OCWEN FINANCIAL CORP
Form 10-Q
November 09, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

or

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

Commission File Number: 1-13219

Ocwen Financial Corporation
(Exact name of registrant as specified in its charter)

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

1661 Worthington Road, Suite 100, West Palm Beach, Florida 33409
(Address of principal executive offices) (Zip Code)

(561) 682-8000
(Registrant's telephone number, including area code)

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

Yes x No o

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

Yes x No o

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

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

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

Number of shares of Common Stock, $0.01 par value, outstanding as of October 30, 2009: 99,835,097 shares.

OCWEN FINANCIAL CORPORATION
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FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

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

	September 30, 2009	December 31, 2008
		(As Adjusted)
Assets		
Cash	$ 195,854	$ 201,025
Trading securities, at fair value		
Auction rate	250,099	239,301
Subordinates and residuals	4,417	4,369
Loans held for resale, at lower of cost or fair value	36,618	49,918
Advances	131,360	102,085
Match funded advances	879,444	1,100,555
Mortgage servicing rights	124,989	139,500
Receivables, net	33,135	42,798
Deferred tax assets, net	129,116	175,145
Intangibles, including goodwill	—	46,227
Premises and equipment, net	3,954	12,926
Investments in unconsolidated entities	18,764	25,663
Other assets	67,303	97,588
Total assets	$ 1,875,053	$ 2,237,100
Liabilities and Equity		
Liabilities		
Match funded liabilities	$ 529,779	$ 961,939
Lines of credit and other secured borrowings	54,665	116,870
Investment line	167,168	200,719
Servicer liabilities	59,457	135,751
Debt securities	109,814	133,367
Income taxes payable, net	18,940	—
Other liabilities	77,770	78,813
Total liabilities	1,017,593	1,627,459
Commitments and Contingencies (Note 24)		
Equity		
Ocwen Financial Corporation stockholders' equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 99,835,097 and 62,716,530 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	998	627
Additional paid-in capital	458,822	201,831
Retained earnings	395,809	404,901

Accumulated other comprehensive income, net of income taxes		1,569		1,876
Total Ocwen Financial Corporation stockholders' equity		857,198		609,235
Non-controlling interest in subsidiaries		262		406
Total equity		857,460		609,641
Total liabilities and equity	$	1,875,053	$	2,237,100

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

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

For the periods ended September 30,	Three months		Nine months	
	2009	2008	2009	2008
		(As Adjusted)		(As Adjusted)
Revenue				
Servicing and subservicing fees	$ 57,534	$ 91,298	$ 201,832	$ 290,200
Process management fees	23,735	27,453	97,513	81,794
Other revenues	2,083	2,510	7,776	8,743
Total revenue	83,352	121,261	307,121	380,737
Operating expenses				
Compensation and benefits	18,959	33,727	74,758	96,567
Amortization of servicing rights	7,159	12,106	25,743	40,712
Servicing and origination	7,804	11,540	36,277	37,589
Technology and communications	4,206	6,022	13,495	17,713
Professional services	6,378	5,973	21,772	27,058
Occupancy and equipment	4,192	5,131	15,056	17,471
Other operating expenses	4,675	2,959	11,188	9,689
Total operating expenses	53,373	77,458	198,289	246,799
Income from operations	29,979	43,803	108,832	133,938
Other income (expense)				
Interest income	1,992	3,448	6,411	11,492
Interest expense	(16,145)	(19,334)	(50,108)	(66,513)
Gain (loss) on trading securities	8,291	(621)	13,346	(22,366)
Gain (loss) on debt redemption	1,600	—	2,134	(86)
Loss on loans held for resale, net	(1,242)	(674)	(8,783)	(11,112)
Equity in losses of unconsolidated entities	(1,059)	(2,928)	(1,608)	(10,628)
Other, net	42	(284)	2,843	214
Other expense, net	(6,521)	(20,393)	(35,765)	(98,999)
Income from continuing operations before income taxes	23,458	23,410	73,067	34,939
Income tax expense	65,294	8,330	82,803	11,693
Income (loss) from continuing operations	(41,836)	15,080	(9,736)	23,246
	(231)	(186)	633	(5,572)

Income (loss) from discontinued operations, net of income taxes				
Net income (loss)	(42,067)	14,894	(9,103)	17,674
Net loss (income) attributable to non-controlling interest in subsidiaries	36	82	11	(143)
Net income (loss) attributable to Ocwen Financial Corporation (OCN)	$ (42,031)	$ 14,976	$ (9,092)	$ 17,531
Basic earnings per share				
Income from continuing operations attributable to OCN common shareholders	$ (0.51)	$ 0.24	$ (0.14)	$ 0.37
Income (loss) from discontinued operations attributable to OCN common shareholders	—	—	0.01	(0.09)
Net income (loss) attributable to OCN common shareholders	$ (0.51)	$ 0.24	$ (0.13)	$ 0.28
Diluted earnings per share				
Income from continuing operations attributable to OCN common shareholders	$ (0.51)	$ 0.23	$ (0.14)	$ 0.37
Income (loss) from discontinued operations attributable to OCN common shareholders	—	—	0.01	(0.09)
Net income (loss) attributable to OCN common shareholders	$ (0.51)	$ 0.23	$ (0.13)	$ 0.28
Weighted average common shares outstanding				
Basic	82,614,456	62,715,551	70,966,393	62,655,655
Diluted	82,614,456	69,750,889	70,966,393	62,897,271

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

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

For the periods ended September 30,	Three months		Nine months	
	2009	2008	2009	2008
		(As Adjusted)		(As Adjusted)
Net income (loss)	$ (42,067)	$ 14,894	$ (9,103)	$ 17,674
Other comprehensive income, net of income taxes:				
Change in unrealized foreign currency translation adjustment (1)	(80)	(88)	(307)	456
Change in deferred loss on cash flow hedge arising during the period (2)	—	—	—	(194)
Reclassification adjustment for loss on cash flow hedge included in net income (3)	—	—	—	345
Net change in deferred loss on cash flow hedge	—	—	—	151
	(80)	(88)	(307)	607
Comprehensive income (loss)	(42,147)	14,806	(9,410)	18,281
Comprehensive loss (income) attributable to non-controlling interest in subsidiaries	47	148	144	(145)
Comprehensive income (loss) attributable to OCN	$ (42,100)	$ 14,954	$ (9,266)	$ 18,136

(1) Net of income tax benefit (expense) of $47 and $63 for the three months ended September 30, 2009 and 2008, respectively, and $180 and $(268) for the nine months ended September 30, 2009 and 2008, respectively.

(2) Net of income tax expense of $114 for the nine months ended September 30, 2008.

(3) Net of income tax expense of $202 for the nine months ended September 30, 2008.

