if there is unused availability under Tranche A. Borrowings under the Revolving Credit Facility are subject to satisfaction of certain conditions, including compliance with a borrowing base coverage ratio test of unencumbered assets to unsecured debt of at least 1.2 to 1.

The Company s obligations under Tranche A are guaranteed by each of its direct, indirect, existing and future domestic subsidiaries, subject to exceptions for (i) securitization subsidiaries, (ii) subsidiaries which are not substantially wholly-owned by the Company and (iii) certain other subsidiaries. The Company s obligations under Tranche B are not guaranteed by any of its existing subsidiaries.

The Revolving Credit Facility is variable-rate and the facility fee and interest rate margin under the facility are subject to change if the Company s senior unsecured long-term debt ratings are changed by certain credit rating agencies.

Convertible Notes

As of September 30, 2012, Convertible notes included: (i) $250 million of 4.0% Convertible senior notes with a maturity date of September 1, 2014; and (ii) $250 million of 6.0% Convertible senior notes with a maturity date of June 15, 2017.

2012 CONVERTIBLE NOTES

During the nine months ended September 30, 2012, the Company paid the outstanding principal balance of the Convertible notes due 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2014 CONVERTIBLE NOTES

As of September 30, 2012 and December 31, 2011, the carrying amount of the Convertible notes due 2014 is net of an unamortized discount of $27 million and $40 million, respectively. The effective interest rate of the notes, which includes the accretion of the discount and issuance costs, is 13.0%. There have been no conversions of the notes since issuance.

2017 CONVERTIBLE NOTES

In January 2012, the Company completed an offering of $250 million in aggregate principal amount of 6.0% Convertible Senior Notes due 2017, governed by an indenture dated January 17, 2012 with The Bank of New York Mellon Trust Company, N.A., as trustee. After deducting the 3% underwriting discount and debt issue costs, the Company realized net proceeds of $243 million from the issuance. The notes are senior unsecured obligations of the Company and rank equally with all existing and future senior unsecured debt and are senior to all of the Company s existing and future subordinated debt. The notes are not redeemable by the Company prior to the maturity date. The Company used the net proceeds from this offering to repay the outstanding aggregate principal amount of the Convertible notes due 2012.

Interest on the notes is payable semiannually in arrears on June 15 and December 15 of each year, beginning June 15, 2012. The notes mature on June 15, 2017, unless previously repurchased or converted in accordance with their terms.

In accordance with GAAP, the liability and equity components of the Convertible notes due 2017 were separately accounted for based on estimates of the Company s non-convertible debt borrowing rate at the time of issuance. Accordingly, the liability component includes an original issue discount of $63 million, including the underwriting discount, and the value of the equity component is recorded separately. Additionally, the Company incurred $1 million of debt issue costs, which were allocated to the liability and equity components based on their relative fair values. At the time of issuance, the Company determined that the conversion option related to the notes was indexed to the Company s own stock and met all of the criteria for equity classification. Accordingly, the initial valuation of the liability component was $188 million recorded within Debt, and the initial valuation of the equity component was $33 million, net of $22 million of deferred taxes, recorded within Additional paid-in capital in the Condensed Consolidated Balance Sheets. Since the conversion option met all of the criteria for equity classification, there have been no changes in value recorded from the date of issuance.

The debt discount and issuance costs allocated to the liability are being accreted to Mortgage interest expense in the Condensed Consolidated Statements of Operations through the earliest conversion date of the notes, December 16, 2016. As of September 30, 2012, the carrying amount of the Convertible notes due 2017 is net of an unamortized discount of $56 million. The effective interest rate of the Convertible notes due 2017, which includes the cost of amortization of the discount and issuance costs, is 13.0%.

Conversion Features:

Holders of the Convertible notes due 2017 may convert all or any portion of the notes, at their option, prior to December 15, 2016 only upon the occurrence of certain triggering events related to (i) the price of the notes, (ii) the price of the Company s Common stock, or (iii) upon the occurrence of specified corporate events. Holders of the Convertible notes due 2017 may also convert all or any portion of the notes at any time, at their option from, and including, December 15, 2016 through the third scheduled trading day immediately preceding the maturity date.

Conversion Based on Note Price

Prior to the close of business on the scheduled trading day immediately preceding December 15, 2016, the notes may be converted during the five business day period after any five consecutive trading day period (the Measurement Period) in which the trading price per $1,000 in principal amount of the notes for each day of the Measurement Period was less than 98% of the product of the last reported sale price of the Company s Common stock and the applicable conversion rate for the notes of such date.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Conversion Based on Stock Price

Prior to the close of business on the scheduled trading day immediately preceding December 15, 2016, the notes may be converted during any calendar quarter after the calendar quarter ending March 31, 2012 and only during such calendar quarter, if the last reported sale price of the Company s Common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect for the notes on each such trading day.

The conversion price of the Convertible notes due 2017 is $12.79 per share (based on an initial conversion rate of 78.2014 shares per $1,000 principal amount of notes). Upon conversion, the principal amount of the converted notes is payable in cash and the Company will pay or deliver (at its election): (i) cash; (ii) shares of the Company s Common stock; or (iii) a combination of cash and shares of the Company s Common stock; to settle amounts due if the conversion value exceeds the principal of the converted notes. As of September 30, 2012, the if-converted value exceeded the principal amount of the notes by $148 million, and the notes met the requirements for conversion.

Subject to certain exceptions, the holders of the Convertible notes due 2017 may require the Company to repurchase all or a portion of their notes upon a fundamental change, as defined under the indenture. The Company will generally be required to increase the conversion rate for holders that elect to convert their notes in connection with a make-whole fundamental change, as defined under the indenture. The conversion rate and the conversion price will be subject to adjustment upon the occurrence of certain events as specified in the indenture; however, in no circumstance will the conversion rate exceed 97.7517 shares per $1,000 in principal amount of notes, subject to certain anti-dilution adjustments.

DEBT COVENANTS

Certain debt arrangements require the maintenance of certain financial ratios and contain other affirmative and negative covenants, termination events, and other restrictions, including, but not limited to, covenants relating to material adverse changes, liquidity maintenance, restrictions on indebtedness of the Company and its material subsidiaries, mergers, liens, liquidations, sale and leaseback transactions, and restrictions on certain types of payments, including dividends and stock repurchases. Certain other debt arrangements, including the Fannie Mae committed facility, contain provisions that permit the Company or our counterparty to terminate the arrangement upon the occurrence of certain events, including those described below.

During the three months ended September 30, 2012, the covenants of the Revolving Credit Facility were amended to require the Company to maintain: (i) on the last day of each fiscal quarter, net worth of at least $1.0 billion; (ii) at any time prior to October 1, 2013, a ratio of indebtedness to tangible net worth no greater than 6.0 to 1 and, thereafter, no greater than 5.75 to 1; (iii) a minimum of $1.0 billion in committed mortgage warehouse financing capacity excluding uncommitted mortgage warehouse facilities provided by the GSEs and certain mortgage gestation facilities; (iv) a minimum of $750 million in committed third party fleet vehicle lease financing capacity; and (v) certain minimum liquidity requirements as of October 31, 2012, and May 2, 2014.

There were no other significant amendments to the terms of debt covenants during 2012. As of September 30, 2012, the Company was in compliance with all financial covenants related to its debt arrangements.

During the nine months ended September 30, 2012, the termination events for the Fannie Mae committed facility were amended to require the Company to maintain (i) on the last day of each fiscal quarter, consolidated net worth of at least $1.0 billion; (ii) on the last day of each fiscal quarter, a ratio of indebtedness to tangible net worth no greater than 6.5 to 1; (iii) a minimum of $1.0 billion in committed mortgage warehouse or gestation facilities, with no more than $500 million of gestation facilities included towards the minimum, but excluding committed or uncommitted loan purchase arrangements or other funding arrangements from Fannie Mae and any mortgage warehouse capacity provided by government sponsored enterprises; and (iv) compliance with certain loan repurchase trigger event criteria related to the aging of outstanding loan repurchase demands by Fannie Mae.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Under certain of the Company s financing, servicing, hedging and related agreements and instruments, the lenders or trustees have the right to notify the Company if they believe it has breached a covenant under the operative documents and may declare an event of default. If one or more notices of default were to be given, the Company believes it would have various periods in which to cure certain of such events of default. If the Company does not cure the events of default or obtain necessary waivers within the required time periods, the maturity of certain debt agreements could be accelerated and the ability to incur additional indebtedness could be restricted. In addition, an event of default or acceleration under certain agreements and instruments would trigger cross-default provisions under certain of the Company s other agreements and instruments.

8. Income Taxes

Interim income tax expense or benefit is recorded by applying a projected full-year effective income tax rate to the quarterly Income before income taxes for results that are deemed to be reliably estimable. Certain results dependent on fair value adjustments of the Mortgage Production and Mortgage Servicing segments are considered not to be reliably estimable and therefore discrete year-to-date income tax provisions are recorded on those results.

