OCWEN FINANCIAL CORP
Form 10-Q
August 04, 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 June 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 filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Number of shares of Common Stock, $0.01 par value, outstanding as of July 30, 2009: 67,513,111 shares.

OCWEN FINANCIAL CORPORATION
FORM 10-Q

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FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, 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)

	June 30, 2009	December 31, 2008
		(As Adjusted)
Assets		
Cash	$ 213,911	$ 201,025
Trading securities, at fair value		
Auction rate	243,285	239,301
Subordinates and residuals	3,440	4,369
Loans held for resale, at lower of cost or fair value	39,726	49,918
Advances	153,732	102,085
Match funded advances	883,209	1,100,555
Mortgage servicing rights	132,729	139,500
Receivables, net	47,923	42,798
Deferred tax assets, net	161,180	175,145
Intangibles, including goodwill of $11,027 and $9,836	46,082	46,227
Premises and equipment, net	11,080	12,926
Investments in unconsolidated entities	21,269	25,663
Other assets	76,719	97,588
Total assets	$ 2,034,285	$ 2,237,100
Liabilities and Equity		
Liabilities		
Match funded liabilities	$ 765,023	$ 961,939
Lines of credit and other secured borrowings	121,810	116,870
Investment line	176,668	200,719
Servicer liabilities	77,774	135,751
Debt securities	109,534	133,367
Other liabilities	88,932	78,813
Total liabilities	1,339,741	1,627,459
Commitments and Contingencies (Note 21)		
Equity		
Ocwen Financial Corporation stockholders’ equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 67,512,096 and 62,716,530 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	675	627
Additional paid-in capital	254,071	201,831
Retained earnings	437,840	404,901
Accumulated other comprehensive income, net of income taxes	1,649	1,876

Total Ocwen Financial Corporation stockholders’ equity		694,235		609,235
Minority interest in subsidiaries		309		406
Total equity		694,544		609,641
Total liabilities and equity	$	2,034,285	$	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 June 30,	Three months		Six months	
	2009	2008	2009	2008
		(As Adjusted)		(As Adjusted)
Revenue				
Servicing and subservicing fees	$ 65,488	$ 100,688	$ 144,298	$ 198,902
Process management fees	40,086	27,391	73,778	54,341
Other revenues	3,605	3,146	5,693	6,233
Total revenue	109,179	131,225	223,769	259,476
Operating expenses				
Compensation and benefits	27,254	32,754	55,799	62,840
Amortization of servicing rights	8,543	14,592	18,584	28,606
Servicing and origination	15,835	11,638	28,473	26,049
Technology and communications	4,481	6,421	9,289	11,691
Professional services	8,208	6,336	15,394	21,085
Occupancy and equipment	4,818	5,807	10,864	12,340
Other operating expenses	3,511	3,718	6,513	6,730
Total operating expenses	72,650	81,266	144,916	169,341
Income from operations	36,529	49,959	78,853	90,135
Other income (expense)				
Interest income	2,254	3,231	4,419	8,044
Interest expense	(17,300)	(21,109)	(33,963)	(47,179)
Gain (loss) on trading securities	5,435	(9,722)	5,055	(21,745)
Gain (loss) on debt repurchases	—	(86)	534	(86)
Loss on loans held for resale, net	(2,987)	(5,929)	(7,541)	(10,438)
Equity in losses of unconsolidated entities	(576)	(14,655)	(549)	(7,700)
Other, net	2,990	1,423	2,801	498
Other expense, net	(10,184)	(46,847)	(29,244)	(78,606)
Income from continuing operations before income taxes	26,345	3,112	49,609	11,529
Income tax expense	9,472	424	17,509	3,363
Income from continuing operations	16,873	2,688	32,100	8,166
Income (loss) from discontinued operations, net of income taxes	1,052	(5,182)	864	(5,386)

Net income (loss)	17,925	(2,494)	32,964	2,780
Net income attributable to minority interest in subsidiaries	(95)	(223)	(25)	(225)
Net income (loss) attributable to Ocwen Financial Corporation (OCN)	$ 17,830	$ (2,717)	$ 32,939	$ 2,555
Basic earnings per share				
Income from continuing operations attributable to OCN common shareholders	$ 0.25	$ 0.04	$ 0.49	$ 0.13
Income (loss) from discontinued operations attributable to OCN common shareholders	0.01	(0.08)	0.02	(0.09)
Net income (loss) attributable to OCN common shareholders	$ 0.26	$ (0.04)	$ 0.51	$ 0.04
Diluted earnings per share				
Income from continuing operations attributable to OCN common shareholders	$ 0.24	$ 0.04	$ 0.48	$ 0.13
Income (loss) from discontinued operations attributable to OCN common shareholders	0.02	(0.08)	0.01	(0.09)
Net income (loss) attributable to OCN common shareholders	$ 0.26	$ (0.04)	$ 0.49	$ 0.04
Weighted average common shares outstanding				
Basic	67,316,446	62,682,783	65,045,842	62,625,378
Diluted	72,854,415	62,892,868	70,375,555	62,853,659

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

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

For the periods ended June 30,	Three months		Six months	
	2009	2008	2009	2008
		(As Adjusted)		(As Adjusted)
Net income (loss)	$ 17,925	$ (2,494)	$ 32,964	$ 2,780
Other comprehensive income, net of taxes:				
Change in unrealized foreign currency translation adjustment (1)	(187)	(170)	(227)	544
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 losses included in net income (2)	—	—	—	151
	(187)	(170)	(227)	695
Comprehensive income	17,738	(2,664)	32,737	3,475
Comprehensive loss (income) attributable to minority interest in subsidiaries	(5)	(204)	97	(293)
Comprehensive income attributable to OCN	$ 17,733	$ (2,868)	$ 32,834	$ 3,182

(1) Net of tax benefit (expense) of $110 and $89 for the three months ended June 30, 2009 and 2008, respectively, and $133 and $(331) for the six months ended June 30, 2009 and 2008, respectively.

(2) Net of tax expense of $114 for the six months ended June 30, 2008.