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009
(Dollars in thousands, except share data)

	OCN Shareholders						
	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Non-controlling interest in subsidiaries	Total
Balance at December 31, 2008 (As Adjusted – See Note 3)	62,716,530	$ 627	$ 201,831	$ 404,901	$ 1,876	$ 406	$ 609,641
Net loss	—	—	—	(9,092)	—	(11)	(9,103)
Net assets distributed in connection with the spin-off of Altisource Portfolio Solutions S.A. (formerly Ocwen Solutions) (Note 2)	—	—	(71,448)	—	—	—	(71,448)
Issuance of common stock	37,671,500	377	334,790	—	—	—	335,167
Repurchase of common stock	(1,000,000)	(10)	(10,990)	—	—	—	(11,000)
Repurchase of 3.25% Convertible Notes	—	—	(4)	—	—	—	(4)
Issuance of common stock awards to employees	29,907	—	(138)	—	—	—	(138)
Exercise of common stock options	405,013	4	2,964	—	—	—	2,968
Excess tax benefits related to share-based awards	—	—	362	—	—	—	362
Employee compensation – Share-based awards	—	—	1,373	—	—	—	1,373
Directors' compensation – Common stock	12,147	—	82	—	—	—	82
Other comprehensive loss, net of income taxes	—	—	—	—	(307)	(133)	(440)
Balance at September 30, 2009	99,835,097	$ 998	$ 458,822	$ 395,809	$ 1,569	$ 262	$ 857,460

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

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

	For the nine months ended September 30,	
	2009	**2008**
		(As Adjusted)
Cash flows from operating activities		
Net income (loss)	$ (9,103)	$ 17,674
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Amortization of mortgage servicing rights	25,743	40,712
Premium amortization and discount accretion	1,735	2,924
Depreciation and other amortization	6,025	9,599
Provision for bad debts	1,138	872
Provision for (reversal of) impairment of mortgage servicing assets	(374)	1,401
Provision for (reversal of) impairment of discontinued operations	(1,227)	4,980
Loss (gain) on trading securities	(13,346)	22,366
Loss on loans held for resale, net	8,783	11,112
Equity in losses of unconsolidated entities	1,608	10,628
Loss (gain) on debt redemption	(2,134)	86
Excess tax benefits related to share-based awards	(362)	(3)
Net cash provided (used) by trading activities	2,500	(238,303)
Net cash provided by loans held for resale activities	3,605	5,641
Decrease in advances and match funded advances	187,669	207,405
Decrease in deferred tax assets	44,325	4,974
Decrease in receivables and other assets, net	27,222	19,780
Decrease in servicer liabilities	(76,294)	(94,187)
Increase (decrease) in other liabilities	23,012	(10,241)
Other, net	(996)	3,808
Net cash provided by operating activities	229,529	21,228
Cash flows from investing activities		
Purchase of mortgage servicing rights	(10,241)	(3,638)
Proceeds from the sale of mortgage servicing rights	—	5,985
Distributions of capital from unconsolidated entities	4,496	32,748
Investment in unconsolidated entities	(62)	(1,250)
Additions to premises and equipment	(3,429)	(4,566)
Proceeds from sales of real estate	1,689	6,003
Other	396	154
Net cash provided (used) by investing activities	(7,151)	35,436
Cash flows from financing activities		
Distribution of cash in connection with the spin-off of Altisource Portfolio Solutions S.A. (formerly Ocwen Solutions) (Note 2)	(20,028)	—

Repayment of match funded liabilities, net	(427,328)	(17,313)
Repayment of lines of credit and other secured borrowings, net	(49,870)	(195,717)
Proceeds from investment line	—	299,964
Repayment of investment line	(33,551)	(84,744)
Repurchase of debt securities	(24,612)	(10,797)
Exercise of common stock options	2,587	3
Repurchase of common stock	(11,000)	—
Issuance of common stock	335,167	—
Excess tax benefits related to share-based awards	362	3
Proceeds from sale of mortgage servicing rights accounted for as a financing	724	—
Net cash used by financing activities	(227,549)	(8,601)

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

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

	For the nine months ended September 30,	
	2009	**2008**
Net increase (decrease) in cash	(5,171)	48,063
Cash at beginning of period	201,025	114,243
Cash at end of period	$ 195,854	$ 162,306
Supplemental disclosure of non-cash investing and financing activities:		
Net assets distributed in connection with the spin-off of Altisource Portfolio Solutions S.A. (formerly Ocwen Solutions), excluding cash (Note 2)	$ 51,420	—

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(Dollars in thousands, except share data)

Note 1 Summary of Significant Accounting Policies

Organization

Ocwen Financial Corporation (NYSE: OCN) (Ocwen or OCN), through its subsidiaries, is a leading provider of residential and commercial mortgage loan servicing, special servicing and asset management services. Ocwen is headquartered in West Palm Beach, Florida with offices in California, the District of Columbia, Florida, Georgia and New York and global operations in India and Uruguay.

At September 30, 2009, OCN owned all of the outstanding stock of its primary subsidiaries: Ocwen Loan Servicing, LLC (OLS); Ocwen Financial Solutions, Private Limited (OFSPL); and Investors Mortgage Insurance Holding Company. OCN owns 70% of Global Servicing Solutions, LLC (GSS) with the remaining 30% minority interest held by ML IBK Positions, Inc.

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

On August 10, 2009, we completed the previously announced distribution of our Ocwen Solutions line of business, except for BMS Holdings and GSS, via the spin-off of a separate publicly-traded company, Altisource Portfolio Solutions S.A. (NASDAQ:ASPS) (Altisource). See Note 2.

Basis of Presentation

Certain amounts included in our 2008 consolidated financial statements have been reclassified to conform to the 2009 presentation, including retrospective application of new accounting pronouncements adopted January 1, 2009. See Note 3 for information regarding our adoption of recent accounting pronouncements.

The accompanying unaudited interim consolidated financial statements have been prepared in conformity with the instructions of the Securities and Exchange Commission (SEC) to Form 10-Q and SEC Regulation S-X, Article 10, Rule 10-01 for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. In our opinion, the accompanying unaudited financial statements contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. The results of operations and other data for the three and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for any other interim period or for the entire year ending December 31, 2009. The unaudited interim consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

Principles of Consolidation

Securitizations or Asset Backed Financing Arrangements

OCN or its subsidiaries have been the transferor in connection with a number of securitizations or asset-backed financing arrangements. As of September 30, 2009, we have continuing involvement with the financial assets of eleven of these securitizations or asset-backed financing arrangements. We have aggregated these securitizations or asset-backed financing arrangements into two groups: (1) securitizations of residential mortgage loans that were accounted for as sales and (2) financings of advances on loans serviced for others that were accounted for as secured borrowings.

Securitizations of Residential Mortgage Loans

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

For the periods ended September 30	Three months		Nine months	
	2009	2008	2009	2008
Total cash received on beneficial interests held	$ 407	$ 583	$ 1,840	$ 2,546
Total servicing and subservicing fee revenues	1,000	1,328	3,415	4,326

	As of	
	September 30, 2009	December 31, 2008
Total collateral balance	$ 629,194	$ 740,477
Non-performing collateral (1)	214,481	219,613
Total certificate balance	628,454	740,121
Total servicing advances	23,929	30,683
Total beneficial interests held at fair value (2)	2,095	2,216
Total mortgage servicing rights at amortized cost	1,773	2,066

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

(2) Includes investments in subordinate and residual securities that we retained in connection with the loan securitization transactions completed in prior years (primarily 2006). These retained interests had a fair value of $90 and $167 at September 30, 2009 and December 31, 2008, respectively.

We have no obligation to provide financial support to the trusts and have provided no such support. Our exposure to loss as a result of our continuing involvement in the trusts is limited to the carrying values of our investments in the residual and subordinate securities of the trusts, our mortgage servicing rights that are related to the trusts and our advances to the trusts. We consider the probability of loss arising from our advances to be remote because of their position ahead of most of the other liabilities of the trusts. See Notes 6, 7, 8 and 9 for additional information regarding trading securities, advances, match funded advances and mortgage servicing rights.