The following table and discussion summarizes items that significantly impacted Income tax benefit and increased (decreased) the effective tax rate:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
State and local income taxes, net of federal tax benefits	$ (4)	$ (15)	$ (3)	$ (14)
Liabilities for income tax contingencies	1		1	(8)
Changes in rate and apportionment factors			(6)	
Changes in valuation allowance	(1)		(1)	6
Noncontrolling interest	(8)	(3)	(17)	(6)

State and local income taxes, net of federal tax benefits. The impact to the effective tax rate from state and local income taxes primarily represents the volatility in the pre-tax income or loss, as well as the mix of income and loss from the operations by entity and state income tax jurisdiction. The effective state tax rate was lower for the nine months ended September 30, 2012 as compared to 2011.

Liabilities for income tax contingencies. The impact to the effective tax rate from changes in the liabilities for income tax contingencies primarily represents decreases in liabilities associated with the resolution and settlement with various taxing authorities, and increases in liabilities associated with new uncertain tax positions taken during the period. During the nine months ended September 30, 2011, the IRS concluded its examination and review of the Company s taxable years 2006 through 2009.

Changes in rate and apportionment factors. Represents the impact to the effective tax rate on deferred tax items for changes in apportionment factors and tax rate. For the nine months ended September 30, 2012, the amount represents the impact of applying statutory changes to apportionment weight, apportionment sourcing and corporate income tax rates that were enacted by various states, primarily New Jersey.

Changes in valuation allowance. The impact to the effective tax rate from changes in valuation allowance primarily represents state loss carryforwards generated during the year for which the Company believes it is more likely than not that the amounts will not be realized. For the nine months ended September 30, 2011, the change was primarily driven by state tax losses generated by our mortgage business.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Noncontrolling interest. The impact to the effective tax rate from noncontrolling interest represents Realogy Corporation s portion of income taxes related to the income or loss attributable to PHH Home Loans. The impact primarily represents the impact of PHH Home Loans election to report as a partnership for federal and state income tax purposes, whereby, the tax expense is reported by the individual LLC members. Accordingly, the Company s Income tax expense includes only its proportionate share of the income tax related to the income or loss generated by PHH Home Loans.

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
- **Commercial credit risk** through fleet management and leasing activities
- **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; however, the Company has exposure in certain circumstances in its capacity as a loan originator and servicer to loan repurchases and indemnifications through representation and warranty provisions. Additionally, the Company has exposure through a reinsurance agreement that is inactive and in runoff.

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, 2012	December 31, 2011

		(In millions)		
Loan Servicing Portfolio Composition				
Owned	$	147,477	$	150,315
Subserviced		37,666		32,072
Total	$	185,143	$	182,387
Conventional loans	$	149,948	$	145,885
Government loans		30,616		29,903
Home equity lines of credit		4,579		6,599
Total	$	185,143	$	182,387
Weighted-average interest rate		4.4%		4.6%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	September 30, 2012		December 31, 2011	
	Number of Loans	Unpaid Balance	Number of Loans	Unpaid Balance
Portfolio Delinquency(1)				
30 days	2.40%	1.91%	2.24%	1.83%
60 days	0.59%	0.47%	0.60%	0.51%
90 or more days	0.76%	0.66%	0.98%	0.95%
Total	3.75%	3.04%	3.82%	3.29%
Foreclosure/real estate owned(2)	1.99%	1.91%	1.83%	1.85%

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

(2) As of September 30, 2012 and December 31, 2011, there were 17,141 and 15,689 of loans in foreclosure with an unpaid principal balance of $3.0 billion and $2.8 billion, respectively.

Foreclosure-Related Reserves

Representations and warranties are provided to purchasers and insurers on a significant portion of loans sold and are assumed on purchased mortgage servicing rights. In the event of a breach of these representations and warranties, the Company may be required to repurchase a mortgage loan or indemnify the purchaser, and any loss on the mortgage loan may be borne by the Company. If there is no breach of a representation and warranty provision, there is no obligation to repurchase the loan or indemnify the investor against loss. In limited circumstances, the full risk of loss on loans sold is retained to the extent the liquidation of the underlying collateral is insufficient. In some instances where the Company has purchased loans from third parties, it may have the ability to recover the loss from the third party. Foreclosure-related reserves are maintained for probable losses related to repurchase and indemnification obligations and on-balance sheet loans in foreclosure and real estate owned.

A summary of the activity in foreclosure-related reserves is as follows:

	Nine Months Ended September 30,	
	2012	2011
	(In millions)	
Balance, beginning of period	$ 127	$ 111
Realized foreclosure losses	(109)	(62)
Increase in reserves due to:		
Changes in assumptions	145	59
New loan sales	13	12
Balance, end of period	$ 176	$ 120

Foreclosure-related reserves consist of the following:

Loan Repurchases and Indemnifications

The maximum exposure to representation and warranty provisions exceeds the amount of loans in the capitalized portfolio of $144.8 billion; however, the maximum amount of losses cannot be estimated because the Company does not service all of the loans for which it has provided representations or warranties. As of September 30, 2012, approximately $193 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).

As of September 30, 2012 and December 31, 2011, liabilities for probable losses related to repurchase and indemnification obligations of $137 million and $95 million, respectively, are included in Other liabilities 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. These assumptions include the estimated amount and timing of repurchase and indemnification requests, the expected success rate in defending against

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requests, and estimated loss severities on repurchases and indemnifications. The liability for loan repurchases and indemnifications does not reflect losses from litigation or governmental and regulatory examinations, investigations or inquiries. While the Company uses the best information available in estimating the liability, our actual experience can vary significantly from the assumptions as the estimation process is inherently uncertain. Given the increased levels of repurchase requests and realized losses in recent periods, there is a reasonable possibility that future losses may be in excess of the recorded liability.

As of September 30, 2012, the estimated amount of reasonably possible losses in excess of the recorded liability was $70 million. This estimate assumes that repurchase and indemnification requests remain at an elevated level through the year ended December 31, 2013, the success rate in defending against requests declines and loss severities remain at current levels. The Company s estimate of reasonably possible losses does not represent probable losses 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 criteria used by investors in selecting loans to request; (iii) borrower delinquency patterns; and (iv) general economic conditions.

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, 2012	December 31, 2011
	(In millions)	
Mortgage loans in foreclosure(1)	$ 138	$ 112
Allowance for probable losses	(23)	(19)
Mortgage loans in foreclosure, net	$ 115	$ 93
Real estate owned	$ 62	$ 51
Adjustment to estimated net realizable value	(16)	(13)
Real estate owned, net	$ 46	$ 38

(1) Includes $64 million and $62 million of recoverable advances as of September 30, 2012 and December 31, 2011, respectively.

Mortgage Reinsurance

In 2012, the Company terminated one of its inactive reinsurance contracts. The termination of the agreement settled the liability and exposure to loss under that contract and, as a result, $37 million of the related restricted cash and investments held in trust to pay future losses were distributed to the primary mortgage insurer and $24 million of previously restricted cash was released and distributed to the Company as unrestricted cash. During the nine months ended September 30, 2012, the termination resulted in a pre-tax loss of $16 million which was recorded in Loan servicing income in the Condensed Consolidated Statements of Operations.

As of September 30, 2012, the Company has remaining exposure to consumer credit risk through losses from one contract with a primary mortgage insurance company that is inactive and in runoff. The exposure to losses through this reinsurance contract is based on mortgage loans pooled by year of origination.

The contractual reinsurance period for each pool was 10 years and the weighted-average reinsurance period was 3 years as of September 30, 2012. Loss rates on these pools are determined based on the unpaid principal balance of the underlying loans. The Company indemnifies the primary mortgage insurer for losses that fall between a stated minimum and maximum loss rate on each annual pool. In return for absorbing this loss exposure, the Company is contractually entitled to a portion of the insurance premium from the primary mortgage insurer.

The Company is required to hold cash and securities in trust related to this potential obligation, which was $126 million, included in Restricted cash, cash equivalents and investments in the Condensed Consolidated Balance

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Sheets as of September 30, 2012. The amount of cash and securities held in trust is contractually specified in the reinsurance agreement and is based on the original risk assumed under the contract and the incurred losses to date.

As of September 30, 2012, $40 million was included in Other liabilities in the Condensed Consolidated Balance Sheets for incurred and incurred but not reported losses associated with mortgage reinsurance activities (estimated on an undiscounted basis), which includes $5 million of known unpaid reinsurance losses outstanding.

A summary of the activity in reinsurance-related reserves is as follows:

	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	(In millions)			
Balance, beginning of period	$	84	$	113
Realized reinsurance losses(1)		(57)		(49)
Increase in liability for reinsurance losses		13		30
Balance, end of period	$	40	$	94

(1) Realized reinsurance losses for the nine months ended September 30, 2012 includes $21 million related to the release of reserves associated with the termination of an inactive reinsurance agreement.

Commercial Credit Risk

Vehicle leases are primarily classified as operating leases; however, certain leases are classified as direct financing leases and recorded within Net investment in fleet leases in the Condensed Consolidated Balance Sheets. As of September 30, 2012 and December 31, 2011, both direct financing leases greater than 90 days past due and direct financing leases greater than 90 days past due that are still accruing interest were $3 million and $16 million, respectively. As of September 30, 2012 and December 31, 2011, there were no allowances for credit losses related to direct financing leases.

10. Commitments and Contingencies

LEGAL CONTINGENCIES

The Company and its subsidiaries are defendants in various legal proceedings, which include private and civil litigation as well as government and regulatory examinations, investigations and inquiries or other requests for information. These matters are at varying procedural stages and primarily relate to contractual disputes and other commercial, employment and tax claims. The resolution of these various 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. Alternately, the Company may engage in settlement discussions on certain matters in order to avoid the additional costs of engaging in litigation.