(3) Net of tax expense of $202 for the six months ended June 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 SIX MONTHS ENDED JUNE 30, 2009
(Dollars in thousands, except share data)

	OCN Shareholders						
	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income,	Minority interest in	
	Shares	Amount	Capital	Earnings	Net of Taxes	subsidiaries	Total
Balance at December 31, 2008 (As Adjusted – See Note 2)	62,716,530	$ 627	$ 201,831	$ 404,901	$ 1,876	$ 406	$ 609,641
Net income	—	—	—	32,939	—	25	32,964
Issuance of common stock	5,471,500	55	60,132	—	—	—	60,187
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	282,012	3	1,861	—	—	—	1,864
Excess tax benefits related to share-based awards	—	—	317	—	—	—	317
Employee compensation – Share-based awards	—	—	1,013	—	—	—	1,013
Director’s compensation – Common stock	12,147	—	49	—	—	—	49
Other comprehensive loss, net of income taxes	—	—	—	—	(227)	(122)	(349)
Balance at June 30, 2009	67,512,096	$ 675	$ 254,071	$ 437,840	$ 1,649	$ 309	$ 694,544

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 six months ended June 30,	
	2009	2008
		(As Adjusted)
Cash flows from operating activities		
Net income	$ 32,964	$ 2,780
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Amortization of mortgage servicing rights	18,584	28,606
Premium amortization and discount accretion	1,445	1,820
Depreciation and other amortization	4,862	6,291
Provision for bad debts	885	601
Provision for (reversal of) impairment of investment in Bankhaus Oswald Kruber GmbH & Co. KG	(1,227)	4,980
Loss (gain) on trading securities	(5,055)	21,745
Loss on loans held for resale, net	7,541	10,438
Equity in losses of unconsolidated entities	549	7,700
Loss (gain) on repurchase of debt securities	(534)	86
Reversal of valuation allowance on deferred tax assets	(329)	—
Excess tax benefits related to share-based awards	(186)	(2)
Net cash provided (used) by trading activities	2,000	(240,145)
Net cash provided by loans held for resale activities	2,738	3,310
Decrease in advances and match funded advances	164,979	60,517
Decrease (increase) in deferred tax assets other than reversal of valuation allowance	12,590	(1,447)
Decrease in receivables and other assets, net	15,089	26,784
Decrease in servicer liabilities	(57,977)	(81,496)
Decrease in other liabilities	(5,626)	(7,362)
Other	(173)	2,542
Net cash provided (used) by operating activities	193,119	(152,252)
Cash flows from investing activities		
Purchase of mortgage servicing rights	(10,241)	(3,640)
Proceeds from the sale of mortgage servicing rights	—	5,985
Distributions from Ocwen Structured Investments, LLC and Ocwen Nonperforming Loans, LLC and related entities	3,246	8,950
Investment in Ocwen Nonperforming Loans, LLC and related entities	—	(1,250)
Additions to premises and equipment	(1,110)	(2,111)
Proceeds from sales of real estate	1,322	4,097
Other	396	60
Net cash provided (used) by investing activities	(6,387)	12,091
Cash flows from financing activities		

Repayment of match funded liabilities, net	(195,226)	(9,831)
Proceeds from (repayment of) lines of credit and other secured borrowings, net	18,421	(34,398)
Proceeds from investment line	—	299,964
Repayment of investment line	(24,051)	(70,190)
Repurchase of debt securities	(24,602)	(10,797)
Exercise of common stock options	1,515	3
Repurchase of common stock	(11,000)	—
Issuance of common stock	60,187	—
Excess tax benefits related to share-based awards	186	2
Proceeds from sale of mortgage servicing rights accounted for as a financing	724	—
Net cash provided (used) by financing activities	(173,846)	174,753
Net increase in cash	12,886	34,592
Cash at beginning of period	201,025	114,243
Cash at end of period	$ 213,911	$ 148,835

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 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 asset manager and business process solutions provider specializing in loan servicing, special servicing, mortgage loan due diligence and receivables management services. At June 30, 2009, OCN owned all of the outstanding stock of its primary subsidiaries: Ocwen Loan Servicing, LLC (OLS); Ocwen Financial Solutions, Private Limited (OFSPL); Investors Mortgage Insurance Holding Company; and NCI Holdings, Inc. (NCI). OCN owns 70% of Global Servicing Solutions, LLC (GSS) with the remaining 30% minority interest held by ML IBK Positions, Inc.

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

On November 12, 2008 our Board of Directors authorized management to pursue a plan to separate, through a tax-free spin-off, into a newly formed publicly traded company, all of our operations included within our Ocwen Solutions line of business except for BMS Holdings and GSS (the Separation). Given the need to consolidate the businesses to be separated and the domicile of the newly formed entity, Altisource Portfolio Solutions S.A. (Altisource), Ocwen will incur taxes to the extent that the fair market value of Altisource assets exceeds Ocwen's tax basis in such assets in accordance with section 367 of the Internal Revenue Code. On August 10, 2009, all OCN shareholders of record as of August 4, 2009 will receive a tax-free pro rata distribution of one share of Altisource common stock for every three shares of OCN common stock. Beginning on August 10, 2009, after completion of the Separation, Altisource is expected to be a separate public company listed on the NASDAQ Global Select Market. A vote of OCN shareholders is not required in connection with the Separation.

Basis of Presentation

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

Certain amounts included in our 2008 consolidated financial statements have been reclassified to conform to the 2009 presentation, including retrospective application of new accounting pronouncements adopted January 1, 2009 and the reclassification of charge-offs of loans held for resale. These charge-offs, totaling $2,556 and $6,020 for the three and six months ended June 30, 2008, were reclassified from other operating expenses to loss on loans held for resale, net, in the consolidated statements of operations. See Note 2 for information regarding our adoption of recent accounting pronouncements.

Principles of Consolidation

Securitizations or Asset Backed Financing Arrangements

OCN or its subsidiaries have been the transferor in connection with a number of securitizations or asset-backed financing arrangements. As of June 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 June 30	Three months		Six months	
	2009	2008	2009	2008
Total cash received on beneficial interests held	$ 944	$ 649	$ 1,434	$ 1,963
Total servicing and subservicing fee revenues	1,068	1,551	2,414	2,998

	As of	
	June 30, 2009	December 31, 2008
Total collateral balance	$ 663,672	$ 740,477
Non-performing collateral (1)	200,464	219,613
Total certificate balance	661,413	740,121
Total servicing advances	24,913	30,683
Total beneficial interests held at fair market value (2)	1,213	2,216
Total mortgage servicing rights at amortized cost	1,892	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 $99 and $167 at June 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 5, 6, 7 and 8 for additional information regarding trading securities, advances, match funded advances and mortgage servicing rights.