Match Funded Advances on Loans Serviced for Others

Match funded advances on loans serviced for others result from our transfers of residential loan servicing advances to special purpose entities (SPEs) in exchange for cash. These four SPEs issue debt supported by collections on the transferred advances. We made these transfers under the terms of four advance facility agreements. These transfers do not qualify for sales accounting because we retain control over the transferred assets. As a result, we account for these transfers as financings and classify the transferred advances on our balance sheet as match funded advances and the related liabilities as match funded liabilities. Collections on the advances pledged to the special purpose entities are used to repay principal and interest and to pay the expenses of the entity. Holders of the debt issued by these entities can look only to the assets of the entities themselves for satisfaction of the debt and have no recourse against OCN. However, OLS has guaranteed the payment by one of the entities, Ocwen Servicer Advance Funding (Wachovia), LLC (OSAFW), of its obligations under the securitization documents. The maximum amount payable under the guarantee is limited to 10% of the notes outstanding at the end of the facility’s revolving period in May 2010. As of September 30, 2009, OSAFW had notes outstanding of $109,668. The following table summarizes the assets and liabilities of the four special purpose entities formed in connection with our match funded advance facilities:

	September 30, 2009	December 31, 2008
Total assets	$ 922,281	$ 1,122,404
Match funded advances	879,444	1,100,555
Total liabilities	596,238	994,244
Match funded liabilities	529,779	961,939

Variable Interest Entities

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

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

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

Mortgage Servicing Fees and Advances

We earn fees for servicing mortgage loans. We collect servicing fees, generally expressed as a percent of unpaid principal balance, from the borrowers' payments. We also include late fees, prepayment penalties, float earnings and other ancillary fees in servicing income. We recognize servicing fees when the fees are earned which is generally when the borrowers' payments are collected.

During any period in which the borrower does not make payments, most of our servicing agreements require that we advance our own funds to meet contractual principal and interest remittance requirements for the investors, pay property taxes and insurance premiums and process foreclosures. We also advance funds to maintain, repair and market foreclosed real estate properties on behalf of investors. These advances are made pursuant to the terms of each servicing contract. Each servicing contract is associated with specific loans, identified as a pool.

When we make an advance on a loan under each servicing contract, we are entitled to recover that advance from either the borrower, for reinstated and performing loans, or from investors, for foreclosed loans. Most of our servicing contracts provide that the advances made under the respective agreement have priority over all other cash payments from the proceeds of the loan, and in the majority of cases, the proceeds of the pool of loans, which are the subject of that servicing contract. As a result, we are entitled to repayment from loan proceeds before any interest or principal is paid on the bonds, and in the majority of cases, advances in excess of loan proceeds may be recovered from pool level proceeds.

We record a charge to earnings to the extent that advances are uncollectible under the provisions of each servicing contract taking into consideration historical loss and delinquency experience, length of delinquency and the amount of the advance. However, we are generally only obligated to advance funds to the extent that we believe the advances are recoverable from expected proceeds from the loan. We assess collectibility using proprietary cash flow projection models which incorporate a number of different factors, depending on the characteristics of the mortgage loan or pool, including, for example, time to a foreclosure sale, estimated costs of foreclosure action, future property tax payments and the value of the underlying property net of carrying costs, commissions and closing costs.

Note 2 Altisource (formerly Ocwen Solutions) Separation Transaction

On August 10, 2009, we completed the separation of Altisource by distributing all of the shares of Altisource common stock to OCN's shareholders of record as of August 4, 2009 (the Separation). Altisource consists of the operations of our former Ocwen Solutions line of business and related assets comprising the Mortgage Services, Financial Services and Technology Products segments except for BMS Holdings and GSS. OCN shareholders received a tax-free pro rata distribution of one share of Altisource common stock for every three shares of OCN common stock held and received cash in lieu of fractional shares.

As a consequence of the Separation and related transactions, Ocwen will incur income taxes to the extent that the fair market value of Altisource assets exceeded Ocwen's tax basis in such assets in accordance with Section 367 of the Internal Revenue Code. Ocwen has recognized $50,631 of income tax expense, of which $26,371 is current expense and $24,260 is deferred expense. Additional disclosure of the impact of the Separation on our deferred tax assets is included in Note 19.

For accounting purposes, we eliminated the assets and liabilities of Altisource from our consolidated balance sheet effective at the close of business on August 9, 2009. Beginning August 10, 2009, the operating results of Altisource are no longer included in our operating results. We do not report the historical operating results of Altisource as a discontinued operation because of the significance of the continuing involvement between Altisource and OCN under the long-term services agreements described in Note 23. Accordingly, for periods prior to August 10, 2009, the historical operating results of Altisource continue to be included in continuing operations.

In connection with the Separation, we recognized $520 and $3,501 of advisory expenses for the three and nine months ended September 30, 2009, respectively.

A summary of the carrying values of the net assets that we transferred to Altisource in the Separation is as follows:

Assets:	
Cash	$ 20,028
Receivables	13,592
Goodwill and intangibles, net	45,794
Premises and equipment, net	8,615
Other assets	2,179
	90,208

Liabilities		
Deferred tax liability		2,473
Accrued expenses and other liabilities		16,287
		18,760
Reduction in Additional paid-in capital	$	71,448

OCN stock options outstanding under Ocwen's various equity compensation plans have been adjusted to reflect the value of Altisource stock distributed to OCN shareholders. At the date of the Separation, all holders of OCN stock awards, including Altisource employees and those who remained with Ocwen after the Separation, received the following:

- New Altisource stock options (issued by Altisource) to acquire the number of shares of Altisource common stock equal to the product of (a) the number of OCN stock options held on the date of the Separation and (b) the distribution ratio of one share of Altisource common stock for every three shares of OCN common stock; and
- Adjusted OCN stock options for the same number of shares of OCN common stock with a reduced exercise price per stock option.

We determined the exercise price of the new Altisource options and the adjusted OCN options based on the exercise price ratio. We calculated the exercise price ratio for each individual stock option based on the ratio of the grant-date exercise price of the individual stock option to the trading value of the OCN stock immediately prior to the Separation. We then applied this exercise price ratio to the trading value of the OCN stock and the Altisource stock on the date the Altisource stock began regular-way trading on the NASDAQ market to determine the exercise price of the new Altisource stock option and the adjusted OCN stock option.

Similarly, each holder of OCN restricted stock retained his or her unvested shares and received one unvested Altisource restricted stock share for every three OCN unvested shares held.

Consequently, the fair value of the adjusted OCN stock award and the new Altisource stock award immediately following the Separation was equivalent to the fair value of such OCN stock award immediately prior to the Separation.

As of September 30, 2009, the following OCN stock incentive awards were outstanding:

	OCN Stock Options	**OCN Restricted Stock**
Held by current and former OCN employees	7,092,220	7,484
Held by Altisource employees	2,203,097	2,381
Total	9,295,317	9,865

In addition, as of September 30, 2009, our current and former employees held 2,380,784 options to purchase Altisource common stock.