Reserves are established for pending or threatened litigation, claims or assessments 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 and other legal proceedings, 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. Given the inherent uncertainties and status of the Company s outstanding legal proceedings, the range of reasonably possible loss cannot be estimated for all matters. For matters where the Company can estimate the range of losses, the aggregate estimated amount of reasonably possible losses in excess of the recorded liability was $20 million as of September 30, 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2012, the Company s recorded reserves associated with legal and regulatory contingencies were not material. There can be no assurance; however, that the ultimate resolution of the Company s pending or threatened litigation, claims or assessments will not result in losses in excess of the Company s recorded reserves. 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, which may involve loss contingencies.

Contingencies Involving Mortgage Origination and Servicing Practices

The Company has received inquiries and requests for information from regulators and attorneys general of certain states as well as from the Committee on Oversight and Government Reform of the U.S. House of Representatives and the U.S. Senate Judiciary Committee, requesting information as to the Company s mortgage origination and servicing practices, including its foreclosure processes and procedures. Specifically, the New Jersey Attorney General has conducted an investigation of the Company s servicing practices and has informed the Company that it believes that the Company has violated the New Jersey Consumer Fraud Act in connection with customer service and other matters related to loss mitigation activities for certain borrowers in the wake of the financial crisis. The Company has also undergone a regulatory examination by a multistate coalition of certain mortgage banking regulators and such regulators have alleged various violations of federal and state laws related to the Company s mortgage servicing practices prior to July 2011. The Company believes it has meritorious defenses to these various allegations. However, there can be no assurance that claims or litigation will not arise from these inquiries or similar inquiries by other governmental authorities or that fines or penalties will not be assessed against the Company in connection with these matters.

In addition to the increased regulatory focus on origination and servicing practices described above, Fannie Mae and Freddie Mac have also had a continued focus on foreclosure practices. They have assessed compensatory fees against the Company for failing to meet certain foreclosure timelines specified in their respective servicing guides. Although such compensatory fees have not been material to date, there can be no assurance that the assessment of any such compensatory fees will not be material to the Company s results in the future.

CFPB Investigation

In January 2012, the Company was notified that the Bureau of Consumer Financial Protection (the CFPB) had opened an investigation to determine whether the Company s mortgage insurance premium ceding practices to captive reinsurers comply with the Real Estate Settlement Procedures Act and other laws enforced by the CFPB. The CFPB has requested certain related documents and information for review and has requested the answers to written questions pursuant to a Civil Investigative Demand (the CID). In June 2012, the Company filed a petition to modify or withdraw the CID and in September 2012 the CFPB denied the Company s petition. The Company has provided reinsurance services in exchange for premiums ceded and believes that it has complied with the Real Estate Settlement Procedures Act and other laws applicable to the Company s mortgage reinsurance activities. The Company did not provide reinsurance on loans originated after 2009.

11. Accumulated Other Comprehensive Income

The after-tax components of Accumulated other comprehensive income (loss) were as follows:

	September 30, 2012	December 31, 2011
	(In millions)	
Currency translation adjustment	$ 38	$ 31
Unrealized gains on available-for-sale securities, net of income taxes of $1 and $1	1	2
Pension adjustment, net of income tax benefit of $(7) and $(7)	(11)	(12)
Total	$ 28	$ 21

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

All components of Accumulated other comprehensive income (loss) presented above are net of income taxes; however the currency translation adjustment presented above excludes income taxes on undistributed earnings of foreign subsidiaries, which are considered to be indefinitely invested.

There were no amounts of Accumulated other comprehensive income (loss) attributable to noncontrolling interests as of September 30, 2012 and December 31, 2011, or during the respective periods.

12. 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.

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, 2012 or December 31, 2011.

Recurring Fair Value Measurements

Discussion of the measurement of fair value for the assets and liabilities measured on a recurring basis follows:

Mortgage Loans Held for Sale. The Company elected to record Mortgage loans held for sale at fair value. This election is intended to both better reflect the underlying economics and eliminate the operational complexities of risk management activities related to MLHS and hedge accounting requirements.

The following table reflects the difference between the carrying amounts of Mortgage loans held for sale measured at fair value, and the aggregate unpaid principal amount that the Company is contractually entitled to receive at maturity:

	September 30, 2012		December 31, 2011	
	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)			
Mortgage loans held for sale:				
Carrying amount	$ 1,953	$ 15	$ 2,658	$ 23
Aggregate unpaid principal balance	1,906	22	2,592	34
Difference	$ 47	$ (7)	$ 66	$ (11)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2012	December 31, 2011
	(In millions)	
First mortgages:		
Conforming (1)	$ 1,765	$ 2,483
Non-conforming	117	109
Construction loans		4
Total first mortgages	1,882	2,596
Second lien	8	10
Scratch and Dent (2)	63	50
Other		2
Total	$ 1,953	$ 2,658

(1) Represents mortgage loans that conform to the standards of the government-sponsored entities.

(2) Represents mortgage loans with origination flaws or performance issues.

Derivative Instruments. The average pullthrough percentage used in measuring the fair value of Interest Rate Lock Commitments (IRLCs) was 73% and 74% as of September 30, 2012 and December 31, 2011, respectively. The pullthrough percentage is considered a significant unobservable input and represents an adjustment to the recorded value of the IRLCs to reflect the estimated percentage that will result in a closed mortgage loan under the original terms of the agreement. The estimate of pullthrough is modeled based on a historical analysis of loan closing and fallout data that considers current interest rates as well as changes in pullthrough resulting from fluctuations in interest rates and loan values. 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.

Mortgage Servicing Rights. The fair value of Mortgage servicing rights (MSRs) is estimated based upon projections of expected future cash flows considering prepayment estimates (developed using a model described below), the Company s historical prepayment rates, portfolio characteristics, interest rates based on interest rate yield curves, implied volatility and other economic factors. On a quarterly basis, assumptions used in estimating fair value are validated against a number of third-party sources, which may include peer surveys, MSR broker surveys, third-party valuations and other market-based sources.

In the first quarter of 2012, the Company integrated an updated prepayment model used in the valuation of MSRs, which is more closely aligned with the actual prepayment speeds of the capitalized servicing portfolio. Additionally, the new model utilizes a combination of standard default curves and current delinquency levels to project future delinquencies and foreclosures, whereas the previous model assumed current delinquency and foreclosure rates would remain constant over the life of the asset. Based upon the results of our analysis of the modeled value and validation of our value and current assumptions against third-party sources, there was no change to the overall value of MSRs as a result of integrating the new prepayment model.

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

	September 30, 2012	December 31, 2011
Weighted-average prepayment speed (CPR)	18%	18%
Option adjusted spread, in basis points	1,004	857
Weighted-average delinquency rate	7%	n/a

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The following table summarizes the estimated change in the fair value of MSRs from adverse changes in the significant assumptions:

	September 30, 2012		
	Weighted-Average Prepayment Speed	Option Adjusted Spread (In millions)	Weighted-Average Delinquency Rate
Impact on fair value of 10% adverse change	$ (70)	$ (37)	$ (17)
Impact on fair value of 20% adverse change	(133)	(70)	(34)

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

The effect of a variation in a particular assumption is calculated without changing any other assumption and the assumptions used in valuing the MSRs are independently aggregated. Although there are certain inter-relationships among the various key assumptions noted above, changes in one of the significant assumptions would not independently drive changes in the others. The 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 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. The option adjusted spread is a measure of the risk in valuing the MSR, considering all other market-based assumptions.

Assets and liabilities measured at fair value on a recurring basis were included in the Condensed Consolidated Balance Sheets as follows:

	September 30, 2012				
	Level One	Level Two	Level Three (In millions)	Cash Collateral and Netting (1)	Total
ASSETS					
Restricted investments	$	$ 126	$	$	$ 126
Mortgage loans held for sale		1,941	12		1,953
Mortgage servicing rights			1,002		1,002
Other assets Derivative assets:					
Interest rate lock commitments			221		221
Forward delivery commitments		40		(21)	19
Option contracts		1			1
MSR-related agreements		27		(26)	1
Interest rate contracts		1			1
Convertible note-related agreements			22		22

LIABILITIES					
Other liabilities Derivative liabilities:					
Forward delivery commitments	$	$ 141	$	$ (116)	$ 25
MSR-related agreements				2	2
Convertible note-related agreements			22		22

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	December 31, 2011				
	Level One	Level Two	Level Three (In millions)	Cash Collateral and Netting(1)	Total
ASSETS					
Restricted investments	$	$ 226	$	$	$ 226
Mortgage loans held for sale		2,641	17		2,658
Mortgage servicing rights			1,209		1,209
Other assets Derivative assets:					
Interest rate lock commitments			184		184
Forward delivery commitments		38		(32)	6
Option contracts		2			2
MSR-related agreements		6		(6)	
Interest rate contracts		1			1
Convertible note-related agreements			4		4
Securitized mortgage loans			28		28
LIABILITIES					
Debt:					
Mortgage loan securitization debt certificates	$	$	$ 21	$	$ 21
Other liabilities Derivative liabilities:					
Forward delivery commitments		127		(86)	41
Interest rate contracts		1			1
Convertible note-related agreements			4		4

(1) Represents adjustments to arrive at the carrying amount of assets and liabilities presented in the Condensed Consolidated Balance Sheets for the effect of netting the payable or receivable and cash collateral held or placed with the same counterparties under master netting arrangements.