Match Funded Advances on Loans Serviced for Others

Match funded advances on loans serviced for others result from our transfers of residential loan servicing advances to special purpose entities (SPEs) in exchange for cash. These four SPEs issue debt supported by collections on the transferred advances. We made these transfers under the terms of four advance facility agreements. These transfers do not qualify for sales accounting because we retain control over the transferred assets. As a result, we account for these transfers as financings and classify the transferred advances on our balance sheet as match funded advances and the related liabilities as match funded liabilities. Collections on the advances pledged to the special purpose entities are used to repay principal and interest and to pay the expenses of the entity. 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 June 30, 2009, OSAFW had notes outstanding of $179,723. The following table summarizes the assets and liabilities of the four special purpose entities formed in connection with our match funded advance facilities:

	June 30, 2009	December 31, 2008

Total assets	$	896,678	$	1,122,404
Match funded advances		888,090		1,100,555
Total liabilities		810,498		994,244
Match funded liabilities		761,882		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 RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an Amendment of ARB No. 51." The FASB issued SFAS No. 160 on December 4, 2007. The statement establishes new accounting and reporting standards for a non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest (minority interest)

as equity in the consolidated financial statements separate from the parent's equity. The amount of net income attributable to the non-controlling interest is included in consolidated net income on the face of the income statement. The statement clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, when a subsidiary is deconsolidated, this statement requires that a parent recognize a gain or loss in net income based on the fair value of the entire entity, irrespective of any retained ownership, on the deconsolidation date. Such a gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. We adopted SFAS No. 160 on January 1, 2009 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 SFAS No. 160 did not have a material effect on our consolidated balance sheets or statements of operations.

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

FSP No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." This FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, "*Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*." Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon adoption of this FSP on January 1, 2009, we recognized a discount to reduce the carrying value of the 3.25% Convertible Notes and an offsetting increase to stockholders' equity. The cumulative effect of adoption resulted in: (1) a reduction of retained earnings of $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 six months ended June 30, 2008 has been adjusted to include amortization of debt discount of $899 and $1,970, respectively, and a reduction in the amortization of debt issue costs of $32 and $71, respectively. Prospectively, the consolidated statement of operations will recognize non-cash interest expense over the remaining estimated life of the notes. 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.

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

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

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

FSP FAS No. 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP extends the annual disclosure requirements of SFAS No. 107, "*Disclosure about Fair Value of Financial Instruments."* to interim periods for all publicly traded companies. Interim disclosures are required to include the estimated fair value and carrying value of financial instruments, a description of the methods and inputs to estimate fair value as well as any changes in the methods and significant assumptions, if any, during the period. The additional disclosures required by this FSP are included in Note 3.

SFAS No. 165, "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 August 4, 2009 as disclosed in Note 22.

SFAS No. 166, "Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140." This statement removes the concept of a qualifying special-purpose entity from SFAS No. 140 and removes the exception from applying FASB Interpretation No. ("FIN") FIN 46 (revised December 2003), "*Consolidation of Variable Interest Entities."* (FIN 46(R)) to QSPEs.

This statement clarifies that the objective of paragraph 9 of SFAS No. 140 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 used in SFAS No. 140 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 SFAS No. 140 and SFAS No. 65, "*Accounting for Certain Mortgage Banking Activities,*" 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 SFAS No. 140, as amended by this statement. 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 Statement. We are evaluating the potential impact of this statement.

SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)." This Statement amends FASB Interpretation (FIN) No. 46(R) to 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 FIN 46(R) to primarily reflect the elimination of the concept of a QSPE. This statement also amends FIN 46(R) 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 statement 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 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 to determine if we should include them in our consolidated financial statements. We are evaluating the potential impact of this statement.

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NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	June 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Trading securities:				
Auction rate	$ 243,285	$ 243,285	$ 239,301	$ 239,301
Subordinates and residuals	3,440	3,440	4,369	4,369
Loans held for resale	39,726	39,726	49,918	49,918
Advances	1,036,941	1,036,941	1,202,640	1,202,640
Receivables	47,923	47,923	42,798	42,798
Financial liabilities:				
Match funded liabilities	$ 765,023	$ 767,567	$ 961,939	$ 965,233
Lines of credit and other secured borrowings	121,810	121,810	116,870	116,870
Investment Line	176,668	176,668	200,719	200,719
Servicer liabilities	77,774	77,774	135,751	135,751
Debt securities	109,534	104,171	133,367	112,764
Derivative financial instruments, net	$ 891	$ 891	$ (533)	$ (533)

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

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

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

Level 3: Unobservable inputs for the asset or liability.

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

	Carrying value	Level 1	Level 2	Level 3
At June 30, 2009:				
Measured at fair value on a recurring basis:				
Trading securities (1):				
Auction rate	$ 243,285	$ —	$ —	$ 243,285
Subordinates and residuals	3,440	—	—	3,440
Derivative financial instruments, net (2)	891	(66)	—	957
Measured at fair value on a non-recurring basis:				
Loans held for resale (3)	39,726	—	—	39,726

Mortgage servicing rights (4)	—	—	—	—
Lines of credit and other secured borrowings (5)	46,519	—	—	46,519
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 19 for additional information on our derivative financial instruments.
(3) Loans held for resale are measured at fair value on a non-recurring basis. At June 30, 2009 and December 31, 2008, the carrying value of loans held for resale is net of a valuation allowance of $17,570 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 June 30, 2009 and December 31, 2008 is net of a valuation allowance for impairment of $3,624 established during the third and fourth quarters of 2008. The valuation allowance, which relates exclusively to the high-loan-to-value stratum of our residential MSRs, reduced the carrying value of the stratum to zero. The estimated fair value exceeded amortized cost for all other strata. See Note 8 for additional information on MSRs.
(5) Lines of credit and other secured borrowings measured at fair value on a nonrecurring basis consist of a fixed-rate term note outstanding under the fee reimbursement advance facility. See Note 13 for additional information on this facility.