We are responsible for fulfilling all stock incentive awards related to OCN common stock, and Altisource is responsible for fulfilling all stock incentive awards related to Altisource common stock regardless of whether such stock incentive awards are held by our or Altisource's employees. Notwithstanding the foregoing, based on the requirements of SFAS 123(R), our stock-based compensation expense, resulting from awards outstanding at the Separation date, is based on the stock incentive awards held by our employees regardless of whether such awards were issued by OCN or Altisource. Accordingly, stock-based compensation that we recognize as expense with respect to Altisource stock incentive awards is included in "Additional paid-in capital" on our Consolidated Balance Sheet.

Note 3 Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. This establishes the FASB Accounting Standards Codification (ASC) as the only source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP, with the exception of Statements of Financial Accounting Standards not yet included in the Codification. We adopted the FASB ASC as required for the period ended September 30, 2009.

ASC 820, *Fair Value Measures.* In April 2009, the FASB issued FASB FSP FAS 157-4 (Codified within ASC 820) which provides additional guidance for estimating fair value when the level of activity for the asset or liability has significantly decreased. The standard is effective for interim and annual reporting periods ending after June 15, 2009. Our initial adoption of this standard during the second quarter of 2009 did not have a material effect on our consolidated financial statements.

ASC 805, Business Combinations. The FASB issued SFAS No. 141R (Codified within ASC 805) which modifies certain elements of the acquisition method of accounting used for all business combinations. The statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at the full amounts of their fair values, with limited exceptions specified in the statement. If the business combination is achieved in stages (a step acquisition), an acquirer is also required to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values. The statement requires the acquirer to recognize restructuring and acquisition costs separately from the business combination. The statement also requires the disclosure of information necessary to understand the nature and effect of the business combination. The adoption of this standard on January 1, 2009 did not have an impact on our consolidated balance sheets or statements of operations.

ASC 810, Consolidations. The FASB issued SFAS No. 160 (Codified within ASC 810) on December 4, 2007. The statement establishes new accounting and reporting standards for a non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements separate from the parent's equity. The amount of net income attributable to the non-controlling interest is included in consolidated net income on the face of the income statement. The statement clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, when a subsidiary is deconsolidated, this statement requires that a parent recognize a gain or loss in net income based on the fair value of the entire entity, irrespective of any retained ownership, on the deconsolidation date. Such a gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. We adopted this standard on January 1, 2009 by retrospectively applying the provisions of the new guidance to all prior periods. Because the outstanding non-controlling interests in consolidated subsidiaries are not significant, the implementation of this standard did not have a material effect on our consolidated balance sheets or statements of operations.

ASC 320, *Investments*. The FASB issued FSP No. APB 14-1 (Codified within ASC 320).which clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement), and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon adoption of this standard on January 1, 2009, we recognized a discount to reduce the carrying value of the 3.25% Convertible Notes and an offsetting increase to stockholders' equity. The cumulative effect of adoption resulted in: (1) a reduction of retained earnings of $19,838 due to the retrospective accretion of the resulting debt discount to interest expense over the expected life of the notes; (2) adjustments to debt issue cost amortization and gains or losses recognized on previous redemptions; and (3) an increase in additional paid-in capital of $21,293. The adjustment to additional paid-in capital includes the recognized debt discount, adjusted for note redemptions, and the effect of deferred taxes, as well as net gains or losses attributable to redemptions of the equity component. Interest expense for the three and nine months ended September 30, 2008 has been adjusted to include amortization of debt discount of $948 and $2,918, respectively, and a reduction in the amortization of debt issue costs of $32 and $103, respectively. The gain previously recognized on the redemption of debt securities during the quarter ended June 30, 2008 of $3,595 has been adjusted to reflect a loss of $86 on the debt component of the convertible notes in the statement of operations and a gain of $2,800 in additional paid in capital for the equity component.

ASC 320*, Investments.* The FASB issued FSP No. FAS 115-2 and FAS 124-2 (Codified within ASC 320) which amends the other-than-temporary impairment guidance for debt securities and improves the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This standard does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. Because our current investments in debt securities are classified as trading securities and therefore measured at fair value on a recurring basis, this standard did not have a material effect on our consolidated financial statements upon adoption during the second quarter of 2009.

ASC 855, Subsequent Events. This statement, which we adopted during the quarter ended June 30, 2009, introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. A public entity is required to evaluate subsequent events through the date that the financial statements are issued. This statement did not result in changes in the subsequent events that we report, either through recognition or disclosure, in our financial statements upon adoption. We have evaluated subsequent events through November 9, 2009 as disclosed in Note 25.

SFAS No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. This statement clarifies that the objective of the standard is to determine whether a transferor and all of the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets. That determination must consider the transferor's continuing involvements in the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. This statement modifies the financial-components approach currently used and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset.

This statement defines the term *participating interest* to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. If the transfer does not meet those conditions, a transferor should account for the transfer as a sale only if it transfers an entire financial asset or a group of entire financial assets and surrenders control over the entire transferred asset(s). This statement requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. Enhanced disclosures are required to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets.

The provisions in for guaranteed mortgage securitizations are removed to require those securitizations to be treated the same as any other transfer of financial assets within the scope of the standard. If such a transfer does not meet the requirements for sale accounting, the securitized mortgage loans should continue to be classified as loans in the transferor's statement of financial position.

We must adopt this statement as of January 1, 2010 and all reporting periods thereafter. Earlier application is prohibited. This statement must be applied to transfers occurring on or after the effective date. Additionally, the disclosure provisions of this statement should be applied to transfers that occurred both before and after the effective date of this standard. We are evaluating the potential impact of this standard.

SFAS No. 167, Amendments to FASB Interpretation No. 46(R). This standard will require an enterprise to perform ongoing periodic assessments to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both of the following characteristics:

a. The power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance

b. The obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

In addition to reintroducing the concept of control into the determination of the primary beneficiary of a VIE, this statement makes numerous other amendments to the current standards to primarily reflect the elimination of the concept of a QSPE. This statement also amends the current standards to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. The enhanced disclosures are required for any enterprise that holds a variable interest in a VIE. The additional disclosures required by this statement are included in Note 1—Principles of Consolidation.

This standard will become effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited.

As disclosed in Note 1—Securitizations of Residential Mortgage Loans, we currently exclude certain loan securitization trusts from our consolidated financial statements because each is a QSPE. Once this statement becomes effective, we will be required to reevaluate these QSPEs as well as all other potentially significant interests in other unconsolidated entities, such as our asset management vehicles and the securitization trusts underlying our servicing portfolio, to determine if we should include them in our consolidated financial statements. We are evaluating the potential impact of this statement.

Note 4 Fair Value of Financial Instruments

The carrying amounts and the estimated fair values of our financial instruments are as follows at the dates indicated:

	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Trading securities:				
Auction rate	$ 250,099	$ 250,099	$ 239,301	$ 239,301
Subordinates and residuals	4,417	4,417	4,369	4,369
Loans held for resale	36,618	36,618	49,918	49,918
Advances	1,010,804	1,010,804	1,202,640	1,202,640
Receivables	33,135	33,135	42,798	42,798
Financial liabilities:				
Match funded liabilities	$ 529,779	$ 529,779	$ 961,939	$ 965,233
Lines of credit and other secured borrowings	54,665	54,665	116,870	116,870
Investment line	167,168	167,168	200,719	200,719
Servicer liabilities	59,457	59,457	135,751	135,751
Debt securities	109,814	101,258	133,367	112,764
Derivative financial instruments, net	$ 631	$ 631	$ (533)	$ (533)

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

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

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

Level 3: Unobservable inputs for the asset or liability.