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

	Three Months Ended September 30, 2012		
	Mortgage loans held for sale	Mortgage servicing rights (In millions)	Interest rate lock commitments, net
Balance, beginning of period	$ 12	$ 1,157	$ 179
Realized and unrealized gains (losses)	(1)	(225)	425
Purchases			
Issuances	2	70	
Settlements	(1)		(383)
Transfers into Level Three			
Transfers out of Level Three			
Balance, end of period	$ 12	$ 1,002	$ 221

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	Nine Months Ended September 30, 2012					
	Mortgage loans held for sale	Mortgage servicing rights	Interest rate lock commitments, net	Investment securities	Securitized mortgage loans	Mortgage loan securitization debt certificates
	(In millions)					
Balance, beginning of period	$ 17	$ 1,209	$ 184	$	$ 28	$ 21
Realized and unrealized gains (losses)	(2)	(451)	1,185	(2)		
Purchases	2					
Issuances	3	244				
Settlements	(3)		(1,148)	(5)		
Transfers into Level Three						
Transfers out of Level Three	(5)					
Deconsolidation of entity(1)				7	(28)	(21)
Balance, end of period	$ 12	$ 1,002	$ 221	$	$	$

	Three Months Ended September 30, 2011				
	Mortgage loans held for sale	Mortgage servicing rights	Interest rate lock commitments, net	Securitized mortgage loans	Mortgage loan securitization debt certificates
	(In millions)				
Balance, beginning of period	$ 155	$ 1,508	$ 48	$ 34	$ 26
Realized and unrealized gains (losses) for assets	(1)	(410)	509	1	
Realized and unrealized losses for liabilities					1
Purchases	1				
Issuances		100			
Settlements	(2)		(382)	(3)	(2)
Transfers into Level Three	1				
Transfers out of Level Three	(134)				
Balance, end of period	$ 20	$ 1,198	$ 175	$ 32	$ 25

	Nine Months Ended September 30, 2011				
	Mortgage loans held for sale	Mortgage servicing rights	Interest rate lock commitments, net	Securitized mortgage loans	Mortgage loan securitization debt certificates
	(In millions)				
Balance, beginning of period	$ 172	$ 1,442	$ (4)	$ 42	$ 30
Realized and unrealized gains (losses) for assets	(11)	(601)	942		
Realized and unrealized losses for liabilities					3
Purchases	25				
Issuances	308	357			
Settlements	(306)		(763)	(10)	(8)
Transfers into Level Three	85				
Transfers out of Level Three	(253)				
Balance, end of period	$ 20	$ 1,198	$ 175	$ 32	$ 25

(1) In 2012, the Company sold its investment in the subordinated debt and residual interests of a Mortgage loan securitization trust that had been consolidated as a variable interest entity.

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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 generally represent mortgage loans held for sale with corrected performance issues or origination flaws or loans that were foreclosed upon. Mortgage loans in foreclosure are measured at fair value on a non-recurring basis.

For the three and nine months ended September 30, 2011, Transfers out of Level Three also represent the transfer of certain mortgage loans to Level Two of the valuation hierarchy based on an increase in the availability of market bids and increased trading activity.

Realized and unrealized gains (losses) related to assets and liabilities classified within Level Three of the valuation hierarchy were included in the Condensed Consolidated Statements of Operations as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Gain on mortgage loans, net:				
Mortgage loans held for sale	$ (1)	$ (2)	$ (3)	$ (18)
Interest rate lock commitments	425	509	1,185	942
Change in fair value of mortgage servicing rights:				
Mortgage servicing rights	(225)	(410)	(451)	(601)
Mortgage interest income:				
Mortgage loans held for sale		1	1	7
Securitized mortgage loans		2		4
Mortgage interest expense:				
Mortgage securitization debt certificates		(1)		(4)
Other income:				
Securitized mortgage loans		(1)		(4)
Investment securities			(2)	
Mortgage securitization debt certificates		1		1

Unrealized gains (losses) included in the Condensed Consolidated Statements of Operations related to assets and liabilities classified within Level Three of the valuation hierarchy that are included in the Condensed Consolidated Balance Sheets were as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Gain on mortgage loans, net	$ 208	$ 174	$ 219	$ 173
Change in fair value of mortgage servicing rights	(150)	(353)	(252)	(455)
Other income		(1)		(4)

Fair Value of Other Financial Instruments

As of September 30, 2012 and December 31, 2011, all financial instruments were either recorded at fair value or the carrying value approximated fair value, with the exception of Debt and derivative instruments included in Total PHH Corporation stockholders equity. For financial instruments that were not recorded at fair value, such as Cash and cash equivalents and Restricted cash and cash equivalents, the carrying value approximates fair value due to the short-term nature of such instruments. These financial instruments are classified within Level One of the valuation hierarchy.

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Debt. As of September 30, 2012 and December 31, 2011, the total fair value of Debt was $6.7 billion and $6.8 billion, respectively, and substantially all of the debt is measured using Level Two inputs. For Level Two Debt, fair value is estimated using either: (i) a market based on the current market pricing of recent trades for similar instruments or the current expected ask price for the Company s debt instruments; (ii) a discounted cash flow model using assumptions based on current market information available for similar debt instruments; or (iii) observable spreads and terms for recent pricing of similar instruments.

13. Variable Interest Entities

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

		September 30, 2012	
	PHH Home Loans	Chesapeake and D.L. Peterson Trust (In millions)	FLRT and PHH Lease Receivables LP
ASSETS			
Cash	$ 57	$ 3	$
Restricted cash(1)	3	177	56
Mortgage loans held for sale	708		
Accounts receivable, net	31	65	
Net investment in fleet leases		2,853	694
Property, plant and equipment, net	2		
Other assets	30	10	9
Total assets	$ 831	$ 3,108	$ 759
Assets held as collateral(2)	$ 683	$ 3,095	$ 743
LIABILITIES			
Accounts payable and accrued expenses	$ 23	$ 2	$ 10
Debt	642	2,700	671
Other liabilities	20		
Total liabilities(3)	$ 685	$ 2,702	$ 681

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	December 31, 2011			
	PHH Home Loans	Chesapeake and D.L. Peterson Trust	FLRT and PHH Lease Receivables LP	Mortgage Securitization Trust
	(In millions)			
ASSETS				
Cash	$ 52	$ 2	$	$
Restricted cash(1)	2	262	49	
Mortgage loans held for sale	476			
Accounts receivable, net	21	58		
Net investment in fleet leases		2,818	572	
Property, plant and equipment, net	1			
Other assets	18	8	12	28
Total assets	$ 570	$ 3,148	$ 633	$ 28
Assets held as collateral(2)	$ 463	$ 3,138	$ 610	$
LIABILITIES				
Accounts payable and accrued expenses	$ 21	$ 2	$ 13	$
Debt	434	2,549	538	21
Other liabilities	9			
Total liabilities(3)	$ 464	$ 2,551	$ 551	$ 21

(1) Represents amounts specifically designated to purchase assets, repay debt and/or provide over-collateralization related to vehicle management asset-backed debt arrangements.

(2) Represents amounts not available to pay the Company s general obligations. See Note 7, Debt and Borrowing Arrangements for further information.

(3) Excludes intercompany payables.

PHH Home Loans

For the nine months ended September 30, 2012, approximately 26% of the mortgage loans originated by the Company were derived from Realogy Corporation s affiliates, of which approximately 85% were originated by PHH Home Loans.

Mortgage Loan Securitization Trust

In 2012, the Company sold the residual interests in a mortgage securitization trust that had been consolidated as a VIE. As a result, the Company is no longer the primary beneficiary of the VIE and the assets and liabilities of the trust were deconsolidated from the Condensed Consolidated Balance Sheets. The loss on the sale of these residual interests was not significant.

14. Segment Information

Operations are conducted through three business segments: Mortgage Production, Mortgage Servicing and Fleet Management Services.

- **Mortgage Production** provides mortgage loan origination services and sells mortgage loans.
- **Mortgage Servicing** performs servicing activities for originated and purchased loans.
- **Fleet Management Services** provides commercial fleet management services.

Certain income and expenses not allocated to the three reportable segments and intersegment eliminations are reported under the heading Other. The Company s operations are substantially located in the U.S.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 Corporation s noncontrolling interest in the profit or loss of PHH Home Loans.

Segment results were as follows:

	Total Assets	
	September 30, 2012	December 31, 2011
	(In millions)	
Mortgage Production segment	$ 2,487	$ 3,085
Mortgage Servicing segment	1,726	2,018
Fleet Management Services segment	4,475	4,337
Other	558	337
Total	$ 9,246	$ 9,777

	Net Revenues			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Mortgage Production segment(1)	$ 337	$ 264	$ 909	$ 647
Mortgage Servicing segment	(118)	(312)	(155)	(313)
Fleet Management Services segment	405	432	1,207	1,233
Other			(1)	(2)
Total	$ 624	$ 384	$ 1,960	$ 1,565

	Segment Profit (Loss)(3)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Mortgage Production segment(1)	$ 122	$ 95	$ 317	$ 172
Mortgage Servicing segment	(205)	(368)	(427)	(467)
Fleet Management Services segment	21	21	67	56
Other(2)	(13)		(13)	(1)
Total	$ (75)	$ (252)	$ (56)	$ (240)

(1) For the nine months ended September 30, 2011, Net revenues and segment profit for the Mortgage Production segment included a $68 million gain on the 50.1% sale of the equity interests in the Company s appraisal services business.