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

	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 June 30
For the three months ended June 30, 2009:					
Trading securities:					
Auction rate	$ 238,161	$ (900)	$ 6,024	$ —	$ 243,285
Subordinates and residuals	4,028	1	(589)	—	3,440
Derivative financial instruments	355	—	602	—	957
For the three months ended June 30, 2008:					
Trading securities:					
Auction rate	$ 289,044	$ (26,869)	$ (7,430)	$ —	$ 254,745
Subordinates and residuals	6,190	40	(1,370)	—	4,860
Derivative financial instruments	578	113	635	—	1,326
For the six months ended June 30, 2009:					
Trading securities:					
Auction rate	$ 239,301	$ (2,000)	$ 5,984	$ —	$ 243,285
Subordinates and residuals	4,369	—	(929)	—	3,440
Derivative financial instruments	193	—	764	—	957
For the six months ended June 30, 2008:					
Trading securities:					
Auction rate	$ —	$ 271,114	$ (16,369)	$ —	$ 254,745
Subordinates and residuals	7,362	22	(2,524)	—	4,860

Derivative financial instruments	4,867	(7,037)	3,496	—	1,326

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

(2) Total gains (losses) on auction rate securities for the second quarter include unrealized gains (losses) of $6,024 and $(6,768) on auction rate securities held at June 30, 2009 and 2008, respectively. For the year to date periods, unrealized gains (losses) on auction rate securities held at June 30, 2009 and 2008 were $5,984 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 June 30, 2009 and 2008.

The methodologies that we use and key assumptions that we make to estimate the fair value of instruments measured at fair value on a recurring basis 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 actual sales and redemptions of the auction rate securities that we hold and a discounted cash flow analysis. When available, we use observable market inputs provided by actual orderly sales of similar auction rate securities. We also discount 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 June 30, 2009:

• Expected term	30 months
• Illiquidity premium	1.63%
• Discount rate	2.60 - 13.60%

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 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 30% 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 45%, and loss assumptions on current balances range from 18% to 28%. Average prepayment assumptions range from 5% to 9%.

At June 30, 2009, securities amounting to $246,725 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 since the cost of $57,296 exceeded the estimated fair value of $39,726 at June 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 upon 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 to 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 June 30, 2009 valuation include prepayment speeds ranging from 17.6% to 23.9% (depending on loan type) and delinquency rates ranging from 18.3% to 24.1% (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.

Lines of Credit and Other Secured Borrowings

Borrowings not subject to a hedging relationship are carried at amortized cost. The carrying value of obligations outstanding under lines of credit that are either short-term or bear interest at a rate that is adjusted monthly based on a market index approximates fair value. The fair value of fixed-rate notes is determined by discounting the contractual future principal and interest repayments at a market rate commensurate with the risk of the estimated cash flows.

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 4 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, its operations have been reclassified 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 June 30 are as follows:

	Three Months		Six Months	
	2009	2008	2009	2008
Revenue	$ 20	$ 148	$ 39	$ 272
Operating expenses	(832)	5,668	(396)	6,299
Income (loss) from operations	852	(5,520)	435	(6,027)
Other income, net	200	338	429	641
Income (loss) before income taxes	1,052	(5,182)	864	(5,386)
Income tax expense (benefit)	—	—	—	—
Net income (loss)	$ 1,052	$ (5,182)	$ 864	$ (5,386)

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

	June 30, 2009	December 31, 2008
Cash	$ 7,332	$ 4,613
Receivables	8,638	10,250
Other	62	33
Total assets	$ 16,032	$ 14,896
Total liabilities (including customer deposits of $6,086 and $5,820)	$ 6,533	$ 6,280

NOTE 5 TRADING SECURITIES

Trading securities consisted of the following at the dates indicated:

	June 30, 2009	December 31, 2008
Auction rate (Corporate Items and Other)	$ 243,285	$ 239,301
Subordinates and residuals:		
Loans and Residuals	$ 3,341	$ 4,204
Corporate Items and Other	99	165
	$ 3,440	$ 4,369

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

	Three months		Six months	
	2009	2008	2009	2008
Unrealized gains (losses) (1)	$ 5,435	$ (8,140)	$ 5,055	$ (20,049)
Realized losses (2)	—	(1,582)	—	(1,696)
	$ 5,435	$ (9,722)	$ 5,055	$ (21,745)

(1) Unrealized gains (losses) on auction rate securities were $6,024 and $(6,768) for the three months ended June 30, 2009 and 2008, respectively. Year to date, the unrealized gains (losses) on auction rate securities were $5,984 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 14) in AAA-rated auction rate securities backed by student loans originated under the U. S. Department of Education's Federal Family Education Loan Program. 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 June 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 June 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 six months of 2009. During the first six months of 2009, issuers redeemed, at par, auction rate securities we held with a face value of $2,000, including $900 during the second quarter. We recognized a $6,024 unrealized gain in the second quarter of 2009, which was due, in part, to the increased probability of a near term liquidity solution for approximately $70,350 principal amount of the 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 6 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:

	June 30, 2009	December 31, 2008
Servicing:		
Principal and interest	$ 67,140	$ 36,183
Taxes and insurance	46,770	32,812
Foreclosures and bankruptcy costs	28,897	23,122
Real estate servicing costs	244	225
Other	5,814	4,756
	148,865	97,098
Loans and Residuals	4,739	4,867
Corporate Items and Other	128	120
	$ 153,732	$ 102,085

NOTE 7 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:

	June 30, 2009	December 31, 2008
Principal and interest	$ 438,343	$ 615,344
Taxes and insurance	303,872	324,605
Foreclosures and bankruptcy costs	63,153	70,142
Real estate servicing costs	45,692	70,658
Other	32,149	19,806
	$ 883,209	$ 1,100,555

Match funded advances on loans serviced for others result from our transfers of residential loan servicing advances to SPEs in exchange for cash. We made these transfers under the terms of four advance facility agreements. We have either retained control of the advances, or the advances were transferred to trusts that are not QSPEs under SFAS No. 140. As a result, we include the SPEs in our consolidated financial statements. The match funded advances are owned by the SPEs and are not available to satisfy general claims of our creditors. Conversely, the holders of the debt issued by the SPEs can look only to the assets of the issuer for satisfaction of the debt and have no recourse against OCN. However, OLS has guaranteed the payment of the obligations of the issuer under the match funded facility that we executed in April 2008. 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.

NOTE 8 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	(7)	—	(7)
Amortization	(17,005)	—	(17,005)
Balance at June 30, 2009	$ 132,729	$ —	$ 132,729
Estimated fair value of MSRs:			
June 30, 2009	$ 138,427	$ —	$ 138,427
December 31, 2008	$ 148,135	$ —	$ 148,135
Unpaid principal balance of assets serviced:			
June 30, 2009:			
Servicing	$ 28,596,580	$ —	$ 28,596,580
Subservicing (1)	9,809,427	109,747	9,919,174
	$ 38,406,007	$ 109,747	$ 38,515,754
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 under a high risk loan pilot program that it announced on February 3, 2009.