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

	Carrying value	Level 1	Level 2	Level 3
At September 30, 2009:				
Measured at fair value on a recurring basis:				
Trading securities (1):				
Auction rate	$ 250,099	$ —	$ —	$ 250,099
Subordinates and residuals	4,417	—	—	4,417
Derivative financial instruments, net (2)	631	(252)	—	883
Measured at fair value on a non-recurring basis:				
Loans held for resale (3)	36,618	—	—	36,618
Mortgage servicing rights (4)	361	—	—	361
At December 31, 2008:				
Measured at fair value on a recurring basis:				
Trading securities (1):				
Auction rate	$ 239,301	$ —	$ —	$ 239,301
Subordinates and residuals	4,369	—	—	4,369
Derivative financial instruments, net (2)	(533)	(726)	—	193
Measured at fair value on a non-recurring basis:				
Loans held for resale (3)	49,918	—	—	49,918
Mortgage servicing rights (4)	—	—	—	—

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

(2) Derivative financial instruments consist of interest rate caps that we use to protect against our exposure to rising interest rates on two of our match funded variable funding notes and foreign currency futures contracts that we use to hedge our net investment in Bankhaus Oswald Kruber GmbH & Co. KG (BOK), our wholly-owned German banking subsidiary, against adverse changes in the value of the Euro versus the U.S. Dollar. We classified the interest rate caps within Level 3 of the fair value hierarchy and the futures contracts within Level 1. See Note 21 for additional information on our derivative financial instruments.

(3) Loans held for resale are measured at fair value on a non-recurring basis. At September 30, 2009 and December 31, 2008, the carrying value of loans held for resale is net of a valuation allowance of $16,468 and $17,491, respectively. Current market illiquidity has reduced the availability of observable pricing data. Consequently, we classify these loans within level 3 of the fair value hierarchy.

(4) The carrying value of MSRs at September 30, 2009 and December 31, 2008 is net of a valuation allowance for impairment of $3,250. The valuation allowance, which relates exclusively to the high-loan-to-value stratum of our residential MSRs, reduced the carrying value of the stratum to $361 at September 30, 2009. The estimated fair value exceeded amortized cost for all other strata. See Note 9 for additional information on MSRs.

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

	Fair value at beginning of period	Purchases, collections and settlements, net (1)	Total realized and unrealized gains and (losses) (2)	Transfers in and/or out of Level 3	Fair value at September 30
For the three months ended September 30, 2009:					
Trading securities:					
Auction rate	$ 243,285	$ (500)	$ 7,314	$ —	$ 250,099
Subordinates and residuals	3,440	—	977	—	4,417
Derivative financial instruments	957	—	(74)	—	883
For the three months ended September 30, 2008:					
Trading securities:					
Auction rate	$ 254,745	$ (801)	$ —	$ —	$ 253,944
Subordinates and residuals	4,860	—	(621)	—	4,239
Derivative financial instruments	1,326	—	(163)	—	1,163
For the nine months ended September 30, 2009:					
Trading securities:					
Auction rate	$ 239,301	$ (2,500)	$ 13,298	$ —	$ 250,099
Subordinates and residuals	4,369	—	48	—	4,417
Derivative financial instruments	193	—	690	—	883
For the nine months ended September 30, 2008:					
Trading securities:					
Auction rate	$ —	$ 270,313	$ (16,369)	$ —	$ 253,944
Subordinates and residuals	7,362	22	(3,145)	—	4,239
Derivative financial instruments	4,867	(7,063)	3,359	—	1,163

(1) Purchases, collections and settlements, net, related to trading securities exclude interest received.

(2) Total gains on auction rate securities for the third quarter include unrealized gains of $7,314 on auction rate securities held at September 30, 2009. We did not record any unrealized gains or losses on auction rate securities during the three months ended September 30, 2008. For the year to date periods, unrealized gains (losses) on auction rate securities held at September 30, 2009 and 2008 were $13,298 and $(15,707), respectively. The total losses attributable to subordinates and residuals and derivative financial instruments were comprised exclusively of unrealized losses on assets held at September 30, 2009 and 2008.

The methodologies that we use and key assumptions that we make to estimate the fair value of instruments are described in more detail by instrument below:

Trading Securities

Auction Rate Securities. We estimated the fair value of the auction rate securities based on a combination of observable market inputs provided by actual orderly sales of similar auction rate securities and a discounted cash flow analysis. This discounted cash flow analysis incorporates expected future cash flows based on our best estimate of market participant assumptions. In periods of market illiquidity, the fair value of auction rate securities is determined after consideration of the credit quality of the securities held and the underlying collateral, market activity and general market conditions affecting auction rate securities.

The discounted cash flow analysis included the following range of assumptions at September 30, 2009:

• Expected term	27 months
• Illiquidity premium	1.0% –1.5%
• Discount rate	3.1% – 14.3%

The expected term was based upon our best estimate of market participants' expectations of future successful auctions. The discount rate and illiquidity premium are consistent with prevailing rates for similar securities. Other significant assumptions that we considered in our analysis included the credit risk profiles of the issuers, the impact on the issuers of the increased debt service costs associated with the payment of penalty interest rates and the collateralization of the securitization trusts. We do not assume defaults in our valuation due to the high credit quality of both the securities we hold and the underlying collateral.

Subordinates and Residuals. Our subordinate and residual securities are not actively traded, and, therefore, we estimate the fair value of these securities based on the present value of expected future cash flows from the underlying mortgage pools. We use our best estimate of the key assumptions we believe are used by market participants. We calibrate our internally developed discounted cash flow models for trading activity when appropriate to do so in light of market liquidity levels. Key inputs include expected prepayment rates, delinquency and cumulative loss curves and discount rates commensurate with the risks. Where possible, we use observable inputs in the valuation of our securities. However, the subordinate and residual securities in which we invest typically trade infrequently and therefore have few or no observable inputs and little price transparency. Additionally, during periods of market dislocation the observability of inputs is further reduced.

Discount rates for the subordinate and residual securities range from 21% to 22% and are determined based upon an assessment of prevailing market conditions and prices for similar assets. We project the delinquency, loss and prepayment assumptions based on a comparison to actual historical performance curves adjusted for prevailing market conditions. Peak delinquency assumptions range from 20% to 30%, and loss assumptions on current balances range from 19% to 28%. Average prepayment assumptions range from 5% to 6%.

At September 30, 2009, securities amounting to $254,516 were carried at their fair value as determined by using valuations based on internally developed discounted cash flow models. These models are calibrated for observable liquid market trading activity.

Derivative Financial Instruments

Exchange-traded derivative financial instruments are valued based on quoted market prices. If quoted market prices or other observable inputs are not available, fair value is based on estimates provided by third-party pricing sources.

Loans Held for Resale

Loans held for resale are reported at the lower of cost or fair value. We account for the excess of cost over fair value as a valuation allowance with changes in the valuation allowance included in gain (loss) on loans held for resale, net, in the period in which the change occurs. All loans held for resale were measured at fair value because the cost of $53,086 exceeded the estimated fair value of $36,618 at September 30, 2009.