(2) For the three and nine months ended September 30, 2012, Other primarily represents the loss on the early retirement of the Medium-term notes due in 2013 which was not allocated to the reportable segments.

(3) The following is a reconciliation of Loss before income taxes to segment loss:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Loss before income taxes	$ (56)	$ (242)	$ (12)	$ (223)
Less: net income attributable to noncontrolling interest	19	10	44	17
Segment loss	$ (75)	$ (252)	$ (56)	$ (240)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

15. Subsequent Events

On October 25, 2012, Chesapeake Funding, LLC issued $600 million of Series 2012-2 Term notes. Proceeds from the notes were used to pay down a portion of the Series 2010-1 and 2011-1 Chesapeake Variable-funding notes.

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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 , Part II Item 1A. Risk Factors and our Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Part I Item 1. Business and Part I Item 1A. Risk Factors , Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.

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

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

OVERVIEW

We are a leading outsource provider of mortgage and fleet management services. We conduct our business through three operating segments: a Mortgage Production segment, a Mortgage Servicing segment and a Fleet Management Services segment. Our Mortgage Production segment originates, purchases and sells mortgage loans through PHH Mortgage. Our Mortgage Servicing segment services mortgage loans originated by PHH Mortgage, and also purchases mortgage servicing rights and acts as a subservicer for certain clients that own the underlying servicing rights. Our Fleet Management Services segment provides commercial fleet management services to corporate clients and government agencies throughout the United States and Canada.

Although our Fleet Management Services segment has historically generated a larger portion of our Net revenues, our Mortgage Production and Mortgage Servicing segments have historically contributed a significantly larger portion of our Net income. Our Mortgage Production and Mortgage Servicing segments have experienced, and may continue to experience, high degrees of earnings volatility due to significant exposure to interest rates and the real estate markets, which impacts our loan origination volumes, valuation of our mortgage servicing rights and foreclosure-related charges.

See Risk Management in this Form 10-Q for additional information regarding our interest rate and market risks.

Executive Summary

For 2012, we are focusing on four key strategies to increase shareholder value:

- pursue disciplined growth in our three franchise platforms which are mortgage private label services, our mortgage relationship with Realogy and our fleet management business;
- drive industry-leading operational excellence;
- continue our unwavering commitment to customer service; and
- in the near-term, prioritize liquidity and cash flow generation from our mortgage and fleet businesses and deleverage the balance sheet.

These strategies represent a shift in focus for 2012 away from an emphasis on growing origination market share and mortgage servicing rights. Some of the actions we are taking to reposition the business, including prioritizing liquidity and cash flow generation in the near-term and investing in operational excellence and customer service initiatives, have had a negative impact on our 2012 earnings.

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We are continuing to execute on our plans to improve our liquidity and cash flow generation, and we accomplished several initiatives in the third quarter of 2012 including amending our existing Credit Facility to extend a portion of the commitments to 2015, repaying $418 million outstanding principal of the Medium-term notes due 2013 and completing the offering of Senior Notes due 2019 with $270 million of net cash proceeds. The early repayment of the Medium-term notes due 2013 generated a $13 million pre-tax loss during the three and nine months ended September 30, 2012.

Our unrestricted cash balance was $677 million as of September 30, 2012 compared to $700 million as of June 30, 2012. The change in balance reflects a $148 million net cash decrease from the term-debt actions outlined above and a reduction of $53 million from the increase in cash collateral posted under derivative agreements and letters of credit. Excluding those changes, we generated $178 million of positive cash flow for the third quarter of 2012, which resulted from our operations and the following actions:

- generated $116 million of cash from the securitization of fleet leases, including the release of overcollateralization from prior securitizations;

- generated $10 million from the sale of non-conforming mortgage loans;

- selectively originated loans in our wholesale/correspondent platform to control cash utilization; and

- aligned our business operations with established cash flow targets.

See Liquidity and Capital Resources for additional information regarding our outstanding indebtedness, debt ratings and our liquidity and capital plan.

In our Mortgage Production segment we continue to experience elevated margins and volume. Total loan margins during the third quarter of 2012 were 420 basis points, representing a 132 basis points increase over the same period in 2011. Wholesale/correspondent declined to 13% of our total closings during the third quarter of 2012 compared to 33% in 2011, reflecting the emphasis on our retail platform and our efforts to manage cash consumption and loan quality.

Our Mortgage Servicing segment continued to be negatively impacted by an increase in foreclosure-related charges. During the first nine months of 2012, we experienced increased levels of loan repurchase and indemnification requests, primarily from the Agencies, that exceeded our historical experience. This increase in repurchase and indemnification requests, coupled with a decline in our overall success rate in appealing repurchase requests resulted in $41 million of provisions during the third quarter of 2012, compared to $39 million during the second quarter of 2012, $65 million during the first quarter of 2012 and $20 million during the third quarter of 2011.

During the third quarter of 2012, we received 997 repurchase and indemnification requests, compared to 1,171 in the second quarter of 2012 as further compared to 663 and 698 in the third and fourth quarters of 2011, respectively. The increase in repurchase requests in 2012 is primarily due to an increase in the number of loan file reviews by the Agencies as they focused more resources on clearing the backlog of previously requested loan files primarily related to the 2005 through 2008 origination years. The majority of repurchase requests continue to be related to the 2005 through 2008 origination years. We continue to monitor these trends and may need to further increase our loan repurchase and indemnification liability if the elevated levels of repurchase requests continue. Additionally, an increased level of repurchase requests could result in an increased use of cash, as compared to prior periods, to fund loan repurchases or make-whole payments under loan indemnification agreements. We expect foreclosure losses to remain elevated through the fourth quarter of 2012, and potentially into 2013, as investors continue to review both performing and non-performing loans for potential underwriting defects and representation and warranty violations. See Risk Management for additional information regarding our repurchase obligations and potential exposure.

Our Fleet Management Services segment continued with steady earnings in the third quarter of 2012, driven by growth in our net investment in leases and additions to maintenance service, fuel, and accident management average units.

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Industry Trends

Regulatory Trends

We are subject to numerous federal, state and local laws and regulations and may be subject to various judicial and administrative decisions imposing various requirements and restrictions on our business. By agreement with our private label clients in our mortgage business, we are required to comply with additional requirements that our clients may be subject to through their regulators. These laws, regulations and judicial and administrative decisions include those pertaining to the following areas:

- Real estate settlement procedures;

- Consumer credit provisions; fair lending, fair credit reporting and truth in lending;

- The establishment of maximum interest rates, finance charges and other charges;

- Secured transactions; collections, foreclosure, repossession and claims-handling procedures;

- Privacy regulations providing for the use and safeguarding of non-public personal financial information of borrowers and guidance on non-traditional mortgage loans issued by the federal financial regulatory agencies;

- Taxing and licensing of vehicles and environmental protection;

- Insurance regulations and licensing requirements pertaining to standards of solvency that must be met and maintained; reserves and provisions for unearned premiums, losses and other obligations and deposits of securities for the benefit of policyholders.

We are monitoring a number of developments in regulations that are expected to impact our Mortgage segments, and there has been a heightened focus of regulators on the practices of the mortgage industry. Regulatory and financial reform efforts continued in the third quarter of 2012, as regulatory agencies proposed and progressed on finalizing numerous rules. We are working diligently in assessing and understanding the implications of the ongoing regulatory changes, and are devoting substantial resources towards implementing all of the new rules and regulations while meeting the needs and expectations of our clients. Certain of these developments include the following:

On August 10, 2012, the Bureau of Consumer Financial Protection (the CFPB) proposed two rules as part of an ongoing effort to address mortgage servicing reforms and create uniform standards for the mortgage servicing industry. The two proposed rules would increase requirements for communications with borrowers and would increase requirements around the maintenance of customer account records. The CFPB is expected to issue final rules for this proposal in January 2013. While we are continuing to evaluate these proposed rules, if enacted, they will likely lead to increased costs to service loans across the mortgage industry.

On September 11, 2012, the Federal Housing Finance Agency (the FHFA) announced that Fannie Mae and Freddie Mac are establishing a new representation and warranty framework for conventional loans sold or delivered on or after January 1, 2013. The objective of the new framework is to provide increased transparency and certainty to lenders with respect to repurchase exposure on future loan sales. The new framework provides relief of certain repurchase obligations provided loans meet specific payment requirements consisting of 36 months of consecutive on-time payments, except for loans originated under the Home Affordable Refinance Program, which requires only 12 months of acceptable payment history. The new representation and warranty framework is also expected to change the quality control review processes of Fannie Mae and Freddie Mac, including changing the timing of reviews and establishing consistent guidelines around the review and appeal process. These rules will likely impact the processing of representation and warranty claims on a prospective basis, and may impact our future expectations of repurchase liabilities for loans originated after January 1, 2013.