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 $385,100 and $370,200 at June 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 market 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. Net of the valuation allowance, the carrying value of this stratum was zero at June 30, 2009. For all other strata, the external valuation was above the carrying value at June 30, 2009.

As of June 30, 2009, MSRs with a carrying value of $119,015 had been pledged as collateral for borrowings under the senior secured credit agreement that was converted to a term note secured by MSRs in August 2008. See Note 13 for additional information regarding this agreement.

We have recognized a servicing liability for those agreements that are not expected to adequately compensate us for performing the servicing. Servicing liabilities were $4,818 and $3,239 at June 30, 2009 and December 31, 2008, respectively, and are included in other liabilities on the balance sheet. During the six months ended June 30, 2009, the amount of charges we recognized to increase our servicing liability obligations exceeded amortization by $1,579, and we have reported this net expense as amortization of servicing rights in the statement of operations.

NOTE 9 RECEIVABLES

Receivables consisted of the following at the dates indicated:

	June 30, 2009	December 31, 2008
Accounts receivable by segment:		
Servicing, net (1)	$ 5,013	$ 6,495
Loans and Residuals	1,169	1,169
Asset Management Vehicles	563	1,171
Mortgage Services	4,565	2,668
Financial Services	5,405	5,747
Technology Products	1,658	975
Corporate Items and Other, net (2)	11,708	13,593
	30,081	31,818
Other receivables:		
Income taxes	2,962	5,386
Term note (3)	7,000	—
Security deposits	4,830	4,645
Other	3,050	949
	$ 47,923	$ 42,798

(1) The balances at June 30, 2009 and December 31, 2008 primarily include reimbursable expenses due from investors. The total balance of receivables for this segment is net of reserves of $2,909 and $1,604 at June 30, 2009 and December 31, 2008, respectively.

(2) The balances at June 30, 2009 and December 31, 2008 include $6,858 and $8,286, respectively, of mortgage loans originated by BOK. These loans were net of allowances of $189 and $1,392, respectively. The balances at June 30, 2009 and December 31, 2008 also include receivables totaling $3,053 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 $6,466 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 13. We receive 1-Month LIBOR plus 300 bps under the terms of this note receivable. We are obligated to pay 1-Month LIBOR plus 350 bps 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 10 INVESTMENT IN UNCONSOLIDATED ENTITIES

	June 30, 2009	December 31, 2008
Asset Management Vehicles:		
Investment in OSI (1)	$ 12,554	$ 15,410
Investment in ONL and affiliates (2)	8,636	10,174
	21,190	25,584
Corporate Items and Other	79	79

	$ 21,269	$ 25,663

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

	Three months		Six months	
	2009	2008	2009	2008
OSI (1) (3)	$ (163)	$ (1,215)	$ 357	$ (1,547)
ONL and affiliates (2) (3)	(413)	112	(906)	(487)
BMS Holdings (4)	—	(13,552)	—	(5,666)
	$ (576)	$ (14,655)	$ (549)	$ (7,700)

(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 six months of 2009, we received distributions from OSI totaling $2,750. We have no remaining commitment to invest in OSI.

(2) Our investment in ONL and OREO represent equity interests of approximately 25%. ONL resolves non-performing loans purchased at a discount. OREO purchases real estate for sale, including real estate that ONL may obtain through foreclosure. During the first six months of 2009, we received distributions totaling $496 from ONL and OREO. We have a remaining commitment that expires in September 2010, to invest up to an additional $33,902 in ONL and OREO, collectively.

(3) OLS earns 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 six months of 2009 and 2008, OLS earned fees of $2,367 and $3,946, 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%. Since 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 application of the equity method of accounting for our investment in BMS Holdings. We will not resume applying the equity method 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 11 OTHER ASSETS

Other assets consisted of the following at the dates indicated:

	June 30, 2009	December 31, 2008
Debt service accounts (1)	$ 43,090	$ 58,468
Deferred debt related costs, net	14,314	14,758
Real estate	7,360	7,771
Interest earning collateral deposits	7,623	9,684
Prepaid expenses and other	4,332	6,907
	$ 76,719	$ 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 12 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:

			Amortization	Unused Borrowing	Balance Outstanding	
Borrowing Type	Interest Rate (1)	Maturity	Date	Capacity (2)	June 30, 2009	December 31, 2008
Variable Funding Note Series 2007-1	Commercial paper rate + 200 basis points (3)	December 2014	December 2009	$ 185,205	$ 114,795	$ 219,722
Term Note Series 2006 -1	5.335%	November 2015 (4)	December 2009	—	165,000	165,000
Variable Funding Note (5)	Commercial paper rate + 150 basis points (5)	December 2013	December 2010	71,258	178,742	192,520
Advance Receivable Backed Notes	1-Month LIBOR + 400 basis points (6)	January 2019 (6)	January 2010 (6)	76,378	123,622	142,361
Advance Receivable Backed Notes	1-Month LIBOR + 275 basis points (7)	May 2011 (7)	May 2010 (7)	320,277	179,723	237,504

	653,118	761,882	957,107
Basis adjustment (4)	—	3,141	4,832
	$ 653,118	$ 765,023	$ 961,939

(1) 1-Month LIBOR was 0.31% and 0.44% at June 30, 2009 and December 31, 2008, respectively.

(2) Unused borrowing capacity is available for use only to the extent that there are assets that have been pledged as collateral to a facility but against which no funds have been drawn. All eligible advances had been pledged to a facility at June 30, 2009. As a result, none of our available borrowing capacity was readily available because we had no additional assets pledged as collateral but not drawn under our facilities.

(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 approximated 1-Month LIBOR plus 200 basis points over time.

(4) 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.

(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 approximated 1-Month LIBOR plus 150 basis points over time.
(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.