When we enter into an agreement to sell a loan to an investor at a set price, the loan is valued at the commitment price. The fair value of loans for which we do not have a firm commitment to sell is based upon a discounted cash flow analysis. We stratify our fair value estimate of uncommitted loans held for resale based upon the delinquency status of the loans. We base the fair value of our performing loans on the expected future cash flows discounted at a rate commensurate with the risk of the estimated cash flows. Significant assumptions include collateral and loan characteristics, prevailing market conditions and the creditworthiness of the borrower. The fair value of our non-performing loans is determined based upon the underlying collateral of the loan and the estimated period and cost of disposition.

Mortgage Servicing Rights

We estimate the fair value of our MSRs by calculating the present value of expected future cash flows utilizing assumptions that we believe are used by market participants. The most significant assumptions used in our internal valuation are the speed at which mortgages prepay and delinquency experience, both of which we derive from our historical experience and available market data. Other assumptions used in our internal valuation are:

- Cost of servicing
- Discount rate
- Interest rate used for computing the cost of servicing advances
- Interest rate used for computing float earnings

- Compensating interest expense

The significant components of the estimated future cash inflows for MSRs include servicing fees, late fees, prepayment penalties, float earnings and other ancillary fees. Significant cash outflows include the cost of servicing, the cost of financing servicing advances and compensating interest payments. We derive prepayment speeds and delinquency assumptions from historical experience adjusted for prevailing market conditions. We develop the discount rate internally, and we consider external market-based assumptions in determining the interest rate for the cost of financing advances, the interest rate for float earnings and the cost of servicing. The more significant assumptions used in the September 30, 2009 valuation include prepayment speeds ranging from 19.3% to 25.7% (depending on loan type) and delinquency rates ranging from 18.0% to 26.1% (depending on loan type). Other assumptions include an interest rate of 1-month LIBOR plus 5% for computing the cost of financing advances, an interest rate of 1-month LIBOR for computing float earnings and a discount rate of 20%.

We perform an impairment analysis based on the difference between the carrying amount and fair value after grouping our loans into the applicable strata based on one or more of the predominant risk characteristics of the underlying loans. The risk factors used to assign loans to strata include the credit score (FICO) of the borrower, the loan to value ratio and the default risk. Our strata include:

- Subprime
- ALT A
- High-loan-to-value
- Re-performing
- Special servicing
- Other

Advances

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

Receivables

The carrying value of receivables generally approximates fair value because of the relatively short period of time between their origination and realization. We carry long-term receivables with an implicit fixed rate or floating rate at a discounted value or approximate face value, respectively, which we believe approximates fair value.

Servicer Liabilities

The carrying value of servicer liabilities approximates fair value due to the short period of time the funds are held until they are deposited in collection accounts, paid directly to an investment trust or refunded to borrowers.

Note 5 Discontinued Operations

In the fourth quarter of 2007, management of OCN approved and committed to a plan to sell its investment in BOK. Management has concluded that BOK met and continues to meet the definition of a discontinued operation. Accordingly, the results of BOK are classified as discontinued in the accompanying consolidated financial statements. For segment reporting purposes, the operations of BOK are included in Corporate Items and Other.

In the second quarter of 2008, we recorded a charge of $4,980 that included the impairment of the remaining $3,423 carrying value of goodwill and intangibles, a $1,377 write-down of receivables and a $180 write-down of premises and equipment.

On June 15, 2009, we entered into an agreement to sell our investment in BOK, subject to regulatory approvals. Based on the terms of this new agreement, we recognized a gain of $1,227 in the second quarter of 2009 to partially reflect the increased sales price for our investment. This gain relates to a previously recorded valuation adjustment**.**

Results of BOK's operations for the periods ended September 30 are as follows:

	Three Months		Nine Months	
	2009	**2008**	**2009**	**2008**
Revenue	$ 25	$ 68	$ 64	$ 339
Operating expenses	414	593	18	6,891

Income (loss) from operations	(389)	(525)	46	(6,552)
Other income, net	158	339	587	980
Income (loss) before income taxes	(231)	(186)	633	(5,572)
Income tax expense (benefit)	—	—	—	—
Net income (loss)	$ (231)	$ (186)	$ 633	$ (5,572)

The following table presents BOK's assets and liabilities at the dates indicated:

	September 30, 2009	December 31, 2008
Cash	$ 9,482	$ 4,613
Receivables	7,224	10,250
Other	56	33
Total assets	$ 16,762	$ 14,896
Total liabilities (including customer deposits of $6,784 and $5,820)	$ 7,087	$ 6,280

Note 6 Trading Securities

Trading securities consisted of the following at the dates indicated:

	September 30, 2009	December 31, 2008
Auction rate (Corporate Items and Other)	$ 250,099	$ 239,301
Subordinates and residuals:		
Loans and Residuals	$ 4,327	$ 4,204
Corporate Items and Other	90	165
	$ 4,417	$ 4,369

Gain (loss) on trading securities for the periods ended September 30 was comprised of the following:

	Three months		Nine months	
	2009	2008	2009	2008
Unrealized gains (losses) (1)	$ 8,291	$ (621)	$ 13,346	$ (20,670)
Realized losses (2)	—	—	—	(1,696)
	$ 8,291	$ (621)	$ 13,346	$ (22,366)

(1) Unrealized gains on auction rate securities were $7,314 for the three months ended September 30, 2009. We did not record any unrealized gains or losses on auction rate securities during the three months ended September 30, 2008. Year to date, the unrealized gains (losses) on auction rate securities were $13,298 and $(15,707) for 2009 and 2008, respectively.

(2) Realized losses for 2008 include a loss of $662 on the sale of auction rate securities in the second quarter.

Auction Rate Securities

During the first quarter of 2008, we invested investment line borrowings (see Note 15) in AAA-rated auction rate securities backed by student loans originated under the U. S. Department of Education's Federal Family Education Loan Program (FFELP). Auction rate securities are long-term variable rate bonds tied to short-term interest rates that reset through an auction process that historically occurred every 7 to 35 days. The student loans underlying the auction rate securities carry a U.S Government guarantee of at least 97% of the unpaid principal balance in the event of default. The auction rate securities that we hold are in the senior-most position and are smaller in amount than the federally guaranteed portion of the underlying loans. Historically, the par value of auction rate securities approximated fair value due to the frequent auctions of these securities at par. In the first quarter of 2008, the auction rate security market began experiencing illiquidity, and auctions began to fail because there were not enough orders to purchase all of the securities being offered at the auction. Within the context of a failed auction, the issuer pays the investor a "fail rate" penalty interest until the auction returns to clearing status, the notes mature at par or the notes are called or redeemed.

On January 21, 2009, Fitch Ratings announced that it had downgraded several tranches of auction rate securities from 'AAA' to 'BBB'. Auction rate securities we hold, with a par value of $70,350 at September 30, 2009, were affected by this ratings action. On January 28, 2009 and February 19, 2009, respectively, Moody's Investors Services, Inc. announced that it had downgraded several tranches of auction rate securities from 'BBB' to 'B' and from 'AAA' to 'A'. Auction rate securities we hold, with a par value of $70,350 and $6,400 at September 30, 2009, were affected by the ratings actions from 'BBB' to 'B' and from 'AAA' to 'A', respectively. The AAA rating from Standard and Poor's Ratings

Services has not been revised. To date we have received all interest payments when due.