On October 4, 2012, the FHFA released a whitepaper for industry comment seeking comments on proposed changes to the infrastructures of Fannie Mae and Freddie Mac. The whitepaper outlines a proposed framework for the future structure of the housing finance system, including a common securitization platform and a model Pooling and Servicing Agreement. The primary goals of the changes proposed are to: (i) replace the outmoded proprietary infrastructures of the Agencies with a common, more efficient model; and (ii) establish a framework

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that is consistent with multiple states of housing finance reform, including greater participation of private capital in assuming credit risk. We are monitoring the developments in this proposal and the potential impacts on the mortgage industry.

We have received inquiries and requests for information from regulators and attorneys general of certain states as well as from the Committee on Oversight and Government Reform of the U.S. House of Representatives and the U.S. Senate Judiciary Committee requesting information as to our mortgage origination and servicing practices, including our foreclosure processes and procedures. Specifically, the New Jersey Attorney General has conducted an investigation of our servicing practices and has informed us that it believes that we have violated the New Jersey Consumer Fraud Act in connection with customer service and other matters related to loss mitigation activities for certain borrowers in the wake of the financial crisis. We have also undergone a regulatory examination by a multistate coalition of certain mortgage banking regulators and such regulators have alleged various violations of federal and state laws related to our mortgage servicing practices prior to July 2011. We believe that we have meritorious defenses to these various allegations. However, there can be no assurance that claims or litigation will not arise from these inquiries or similar inquiries by other governmental authorities or that fines or penalties will not be assessed against us in connection with these matters.

In addition to the increased regulatory focus on origination and servicing practices described above, Fannie Mae and Freddie Mac have also had a continued focus on foreclosure practices. They have assessed compensatory fees against us for failing to meet certain foreclosure timelines specified in their respective servicing guides. Although such compensatory fees have not been material to date, there can be no assurance that the assessment of any such compensatory fees will not be material to our results in the future.

In January 2012, we were notified that the CFPB had opened an investigation to determine whether our mortgage insurance premium ceding practices to captive reinsurers comply with the Real Estate Settlement Procedures Act and other laws enforced by the CFPB. The CFPB has requested certain related documents and information for review and has requested the answers to written questions pursuant to a Civil Investigative Demand (the CID). In June 2012, we filed a petition to modify or withdraw the CID and in September 2012 the CFPB denied our petition. We have provided reinsurance services in exchange for premiums ceded and believe that we have complied with the Real Estate Settlement Procedures Act and other laws applicable to the Company s mortgage reinsurance activities. We did not provide reinsurance on loans originated after 2009. The CFPB s investigation is still ongoing and there can be no assurance that this investigation will not result in the imposition of any penalties or fines against us or our subsidiaries.

The U.S. Department of Justice has recently announced settlements with, and initiated various other actions against, major lenders under the False Claims Act and other statutes. In connection with these settlements and actions, the U.S. Department of Justice has alleged, among other things, reckless mortgage lending practices and improper or inadequate certification to the government in connection with the Federal Housing Administration s Direct Endorsement Lending Program. The U.S. Department of Justice s civil frauds unit has brought these cases as part of its continuing investigation of lending practices. Although we have not been notified that we are the subject of any investigation by the U.S. Department of Justice, there can be no assurance that future investigations may not arise.

We expect that the higher level of legislative and regulatory focus on mortgage origination and servicing practices will result in higher legal, compliance and servicing related costs as well as potential regulatory fines and penalties. It is also reasonably possible that we could experience an increase in mortgage origination or servicing related litigation in the future. For more information, see Part II Item 1A. Risk Factors The businesses in which we engage are complex and heavily regulated, and changes in the regulatory environment affecting our businesses could have a material adverse effect on our business, financial position, results of operations or cash flows. In addition, we are subject to litigation, regulatory investigations and inquiries and may incur fines, penalties, and increased costs that could negatively impact our future results of operations or damage our reputation. in this Form 10-Q.

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Mortgage Production Trends

As of October 2012, Fannie Mae s *Economics and Mortgage Market Analysis* forecasts an increase in industry loan originations to $1.8 trillion during 2012 compared to $1.5 trillion during 2011, consisting primarily of a 30% increase in projected refinance originations. Refinance originations are sensitive to interest rates which have remained historically low, and Fannie Mae is projecting interest rates will remain at these levels for the remainder of 2012 and into 2013, positively impacting consumer demand. Fannie Mae is also projecting purchase originations to remain relatively flat compared to 2011 despite an increase in new and existing home sales expected during 2012.

We have continued to experience elevated levels of pricing margins compared to historical periods as mortgage interest rates remained low and consumer demand persisted. In the third quarter of 2012, the Federal Reserve announced plans to purchase an additional $40 billion of agency mortgage-backed securities per month, among other actions. The Federal Reserve stated their actions are intended to reinforce the low interest rate environment and support the mortgage markets. Although we expect margins to eventually decline from current levels, we believe that pricing margins could remain elevated during the fourth quarter of 2012 and potentially into 2013 reflecting a longer term industry view of the returns required to manage the underlying risk of a mortgage production and servicing business.

The Federal Housing Finance Agency increased guarantee fees on mortgage backed securities issued by Fannie Mae and Freddie Mac which became effective on April 1, 2012 with another increase that will become effective on December 1, 2012. These increases, and any future increases, will have the impact of increasing mortgage interest rates charged to borrowers, which could negatively impact future conforming loan origination volumes.

The increased consumer demand for mortgage loans, coupled with more stringent underwriting guidelines and the increasingly complex regulatory compliance environment have led to longer processing cycle times across the mortgage industry. Consistent with these industry trends, we have experienced loan processing delays and other service issues that have negatively impacted customer service delivery in our Mortgage Production segment. As a result, we have failed to satisfy certain service level agreements and other performance provisions under some of our mortgage origination assistance agreements. During the nine months ended September 30, 2012, we incurred an immaterial amount of contractual penalties related to these issues; however, a continuation of our failure to fully satisfy the terms of service-level and other performance provisions of these contracts could result in material penalties or the loss of client relationships. We are currently implementing measures to improve our loan processing and customer service delivery in an effort to more fully satisfy the terms of our mortgage origination assistance agreements.

For more information, see Part II Item 1A Risk Factors Changes in existing U.S. government sponsored mortgage programs or servicing eligibility standards could materially and adversely affect our business, financial position, results of operations or cash flows. in this Form 10-Q.

Mortgage Servicing Trends

We have continued to experience an elevated level of repurchase requests which have primarily been concentrated in Agency loans originated from 2005 through 2008. This trend has been volatile in recent periods and has accelerated during 2012 resulting in a 55% increase in repurchase requests during the nine months ended September 30, 2012 compared to 2011. Although we have reduced the amount of outstanding unresolved repurchase requests from the highs observed earlier in 2012, the amount of outstanding unresolved repurchase requests stands at

$250 million as of September 30, 2012 compared to $222 million at the end of 2011. In September 2012, the Federal Housing Finance Agency reiterated its commitment to identify underwriting and documentation deficiencies in loans originated prior to 2009 that have resulted in significant taxpayer losses from the support of Fannie Mae and Freddie Mac. The Agencies are expected to continue with a strict enforcement of representation and warranty provisions to resolve contractual claims of deficiencies in those loan vintages and to provide an effective means of loss mitigation.

We believe repurchase requests and foreclosure costs will continue to remain high during the fourth quarter of 2012 and potentially into 2013. We expect that the Agencies will continue to focus on losses from origination years prior to 2009 since losses from those years have been intensified by the poor economic environment and challenging conditions in the housing market. The Agencies have also increased their reviews of more current loan production, which could further increase future repurchase activity.

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In addition to the increased focus on loan repurchases and indemnifications, we have experienced higher reinsurance losses resulting from elevated levels of delinquency and foreclosure experience and overall weakness in the housing market. During the nine months ended September 30, 2012, we paid $36 million in reinsurance claims, which included $8 million paid in connection with a reinsurance agreement that was terminated during the second quarter of 2012. Although we expect claim payments to remain elevated during the fourth quarter of 2012 as additional foreclosures are completed and insurance claims are processed, we do not expect paid claims to remain at the current levels since we have reached the maximum paid loss thresholds for certain origination years. We hold cash and securities in trust related to our potential obligation to pay such claims and we expect that the amount currently held in trust will be significantly higher than future claims for reinsurance losses.

See Risk Management for additional information regarding mortgage reinsurance and loan repurchases.

Fleet Management Services Trends

The fleet management industry continues to be influenced by the current condition of the U.S. economy and we would expect to see improvement in the industry if the U.S. economy improves. Although we have experienced a decline in our leased units in recent years, our net investment in leases has increased as our mix has changed to include more expensive truck and service-type vehicles. We have seen positive trends in our service units and we expect to balance the growth in our service unit counts with our leased units.