NOTE 13 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 June 30, 2009	Balance Outstanding December 31, 2008
Servicing:						
Fee reimbursement advance	Term note (2)	See (2) below	March 2014	$ —	$ 46,519	$ —
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	—	55,992	97,987
				—	109,511	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	—	12,299	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
				$ —	$ 121,810	$ 116,870

(1) 1-Month LIBOR was 0.31% and 0.44% at June 30, 2009 and December 31, 2008, respectively.
(2) This advance is secured by the pledge to the lender of our interest in a $60,000 term note issued by OSAF on March 31, 2009. The OSAF note, in turn, is secured by advances on loans serviced for others, similar to match funded advances and liabilities. The advance is payable annually in five installments of $12,000. The advance does not carry a stated rate of interest. However, we are compensating the lender for the advance of funds by forgoing the receipt of fees due from the lender over the five-year term of the advance. Accordingly, we recorded the advance as a zero-coupon bond issued at an initial implied discount of $14,627. We used an implicit market rate to compute the discount that we are amortizing to interest expense over the five-year term of the advance.
(3) This note was issued by OSAF and is secured by advances on loans serviced for others, similar to match funded advances and liabilities. The lender has pledged its interest in this note to us as collateral against the $7,000 term note receivable due on April 1, 2014.
(4) The interest incurred on this facility is based on 1-Month LIBOR plus 187.5 basis points but could be reduced to as low as 0.10% to the extent that we have available balances on deposit with the lender.

(5) In 2007, we issued A-rated securities in connection with the transfer of loan and real estate collateral to OREALT, a bankruptcy remote VIE that we consolidate. In August 2008, we sold a portion of these A-rated securities with a face value of $23,200 to a third party. The notes were sold net of an original discount of $928 that is being amortized to interest expense over the estimated remaining life of the notes.

(6) We terminated this agreement in June 2009. There were no borrowings outstanding at the time that we terminated the agreement.

NOTE 14 INVESTMENT LINE

Under this agreement, we borrowed funds each month under a revolving demand note equal to the projected average float balance and invested those funds in certain permitted investments, including auction rate securities. The custodial funds comprising most of the float balance remained on deposit in bank accounts that meet the requirements of each trust. The terms of the Investment Line required that we sell the investments and repay the associated borrowings prior to the end of each quarter.

As a result of failed auctions in the first quarter of 2008, we were unable to liquidate our investment in auction rate securities. On March 28, 2008, we executed an amendment to the Investment Line that eliminated the requirement that borrowings be repaid at quarter end, increased the annual interest rate from 0.1% to 0.35% and limited borrowings to $350,000. We recognized these securities and a corresponding liability on our balance sheet in the first quarter of 2008. On June 30, 2008, we executed an extension of this agreement through July 13, 2008.

On July 10, 2008, in addition to further reducing the borrowing limit under the revolving demand note to $120,000, we executed another amendment to the Investment Line that created a new term note maturing on June 30, 2009 that is secured by our investment in the auction rate securities. Interest on the term note is 0.35% to the extent that we have available balances on deposit with the lender. For any portion of the outstanding balance of the term note that is in excess of the available balances, the interest rate is 1-month LIBOR plus 35 basis points. In the event that the 0.35% rate does not fairly reflect the cost to the lender in providing the funds, the lender may, with notice, adjust the rate upward to a rate not exceeding 3.35%.

The revolving demand note expired on September 30, 2008. At that time, we repaid the borrowings in full using proceeds received from the liquidation of the investments.

Under the term note, we receive the interest on the auction rate securities while the proceeds from the redemption or sale of auction rate securities are applied to the outstanding balance. If the proceeds are below the then-effective maximum borrowing percentage, we are required to make up the shortfall. If the application of proceeds to the outstanding balance results in the total outstanding balance of this note falling below 70% of the face value of the auction rate securities held, we receive one-half of sales or redemptions, and the remainder is used to pay down the Investment Line.

The maximum borrowing under the term note was reduced from approximately 85% of the face value of the auction rate securities at the time that the note was executed to 75% on December 31, 2008. On April 30, 2009, we negotiated a one-year extension of the term note maturity to June 30, 2010. This agreement was renewed under terms substantially similar to the previous agreement. However, in lieu of quarterly advance rate reductions, we now make monthly amortization payments of $3,000 per month. During the first six months of 2009, we made payments totaling $24,051 that reduced the Investment Line obligation to $176,668.

NOTE 15 SERVICER LIABILITIES

Servicer liabilities represent amounts we have collected, primarily from residential borrowers, whose loans we service, that will be deposited in custodial accounts and paid directly to an investment trust or refunded to borrowers. The following table sets forth the components of servicer liabilities at the dates indicated:

	June 30, 2009	December 31, 2008
Borrower payments due to custodial accounts	$ 32,934	$ 67,227
Escrow payments due to custodial accounts	3,920	5,488
Partial payments and other unapplied balances	40,920	63,036
	$ 77,774	$ 135,751

NOTE 16 DEBT SECURITIES

Our debt securities consisted of the following at the dates indicated:

	June 30, 2009	December 31, 2008
3.25% Contingent Convertible Unsecured Senior Notes due August 1, 2024	$ 56,155	$ 79,988
10.875% Capital Trust Securities due August 1, 2027	53,379	53,379
	$ 109,534	$ 133,367

Each of our debt securities contain qualitative and quantitative covenants that establish, among other things, the maintenance of specified net worth and restrictions on future indebtedness as well as the monitoring and reporting of various specified transactions or events. We are currently in compliance with these covenants.

Convertible Notes. In July 2004, OCN issued $175,000 aggregate principal amount of 3.25% Contingent Convertible Unsecured Senior Notes due 2024 (the Convertible Notes). The Convertible Notes are senior general unsecured obligations not guaranteed by any of our

subsidiaries and bear interest at the rate of 3.25% per year. Interest is payable on February 1 and August 1 of each year. The Convertible Notes mature on August 1, 2024. As a result of our adoption of FSP No. APB 14-1, we recognized a discount on the Convertible Notes. We are amortizing the debt discount over the period from the date of issuance to August 1, 2009, the first date at which holders may require us to repurchase their notes.

The principal outstanding on June 30, 2009 and December 31, 2008 of $56,445 and $82,355 is reported net of the unamortized debt discount of $290 and $2,367 respectively. Interest expense on the Convertible Notes for the first six months of 2009 and 2008, respectively, includes amortization of debt discount of $1,471 and $1,970 and cash interest expense at the contractual rate of $987 and $1,486. We are recognizing interest on the debt at an effective annual rate of 8.25%.

In February 2009, we repurchased $25,910 of our 3.25% Convertible Notes in the open market at a price equal to 95% of the principal amount. We recognized a gain of $534 on these repurchases, net of the write-off of unamortized issuance costs and debt discount.