We did not sell any of our auction rate securities during the first nine months of 2009. During this same period, issuers redeemed, at par, auction rate securities we held with a face value of $2,500, including $500 during the third quarter. We recognized an $8,291 unrealized gain in the third quarter of 2009. This gain was due to the increased probability of a near term liquidity solution for approximately $70,350 principal amount of the auction rate securities and continued improvement in the underlying FFELP student loan market since December 31, 2008. See Note 25 for a subsequent event related to auction rate securities.

Subordinates and Residuals

Through our investment in subordinate and residual securities, we support senior classes of securities. Principal from the underlying mortgage loans generally is allocated first to the senior classes with the most senior class having a priority right to the cash flow from the mortgage loans until its payment requirements are satisfied. To the extent that there are defaults and unrecoverable losses on the underlying mortgage loans, resulting in reduced cash flows, the most subordinate security will be the first to bear this loss.

Note 7 Advances

Advances, representing payments made on behalf of borrowers or on foreclosed properties, as more fully described in Note 1—Mortgage Servicing Fees and Advances, consisted of the following at the dates indicated:

	September 30, 2009	December 31, 2008
Servicing:		
Principal and interest	$ 51,368	$ 36,183
Taxes and insurance	42,377	32,812
Foreclosure and bankruptcy costs	25,860	23,122
Real estate servicing costs	287	225
Other	6,894	4,756
	126,786	97,098
Loans and Residuals	4,432	4,867
Corporate Items and Other	142	120
	$ 131,360	$ 102,085

Note 8 Match Funded Advances

Match funded advances on residential loans we service for others, as more fully described in Note 1—Mortgage Servicing Fees and Advances, are comprised of the following at the dates indicated:

	September 30, 2009	December 31, 2008
Principal and interest	$ 410,641	$ 615,344
Taxes and insurance	319,855	324,605
Foreclosure and bankruptcy costs	75,525	70,142
Real estate servicing costs	51,091	70,658
Other	22,332	19,806
	$ 879,444	$ 1,100,555

See also Note 1—Principles of Consolidation—Match Funded Advances on Loans Serviced for Others.

Note 9 Mortgage Servicing Rights

	Residential	Commercial	Total
Carrying value of MSRs:			
Balance at December 31, 2008	$ 139,500	$ —	$ 139,500
Purchases	10,241	—	10,241

Servicing transfers and adjustments		(8)		—		(8)
Reduction in impairment valuation allowance		374		—		374
Amortization		(25,118)		—		(25,118)
Balance at September 30, 2009	$	124,989	$	—	$	124,989
Estimated fair value of MSRs:						
September 30, 2009	$	131,327	$	—	$	131,327
December 31, 2008	$	148,135	$	—	$	148,135
Unpaid principal balance of assets serviced:						
September 30, 2009:						
Servicing	$	27,039,067	$	—	$	27,039,067
Subservicing (1)		13,254,631		154,031		13,408,662
	$	40,293,698	$	154,031	$	40,447,729
December 31, 2008:						
Servicing	$	29,830,654	$	—	$	29,830,654
Subservicing		10,340,878		1,319,175		11,660,053
	$	40,171,532	$	1,319,175	$	41,490,707

(1) Includes non-performing loans serviced for Freddie Mac.

We service residential mortgage loans and real estate that we do not own under contractual servicing agreements. We generally obtain MSRs by purchasing them from the owners of the mortgages. We also enter into subservicing agreements with entities that own the servicing rights. Residential assets serviced consist almost entirely of mortgage loans, primarily subprime, but also include real estate. An agreement between the various parties to a mortgage securitization transaction typically specifies the rights and obligations of the holder of the servicing rights which include guidelines and procedures for servicing the loans including remittance and reporting requirements, among other provisions. Assets serviced for others are excluded from our balance sheet. Custodial accounts, which hold funds representing collections of principal and interest that we have received from borrowers, are escrowed with an unaffiliated bank and excluded from our balance sheet. Custodial accounts amounted to approximately $283,600 and $370,200 at September 30, 2009 and December 31, 2008, respectively.

During 2008, we established a valuation allowance for impairment of $3,624 on the high-loan-to-value stratum of our mortgage servicing rights as the external valuation that we consider in our impairment analysis fell below the carrying value due primarily to the declining fair value for rights to service second liens. The external valuation reflects industry averages for delinquencies on loans in the second lien position that are higher than those currently experienced by our servicing portfolio. During the third quarter of 2009, the valuation increased, and we reduced the valuation allowance by $374. Net of the valuation allowance of $3,250, the carrying value of this stratum was $361 at September 30, 2009. For all other strata, the fair value was above the carrying value at September 30, 2009.

We have recognized a servicing liability for those agreements that are not expected to adequately compensate us for performing the servicing. Servicing liabilities were $3,864 and $3,239 at September 30, 2009 and December 31, 2008, respectively, and are included in other liabilities on the balance sheet. During the nine months ended September 30, 2009, the amount of charges we recognized to increase our servicing liability obligations exceeded amortization by $625, and we have reported this net expense as amortization of servicing rights in the statement of operations.

Note 10 Receivables

Receivables consisted of the following at the dates indicated:

	September 30, 2009	December 31, 2008
Accounts receivable by segment:		
Servicing, net (1)	$ 8,140	$ 6,495
Loans and Residuals	1,145	1,169
Asset Management Vehicles	464	1,171
Mortgage Services	71	2,668
Financial Services	—	5,747
Technology Products	—	975
Corporate Items and Other, net (2)	9,715	13,593
	19,535	31,818
Other receivables:		
Term note (3)	7,000	—
Security deposits	4,144	4,645
Income taxes	—	5,386
Other	2,456	949
	$ 33,135	$ 42,798

(1) The balances primarily include reimbursable expenses due from investors. The total balance of receivables for this segment is net of reserves of $2,398 and $1,604 at September 30, 2009 and December 31, 2008, respectively.

(2) The balances at September 30, 2009 and December 31, 2008 include $5,384 and $8,286, respectively, of mortgage loans originated by BOK. These loans were net of allowances of $197 and $1,392, respectively. The balances at September 30, 2009 and December 31, 2008 also include receivables totaling $1,698 and $3,324, respectively, that primarily represent payments to be received in future years

(through June 2014) of proceeds from the sales of investments in affordable housing properties. These affordable housing receivables are net of reserves for doubtful accounts of $6,517 and $6,400, respectively.

(3) In March 2009, we issued a note receivable, maturing on April 1, 2014, in connection with advances funded by the Ocwen Servicer Advance Funding, LLC (OSAF) term note pledged as collateral, as described in Note 14. We receive 1-Month LIBOR plus 300 basis points under the terms of this note receivable. We are obligated to pay 1-Month LIBOR plus 350 basis points under the terms of a five-year note payable to the same counterparty. We do not have a contractual right to offset these payments.