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RESULTS OF OPERATIONS

Consolidated Results

The following table presents our consolidated results of operations:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions, except per share data)			
Net fee income	$ 136	$ 110	$ 391	$ 338
Fleet lease income	340	370	1,014	1,050
Gain on mortgage loans, net	257	203	695	381
Mortgage net finance expense	(30)	(24)	(92)	(68)
Loan servicing income	112	112	333	337
Valuation adjustments relating to mortgage servicing rights, net	(217)	(409)	(446)	(600)
Other income	26	22	65	127
Net revenues	624	384	1,960	1,565
Depreciation on operating leases	304	307	908	922
Fleet interest expense	18	19	52	60
Total other expenses	358	300	1,012	806
Total expenses	680	626	1,972	1,788
Loss before income taxes	(56)	(242)	(12)	(223)
Income tax benefit	(33)	(104)	(32)	(100)
Net (loss) income	(23)	(138)	20	(123)
Less: net income attributable to noncontrolling interest	19	10	44	17
Net loss attributable to PHH Corporation	$ (42)	$ (148)	$ (24)	$ (140)
Basic loss earnings per share attributable to PHH Corporation	$ (0.74)	$ (2.62)	$ (0.42)	$ (2.48)
Diluted loss earnings per share attributable to PHH Corporation	$ (0.74)	$ (2.62)	$ (0.42)	$ (2.48)

The following table summarizes the key highlights that drove our operating performance and segment profit (loss) for our reportable segments:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Reportable Segments Profit (Loss):(1)				
Mortgage Production segment	$ 122	$ 95	$ 317	$ 172
Mortgage Servicing segment	(205)	(368)	(427)	(467)
Fleet Management Services segment	21	21	67	56
Other(2)	(13)		(13)	(1)

(1) Segment profit (loss) is described in Note 14, Segment Information , in the accompanying Notes to Condensed Consolidated Financial Statements.

(2) For the three and nine months ended September 30, 2012, Other primarily represents the loss on early retirement of our Medium-term notes due in 2013.

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Mortgage Production Segment

Quarterly Comparison:

- Segment profit was $27 million higher compared to 2011 primarily due to 132 basis points of higher total margins and a 75% increase in fee-based loan closings, partially offset by a 41% decline in interest rate lock commitments expected to close.

- Interest rate lock commitments expected to close decreased to $6.8 billion from $11.4 billion in 2011, due to the decline in wholesale/correspondent volume and a shift in mix towards fee-based production. Total closings reflect the significant increase in refinance activity as refinance closings increased by 48% compared to 2011 due to the historically low interest rate environment.

- The mix of wholesale/correspondent originations declined to 13% in 2012 from 33% in 2011, reflecting our strategy to selectively manage originations in this platform considering cash consumption and loan quality.

Year-to-Date Comparison:

- Segment profit was $145 million higher compared to 2011 primarily due to 123 basis points of higher total margins and a 13% increase in total closings, partially offset by a 15% decrease in the volume of interest rate lock commitments expected to close. In addition, the prior year profit includes a $68 million gain on the sale of 50.1% of the equity interests in STARS.

- Total mortgage applications increased by 12% compared to 2011 and interest rate lock commitments expected to close decreased to $20.4 billion from $24.0 billion in 2011 due to a shift in mix towards fee-based production and the decline in wholesale/correspondent volume.

Mortgage Servicing Segment

Quarterly Comparison:

- Segment loss was unfavorably impacted by a $21 million increase in foreclosure-related charges compared to 2011 driven by a significant increase in loan repurchase and indemnification requests in 2012 as discussed above under Executive Summary .

- Loan payoffs in our capitalized servicing portfolio increased 92% compared to 2011, resulting in a $27 million reduction in the fair value of our mortgage servicing rights and an additional $5 million of curtailment interest expense.

Year-to-Date Comparison:

- Segment loss was unfavorably impacted by an $86 million increase in foreclosure-related charges compared to 2011 driven by a significant increase in loan repurchase and indemnification requests in 2012, as discussed above under Executive Summary.

- Loan servicing income for 2012 includes a loss of $16 million from the termination of one of our inactive reinsurance contracts as discussed under Risk Management.

- Loan payoffs in our capitalized servicing portfolio increased 77% compared to 2011, resulting in a $57 million reduction in the fair value of our mortgage servicing rights and an additional $12 million of curtailment interest expense.

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Fleet Management Services Segment

Quarterly Comparison:

- Segment profit was consistent with 2011, reflecting the growth in net investment in leases, higher units and usage of fee-based and asset-based management services, partially offset by lower syndication results and leasing revenues.

- Maintenance service, fuel, and accident management average units all increased in 2012 compared to 2011.

Year-to-Date Comparison:

- Segment profit increased by $11 million to $67 million in 2012, driven by growth in net investment in leases, lower funding costs and higher units and usage of fee-based and asset-based management services.

- Maintenance service, fuel, and accident management average units all increased in 2012 compared to 2011.

- The average number of leased vehicles declined by 3% compared to 2011; however, our net investment in leases increased by $239 million compared to September 30, 2011.

The results of each of our reportable segments are discussed in detail below.

Income tax expense

We record our interim tax provisions or benefits 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 of our Mortgage Production and Mortgage Servicing segments are considered to not be reliably estimable and therefore we record discrete year-to-date income tax provisions on those results.

For the nine months ended September 30, 2012, our effective tax rate was primarily impacted by: (i) the noncontrolling interest holder s portion of taxes on the income of PHH Home Loans; and (ii) the impact of applying statutory changes to apportionment weight, apportionment sourcing and corporate income tax rates that were enacted by various states, primarily New Jersey, in the first quarter of 2012.

For the nine months ended September 30, 2011, our effective tax rate was primarily impacted by: (i) a decrease in our liability for tax contingencies resulting from the resolution and settlement with various taxing authorities including the conclusion of the IRS examination and review of our taxable years 2006 through 2009; and (ii) the noncontrolling interest holder s portion of taxes on the income of PHH Home Loans; partially offset by (iii) changes in the valuation allowance driven by state tax losses generated by our mortgage business.

See Note 8, Income Taxes in the accompanying Notes to Condensed Consolidated Financial Statements for further detail.

Appraisal Services Business Joint Venture

On March 31, 2011, we sold 50.1% of the equity interests in our appraisal services business, Speedy Title and Appraisal Review Services, (STARS) to CoreLogic, Inc. for a total purchase price of $35 million. We retained a 49.9% equity interest in STARS, which is accounted for under the equity method.

For the nine months ended September 30, 2012, earnings from the equity method investment in STARS of $5 million are recorded as a component of Other income in the Mortgage Production segment. During the nine months ended September 30, 2011, a $68 million gain on the sale of STARS was recorded within Other income of the Mortgage Production segment, which consisted of the net present value of the purchase price from CoreLogic plus the $34 million from the initial valuation of our equity method investment.

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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, marketing and communications. The costs associated with these shared general and administrative functions, in addition to the cost of managing the overall corporate function, are incurred and recorded within Other and allocated back to our reportable segments through a corporate overhead allocation. Other also includes intersegment eliminations and certain income and expenses that are not allocated back to our reportable segments.

The following table presents the revenues and expenses recorded in Other:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
		(In millions)		
Net revenues	$	$	$ (1)	$ (2)
Salaries and related expenses	20	16	55	52
Occupancy and other office expenses	1	2	3	4
Fleet interest expense	1	(1)	(1)	(3)
Other depreciation and amortization	2	1	6	3
Other operating expenses	25	17	53	37
Corporate overhead allocation	(36)	(35)	(104)	(94)
Total expenses	13		12	(1)
Net loss before income taxes	$ (13)	$	$ (13)	$ (1)

Net revenues

Net revenues represent income that is not allocated to the reportable segments and intersegment eliminations.

Salaries and Related Expenses

Salaries and related expenses represent costs associated with operating corporate functions and our centralized management platform and consist of salaries, payroll taxes, benefits and incentives paid to shared service support employees. These expenses are primarily driven by the average number of permanent employees.

Quarterly Comparison: Salaries and related expenses increased by $4 million compared to 2011 primarily due to an increase in management incentive compensation.

Year-to-Date Comparison: Salaries and related expenses increased by $3 million compared to 2011 primarily due to an increase in management incentives related to 2012 compensation plans and an increase in the average number of permanent employees which was partially offset by $2 million in lower actual payments related to 2011 incentive compensation plans.

Other Operating Expenses

The components of Other operating expenses were as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Professional fees	$ 4	$ 7	$ 22	$ 21
Other expenses	21	10	31	16
Total	$ 25	$ 17	$ 53	$ 37

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Quarterly Comparison: Professional fees decreased by $3 million compared to 2011 and was primarily attributable to fees incurred during 2011 related to the development of our information technology infrastructure that were nonrecurring in 2012. Other expenses increased by $11 million compared to 2011 which was primarily driven by costs associated with the early retirement of the Medium-term notes due in 2013.

Year-to-Date Comparison: Professional fees increased by $1 million compared to 2011 and was primarily attributable to an increase in information technology-related expenses associated with private label client implementations in our Mortgage Production segment that was offset by fees incurred during 2011 related to the development of our information technology infrastructure that were nonrecurring in 2012. Other expenses increased by $15 million compared to 2011 which was primarily driven by costs associated with the early retirement of the Medium-term notes due in 2013 and higher computer software and hardware expenses resulting from investments in our information technology infrastructure.

Corporate Overhead Allocation

The table below provides a summary of our corporate overhead allocation by segment:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Mortgage Production segment	$ 20	$ 20	$ 58	$ 50
Mortgage Servicing segment	5	4	13	11
Fleet Management Services segment	11	11	33	33
Other	(36)	(35)	(104)	(94)
Total	$	$	$	$

The amount of expense allocated to each segment is based upon the actual and estimated usage by function or expense category or based on the relative size of the operating segment.