Holders may convert all or a portion of their notes into shares of our common stock under the following circumstances: (1) at any time during any calendar quarter (and only during such calendar quarter) commencing after December 31, 2004, if the closing sale price of our common stock for at least 20 consecutive trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than 125% of the conversion price per share of common stock on such last day; (2) subject to certain exceptions, during the five business day period after any five-consecutive-trading-day period in which the trading price per $1,000 (actual dollars) principal amount of the notes for each day of the five-consecutive-trading-day period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of $1,000 (actual dollars) principal amount of the notes; (3) if the notes have been called for redemption; or (4) upon the occurrence of specified corporate transactions.

The conversion rate is 82.1693 shares of our common stock per $1,000 (actual dollars) principal amount of the notes, subject to adjustment. Events that may cause the conversion rate to be adjusted primarily relate to cash dividends or other distributions to holders of our common stock. Upon conversion, we may at our option choose to deliver, in lieu of our common stock, cash or a combination of cash and common stock. At June 30, 2009 and December 31, 2008, the if-converted value of the Convertible Notes was $60,155 and $62,106 respectively.

On June 26, 2009, we provided notice to holders of the Convertible Notes of their right to request that we repurchase all or a portion of their notes for cash on August 3, 2009 at a redemption price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest, if any. Holders that do not choose to exercise their repurchase right on August 3, 2009 will receive the same right to request that we repurchase all or a portion of their notes for cash on August 1, 2014 and August 1, 2019. A similar right is also available to holders of the Convertible Notes in the event of a “fundamental change.” A “fundamental change” is a change of control or a termination of trading in our common stock.

Beginning August 1, 2009, we may redeem all or a portion of the notes for cash for a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest, if any.

See Note 22 for information regarding the subsequent notice provided to holders of our Convertible Notes of their right to participate in the Altisource Separation and for the impact of the holders’ repurchase right described above.

Capital Trust Securities. In August 1997, Ocwen Capital Trust (OCT) issued $125,000 of 10.875% Capital Securities (the Capital Trust Securities). OCT invested the proceeds from issuance of the Capital Trust Securities in 10.875% Junior Subordinated Debentures issued by OCN. The Junior Subordinated Debentures, which represent the sole assets of OCT, will mature on August 1, 2027. For financial reporting purposes, we treat OCT as a subsidiary and, accordingly, the accounts of OCT are included in our consolidated financial statements.

Holders of the Capital Trust Securities are entitled to receive cumulative cash distributions accruing from the date of original issuance and payable semiannually in arrears on February 1 and August 1 of each year at an annual rate of 10.875% of the liquidation amount of $1,000 (actual dollars) per Capital Security. OCN guarantees payment of distributions out of moneys held by OCT, and payments on liquidation of OCT or the redemption of Capital Trust Securities to the extent OCT has funds available. If OCN does not make principal or interest payments on the Junior Subordinated Debentures, OCT will not have sufficient funds to make distributions on the Capital Trust Securities in which event the guarantee shall not apply to such distributions until OCT has sufficient funds available therefore.

We have the right to defer payment of interest on the Junior Subordinated Debentures at any time or from time to time for a period not exceeding 10 consecutive semiannual periods with respect to each deferral period provided that no extension period may extend beyond the stated maturity of the Junior Subordinated Debentures. Upon the termination of any such extension period and the payment of all amounts then due on any interest payment date, we may elect to begin a new extension period. Accordingly, there could be multiple extension periods of varying lengths throughout the term of the Junior Subordinated Debentures. If we defer interest payments on the Junior Subordinated Debentures, distributions on the Capital Trust Securities will also be deferred, and we may not, nor may any of our subsidiaries, (i) declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, their capital stock or (ii) make any payment of principal, interest or premium, if any, on or repay, repurchase or redeem any debt securities that rank pari passu with or junior to the Junior Subordinated Debentures. During an extension period, interest on the Junior Subordinated Debentures will continue to accrue at the rate of 10.875% per annum, compounded semiannually.

We may redeem the Junior Subordinated Debentures before maturity at our option subject to the receipt of any necessary prior regulatory approval, in whole or in part at the redemption prices (expressed as a percentage of the principal amount) set forth below, plus accrued interest thereon, if redeemed during the twelve-month period beginning on August 1 of the years indicated below:

	Percentages
2008	104.894%
2009	104.350
2010	103.806
2011	103.263
2012	102.719
2013	102.175
2014	101.631
2015	101.088
2016	100.544

On or after August 1, 2017, the redemption price will be 100%, plus accrued interest to the redemption date.

We may also redeem the Junior Subordinated Debentures at any time upon the occurrence and continuation of a special event (defined as a tax event, regulatory capital event or an investment company event) at 100%. The Capital Trust Securities are subject to mandatory redemption upon repayment of the Junior Subordinated Debentures, in an amount equal to the amount of the related Junior Subordinated Debentures maturing or being redeemed and at a redemption price equal to the redemption price of the Junior Subordinated Debentures, plus accumulated and unpaid distributions thereon to the date of redemption.

NOTE 17 BASIC AND DILUTED EARNINGS PER SHARE

Basic EPS excludes common stock equivalents and is calculated by dividing net income by the weighted average number of common shares outstanding during the period. We calculate diluted EPS by dividing net income, as adjusted to add back interest expense net of tax on the Convertible Notes, by the weighted average number of common shares outstanding including the potential dilutive common shares related to outstanding stock options, restricted stock awards and the Convertible Notes. The following is a reconciliation of the calculation of basic EPS to diluted EPS for the three and six months ended June 30:

	Three months		Six months	
	2009	2008	2009	2008
Basic EPS:				
Net income (loss) attributable to OCN	$ 17,830	$ (2,717)	$ 32,939	$ 2,555
Weighted average shares of common stock	67,316,446	62,682,783	65,045,842	62,625,378
Basic EPS	$ 0.26	$ (0.04)	$ 0.51	$ 0.04
Diluted EPS:				
Net income (loss) attributable to OCN	$ 17,830	$ (2,717)	$ 32,939	$ 2,555
Interest expense on Convertible Notes, net of income tax (1)	773	—	1,664	—
Adjusted net income (loss) attributable to OCN	$ 18,603	$ (2,717)	$ 34,603	$ 2,555

Weighted average shares of common stock	67,316,446	62,682,783	65,045,842	62,625,378
Effect of dilutive elements (2):				
Convertible Notes (1)	4,638,046	—	4,638,046	—
Stock options (3)	887,720	199,972	680,292	202,695
Common stock awards	12,203	10,113	11,375	25,586
Dilutive weighted average shares of common stock	72,854,415	62,892,868	70,375,555	62,853,659
Diluted EPS	$ 0.26	$ (0.04)	$ 0.49	$ 0.04

(1) The effect of our Convertible Notes on diluted EPS is computed using the if-converted method. Interest expense and related amortization costs applicable to the Convertible Notes, net of income tax, are added back to net income. Conversion of the Convertible Notes into shares of common stock has not been assumed for purposes of computing diluted EPS for the three and six months ended June 30, 2008 because the effect would be anti-dilutive. The effect is anti-dilutive whenever interest expense on the Convertible Notes, net of income tax, per common share obtainable on conversion exceeds basic EPS.