Note 11 Investment in Unconsolidated Entities

	September 30, 2009	December 31, 2008
Asset Management Vehicles:		
Investment in OSI (1)	$ 10,140	$ 15,410
Investment in ONL and affiliates (2)	8,545	10,174
	18,685	25,584
Corporate Items and Other	79	79
	$ 18,764	$ 25,663

Equity in earnings (losses) of unconsolidated entities was as follows for the periods ended September 30:

	Three months		Nine months	
	2009	2008	2009	2008
OSI (1) (3)	$ (956)	$ (1,864)	$ (599)	$ (3,411)
ONL and affiliates (2) (3)	(103)	(1,064)	(1,009)	(1,551)
BMS Holdings (4)	—	—	—	(5,666)
	$ (1,059)	$ (2,928)	$ (1,608)	$ (10,628)

(1) Our investment in OSI represents a 25% equity interest. OSI invests in the lower tranches and residuals of residential mortgage-backed securities, the related mortgage servicing rights and other similar assets. During the first nine months of 2009, we received distributions from OSI totaling $4,000. We have no remaining commitment to invest in OSI.

(2) Our investment in ONL and affiliates represent equity interests of approximately 25%. ONL resolves non-performing loans purchased at a discount. An affiliate purchases real estate for sale, including real estate that ONL may obtain through foreclosure. During the first nine months of 2009, we received distributions totaling $496 from ONL and affiliates and invested an additional $62 in these entities. We have a remaining commitment that expires in September 2010, to invest up to an additional $33,840 in ONL and affiliates, collectively.

(3) We earn loan servicing and management fees from OSI and from ONL and affiliates. In determining the amount of consolidated equity in earnings to recognize, we add back our share of the loan servicing and management fee expense recognized by OSI, ONL and affiliates. For the first nine months of 2009 and 2008, OLS earned fees of $3,401 and $5,539, respectively, from OSI and from ONL and affiliates. On a consolidated basis, we have recognized approximately 75% of the loan servicing and management fee revenue.

(4) During the second quarter of 2008, our share of the losses of BMS Holdings reduced our investment to zero. Our investment in BMS Holdings represents an equity interest of approximately 45%. Because we are not required to advance funds to BMS Holdings to finance operations and we are not a guarantor of any obligations of BMS Holdings, we suspended the recognition of losses from our investment in BMS Holdings. We will not resume recording income or losses until our share of BMS Holdings' earnings exceeds our share of their losses that we did not recognize during the period when the equity method was suspended.

Note 12 Other Assets

Other assets consisted of the following at the dates indicated:

	September 30, 2009	December 31, 2008
Debt service accounts (1)	$ 39,738	$ 58,468
Deferred debt related costs, net	9,122	14,758
Real estate	8,556	7,771
Interest earning collateral deposits	7,612	9,684
Prepaid expenses and other	2,275	6,907
	$ 67,303	$ 97,588

(1) Under our four advance funding facilities, we are contractually required to remit collections on pledged advances to the trustee within two days of receipt. The collected funds are not applied to reduce the related match funded debt until the payment dates specified in the indenture. The balance also includes amounts that have been set aside from the proceeds of our four match funded advance facilities to provide for possible shortfalls in the funds available to pay certain expenses and interest. These funds are held in interest earning accounts.

Note 13 Match Funded Liabilities

Match funded liabilities, representing obligations secured by related match funded advances and repaid through the cash proceeds arising from those assets, as more fully described in Note 1—Mortgage Servicing Fees and Advances, consisted of the following at the dates indicated:

Borrowing Type	Interest Rate (1)	Maturity	Amortization Date	Unused Borrowing Capacity (2)	Balance Outstanding September 30, 2009	Balance Outstanding December 31, 2008
Variable Funding Note Series 2007-1	Commercial paper rate + 200 basis points (3)	December 2014	December 2009	$ 75,514	$ 224,486	$ 219,722
Term Note Series 2006 -1	5.335%	November 2015 (4)	December 2009	—	—	165,000
Variable Funding Note (5)	Commercial paper rate + 150 basis points (5)	December 2013	December 2010	133,595	116,405	192,520
Advance Receivable Backed Notes	1-Month LIBOR + 400 basis points (6)	January 2019 (6)	January 2010 (6)	120,780	79,220	142,361
Advance Receivable Backed Notes	1-Month LIBOR + 275 basis points (7)	May 2011 (7)	May 2010 (7)	390,332	109,668	237,504
				720,221	529,779	957,107
Basis adjustment (4)				—	—	4,832
				$ 720,221	$ 529,779	$ 961,939

(1) 1-Month LIBOR was 0.25% and 0.44% at September 30, 2009 and December 31, 2008, respectively.

(2) At September 30, 2009, all eligible advances are pledged as collateral to a facility. Our unused borrowing capacity is available to us provided that we have additional eligible collateral to pledge. Collateral may only be pledged to one facility.

(3) The interest rate for this note is determined using a commercial paper rate that reflects the borrowing costs of the lender plus a margin of 200 basis points that has generally approximated 1-Month LIBOR plus 200 basis points.

(4) On August 11, 2009, we repaid this note and transferred the majority of the borrowing to the Variable Funding Note Series 2007-1. We previously carried this note on the balance sheet at fair value as the result of a designated fair value hedging relationship that we established in December 2006 using an interest rate swap. We terminated the swap agreement in February 2008 and began amortizing the basis adjustment to earnings over the expected remaining term of the note. In connection with the repayment of this note, we recognized a gain on debt redemption of $1,600, representing the reversal of the fair value hedging basis adjustment less early termination fees and the write-off of unamortized debt issue costs.

(5) The interest rate for this note is determined using a commercial paper rate that reflects the borrowing costs of the lender plus a margin of 150 basis points that has generally approximated 1-Month LIBOR plus 150 basis points.

(6) In January 2009, the lender agreed to renew this facility and to extend the amortization date from February 2009 to January 2010. The interest rate was increased from 1-Month LIBOR plus 200 basis points to 1-Month LIBOR plus 400 basis points.

(7) In May 2009, we negotiated an increase in the maximum borrowing capacity from $300,000 to $500,000 and extended the amortization date from April 2009 to May 2010. Under the terms of the new facility, we pay interest on drawn balances at 1-Month LIBOR plus 275 basis points. The previous interest rate was 1-Month LIBOR plus 250 basis points. In addition, we pay, in twelve monthly installments, a

facility fee of 2.25% of the maximum borrowing capacity of $500,000.

Note 14 Lines of Credit and Other Secured Borrowings

Secured lines of credit from various unaffiliated financial institutions are as follows:

Borrowings	Collateral	Interest Rate (1)	Maturity	Unused Borrowing Capacity	Balance Outstanding September 30, 2009	Balance Outstanding December 31, 2008
Servicing:						
Fee reimbursement advance	Term note (2)	See (2) below	March 2014	$ —	$ 60,000	$ —
Term note (3)	Advances	1-Month LIBOR + 350 basis points	March 2014	—	7,000	—
Senior secured credit agreement - Term note	MSRs	1-Month LIBOR +187.5 basis points (4)	February 2010	—	—	97,987
				—	67,000	97,987
Loans and Residuals:						
Class A-1 notes (5)	Loans held for resale and real estate	1-Month LIBOR + 600 basis points	April 2037	—	—	17,760
Financial Services:						
Revolving note (6)	Receivables	1, 3, 6 or 12-Month LIBOR + 200 basis points or Prime plus 125 basis points	(6)	—	—	1,123
				—	67,000	116,870
Discount (2)				—	(12,335)	—
				$ —	$ 54,665	$ 116,870

(1) 1-Month LIBOR was 0.25% and 0.44% at September 30, 2009 and December 31, 2008, respectively.