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Mortgage Production Segment

The following tables present a summary of our financial results and key related drivers for the Mortgage Production segment and are followed by a discussion of each of the key components of Net revenues and Total expenses:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	($ in millions, except average loan amount)			
Loans closed to be sold	$ 8,793	$ 9,552	$ 27,529	$ 26,082
Fee-based closings	5,595	3,197	13,642	10,244
Total closings	$ 14,388	$ 12,749	$ 41,171	$ 36,326
Purchase closings	$ 4,731	$ 6,211	$ 13,591	$ 16,078
Refinance closings	9,657	6,538	27,580	20,248
Total closings	$ 14,388	$ 12,749	$ 41,171	$ 36,326
Fixed rate	$ 9,863	$ 9,139	$ 29,264	$ 25,804
Adjustable rate	4,525	3,610	11,907	10,522
Total closings	$ 14,388	$ 12,749	$ 41,171	$ 36,326
Retail closings	$ 12,466	$ 8,597	$ 33,012	$ 25,373
Wholesale/correspondent closings	1,922	4,152	8,159	10,953
Total closings	$ 14,388	$ 12,749	$ 41,171	$ 36,326
Average loan amount	$ 301,101	$ 257,872	$ 278,474	$ 256,977
Loans sold	$ 8,808	$ 8,579	$ 28,285	$ 28,307
Applications	$ 18,579	$ 22,704	$ 55,088	$ 49,006
IRLCs expected to close	$ 6,769	$ 11,429	$ 20,394	$ 23,974

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Mortgage fees	$ 91	$ 68	$ 254	$ 210
Gain on mortgage loans, net	257	203	695	381
Mortgage interest income	22	21	64	72
Mortgage interest expense	(38)	(29)	(113)	(90)
Mortgage net finance expense	(16)	(8)	(49)	(18)
Other income	5	1	9	74
Net revenues	337	264	909	647
Salaries and related expenses	114	84	307	251
Occupancy and other office expenses	8	7	23	22
Other depreciation and amortization	2	2	5	7
Other operating expenses	72	66	213	178
Total expenses	196	159	548	458
Income before income taxes	141	105	361	189
Less: net income attributable to noncontrolling interest	19	10	44	17
Segment profit	$ 122	$ 95	$ 317	$ 172

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Mortgage Production Statistics

Mortgage loan originations are driven by the demand to fund home purchases and the demand to refinance existing loans. Purchase closings are influenced by the number of home sales and the overall condition of the housing market whereas refinance closings are sensitive to interest rate changes relative to borrowers current interest rates. Refinance closings typically increase when interest rates fall and decrease when interest rates rise. Although the level of interest rates is a key driver of refinancing activity, there are other factors which influence the level of refinance closings including home prices, levels of home equity, underwriting standards and product characteristics.

As of October 2012, Fannie Mae s *Economics and Mortgage Market Analysis* shows an increase in mortgage industry origination volumes of approximately 36% and 28% during the third quarter and nine months ended September 30, 2012, respectively, as compared to the same periods of 2011. Refinance closings continued to be positively impacted by a sustained low interest rate environment despite the many borrowers who took advantage of refinance incentives during prior periods of low interest rates. Based on the October industry origination volumes reported by Fannie Mae, refinance closings represented 74% and 71% of total origination volumes during the third quarter and nine months ended September 30, 2012, respectively.

The level of wholesale/correspondent closings can be influenced by a variety of factors, including overall industry capacity, pricing margins and the competitive landscape. Our decline in wholesale/correspondent volume reflects our efforts to manage cash consumption and our strategy to generate mortgage servicing rights with minimal use of cash, while at the same time, focusing on the underlying quality of the loans originated in this platform. As of September 30, 2012, 25% of our outstanding Interest rate lock commitments (IRLCs) expected to close were wholesale/correspondent compared to 44% as of December 31, 2011. Wholesale/correspondent loans are generally less profitable than retail loans and have lower loan margins and expenses.

IRLCs represent an agreement to extend credit to a mortgage loan applicant, or an agreement to purchase a loan from a third-party originator, whereby the interest rate on the loan is set prior to funding. IRLCs expected to close are adjusted for the amount of loans expected to close in accordance with the terms of the commitment. IRLCs expected to close result in loans closed to be sold as we do not enter into interest rate lock commitments on fee-based closings.

Quarterly Comparison: Our total closings increased by $1.6 billion (13%) compared to 2011 and were comprised of a $3.1 billion increase in refinance closings offset by a $1.5 billion decrease in purchase closings. Refinance closings were positively impacted by the low interest rate environment and represented 67% of our total closing volumes during 2012 compared to 51% in 2011. While we have seen a positive trend in closings from our real estate channel driven by an improvement in home sales, our purchase closings decreased compared to 2011 due to our planned reduction in wholesale/correspondent volume.

Wholesale/correspondent closings represented 13% and 33% of our total closing volumes in 2012 and 2011, respectively which reflects our shift in focus to ensure that our operations are cash flow positive and to manage our wholesale/correspondent originations to control cash consumption. Although total loan margins have reached historical highs, we have maintained a focus on limiting the cash consumption and originating high quality loans in the wholesale/correspondent platform, which has reduced our wholesale/correspondent origination volume.

Although total applications decreased by 18% compared to 2011 resulting from a decline in wholesale/correspondent volume, we continue to pursue growth in our retail platform where a low interest rate environment and higher consumer demand contributed to a 5% increase in retail applications. Our IRLCs expected to close declined by 41% primarily due to the change in mix to a greater composition of fee-based production where we do not enter into an interest rate lock commitment and lower wholesale/correspondent volume.

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Year-to-Date Comparison: Our total closings increased by $4.8 billion (13%) compared to 2011 and were comprised of a $7.3 billion increase in refinance closings offset by a $2.5 billion decrease in purchase closings. Refinance closings were positively impacted by the low interest rate environment and represented 67% of our total closing volumes during 2012 compared to 56% in 2011. While we have seen a positive trend in closings from our real estate channel driven by an improvement in home sales, our purchase closings decreased compared to 2011 due to our planned reduction in wholesale/correspondent volume.

Wholesale/correspondent closings represented 20% and 30% of our total closing volumes in 2012 and 2011, respectively which reflects our shift in focus to ensure that our operations are cash flow positive and to manage our wholesale/correspondent originations to control cash consumption.

Total applications increased by 12% compared to 2011 resulting from growth in our retail platform where a low interest rate environment and higher consumer demand contributed to a 39% increase in retail applications which was offset by a decline in wholesale/correspondent volume. Our IRLCs expected to close declined by 15% primarily due to the change in mix to a greater composition of fee-based production where we do not enter into an interest rate lock commitment and lower wholesale/correspondent volume.

Mortgage Fees

Retail closings and fee-based closings are key drivers of Mortgage fees. Mortgage fees consist of fee income earned on all loan originations, including loans closed to be sold and fee-based closings. Fee income consists of amounts earned related to application and underwriting fees and fees on cancelled loans. Appraisal and other income generated by our appraisal services business is included through the quarter ended March 31, 2011. Fee income also consists of amounts earned from financial institutions related to brokered loan fees and origination assistance fees resulting from our private-label mortgage outsourcing activities. Fees associated with the origination and acquisition of mortgage loans are recognized as earned.

Quarterly Comparison: Mortgage fees increased by $23 million (34%) compared to 2011 primarily due to a $16 million increase in origination assistance fees from private label clients resulting from a 34% increase in private label closing units. Mortgage fees were also positively impacted by a $5 million increase in appraisal income and a $2 million increase in application revenue both driven by a 28% increase in the number of retail closing units compared to 2011.

Year-to-Date Comparison: Mortgage fees increased by $44 million (21%) compared to 2011 primarily due to a $31 million increase in origination assistance fees from private label clients resulting from a 24% increase in private label closing units. Mortgage fees were also positively impacted by an $8 million increase in appraisal income and a $5 million increase in application revenue both driven by a 25% increase in the number of retail closing units compared to 2011.

Gain on Mortgage Loans, Net

IRLCs expected to close are the primary driver of Gain on mortgage loans, net. Gain on mortgage loans, net includes realized and unrealized gains and losses on our mortgage loans, as well as the changes in fair value of our interest rate locks and loan-related derivatives. The fair value of our IRLCs is based upon the estimated fair value of the underlying mortgage loan, adjusted for: (i) the estimated costs to complete and originate the loan and (ii) the estimated percentage of IRLCs that will result in a closed mortgage loan. The valuation of our interest rate lock commitments and mortgage loans approximates a whole-loan price, which includes the value of the related mortgage servicing rights. Mortgage servicing rights are recognized and capitalized at the date the loans are sold and subsequent changes in the fair value are recorded in Change in fair value of mortgage servicing rights in the Mortgage Servicing segment.

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The components of Gain on mortgage loans, net were as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In millions)			
Gain on loans	$ 227	$ 200	$ 589	$ 341
Change in fair value of Scratch and Dent and certain non-conforming mortgage loans	(17)	(3)	(33)	(3)
Economic hedge results	47	6	139	43
Total change in fair value of mortgage loans and related derivatives	30	3	106	40
Total	$ 257	$ 203	$ 695	$ 381