(2) Because we have reported discontinued operations, we use income from continuing operations as the “control number” in determining whether potential common shares are dilutive or anti-dilutive. That is, the same number of potential common shares used in computing the diluted per-share amount for income from continuing operations is used in computing all other diluted per-share amounts even though those amounts are anti-dilutive to their respective basic per-share amounts.

(3) An average of 749,810 and 2,353,081 options that were anti-dilutive have been excluded from the computation of diluted EPS for the second quarter of 2009 and 2008, respectively. These options were anti-dilutive because their exercise price was greater than the average market price of our stock. Also excluded from the computation of diluted EPS are 5,130,000 options granted on July 14, 2008, for shares that are issuable upon on the achievement of certain performance criteria related to OCN’s stock price and an annualized rate of return to investors. Year to date, an average of 1,106,029 and 2,353,081 options were anti-dilutive for 2009 and 2008, respectively.

NOTE 18 EQUITY

In a private placement transaction that closed on April 3, 2009, OCN sold 5,471,500 shares of its common stock for a price of $11.00 per share. We realized $60,187 in proceeds from this issuance. The purchasers, most of whom are existing OCN shareholders, purchased approximately 8% of OCN’s total outstanding shares pursuant to this new issuance. Accordingly, the purchasers own approximately 9.6% of OCN’s total outstanding shares, after giving effect to the share repurchase below, as of the closing of the transaction. In addition to making customary representations, warranties and covenants, the purchasers have agreed to certain restrictions on the sale of the shares for a one-year period following the closing date. OCN is obligated to register the newly-issued shares and will apply to list such shares on the New York Stock Exchange within 270 days of the closing.

On April 3, 2009, OCN repurchased from William C. Erbey, its Chairman of the Board and Chief Executive Officer, one million shares of its common stock at a per-share price of $11.00. We used a portion of the proceeds received from the above-described private placement transaction to acquire the shares from Mr. Erbey. In addition to making customary representations and warranties, Mr. Erbey agreed to certain restrictions on the sale or transfer of the remainder of his shares for a one-year period following the closing date.

NOTE 19 DERIVATIVE FINANCIAL INSTRUMENTS

The following table summarizes our use of derivative financial instruments during the six months ended June 30, 2009:

	Interest Rate Cap	Euro Currency Futures
Notional balance at December 31, 2008	$ 450,000	$ 10,125
Additions	—	19,777
Maturities	(41,667)	(19,730)
Notional balance at June 30, 2009	$ 408,333	$ 10,172
Fair value (1):		
June 30, 2009	$ 957	$ (66)
December 31, 2008	$ 193	$ (726)
Maturity	January 2011 and December 2013	September 2009

(1) We report the fair value of our derivative financial instruments as a component of receivables in the consolidated balance sheets.

In our Servicing segment, we have entered into interest rate swaps, under which we pay a floating rate and receive a fixed rate, and interest rate caps. In connection with our issuance of a match funded variable funding note in December 2007 with a variable rate of interest and a $250,000 maximum borrowing capacity, we entered into interest rate caps with a notional amount of $250,000 to hedge our exposure to rising interest rates. We designated this cap as a cash flow hedge but de-designated it as of March 31, 2008 because of ineffectiveness. As a result, we reclassified to earnings the unrealized loss of $239 included in other comprehensive income at December 31, 2007. In connection with our

renewal and upsizing of a match funded variable funding note in February 2008 that carried a variable interest rate and a maximum borrowing capacity of $200,000, we entered into an interest rate cap with a notional amount of $200,000 to hedge our exposure to rising interest rates. This cap began amortizing at the rate of $8,333 per month in February 2009. We did not designate this cap as a hedge.

In June 2008, we entered into foreign currency futures contracts to hedge our net investment in BOK against adverse changes in the value of the Euro versus the U.S. Dollar. We designated these derivatives as a foreign-currency net investment hedge. Net losses on these foreign currency futures were $558 and $95 for the three and six months ended June 30, 2009, respectively and $169 for the three and six months ended June 30, 2008. These losses were included in the net change in unrealized foreign currency translation adjustment in accumulated other comprehensive income.

Our operations in India and Canada also expose us to foreign currency exchange rate risk, but we consider this risk to be insignificant.

Net realized and unrealized gains included in other income (expense), net related to derivative financial instruments were $603 and $636 for the second quarter of 2009 and 2008, respectively. Year to date, the net realized and unrealized gains were $764 and $3,258 for 2009 and 2008, respectively, including in 2008 the $239 loss related to the interest rate cap that we de-designated as a cash flow hedge. In addition, we recorded unrealized losses of $3,149 in the first quarter of 2008 that represented fair value basis adjustments on the $165,000 fixed-rate match funded term note that we had designated as part of a fair value hedging relationship that was established using an interest rate swap that we subsequently terminated in the first quarter of 2008.

NOTE 20 BUSINESS SEGMENT REPORTING

We manage our business through two distinct lines of business, Ocwen Asset Management and Ocwen Solutions. Ocwen Asset Management includes our core residential servicing business, equity investments in asset management vehicles and our remaining investments in subprime loans and residual securities. Ocwen Solutions, our knowledge-based business process outsourcing (BPO) operation, includes our residential fee-based loan processing businesses, all of our technology platforms, our unsecured collections business and our equity interest in BMS Holdings. We have aligned our internal planning and operating structure to give support and focus to these operations. Our business segments reflect the internal reporting that we have used to evaluate operating performance and to assess the allocation of our resources. Our segments are based upon our organizational structure that focuses primarily on the products and services offered.

A brief description of our current business segments aligned within our two lines of business follows:

Ocwen Asset Management

- *Servicing*. This segment provides loan servicing for a fee, including asset management and resolution services, primarily to owners of subprime residential mortgages. Subprime loans represent residential loans we service that were made to borrowers who generally did not qualify under guidelines of Fannie Mae and Freddie Mac (nonconforming loans). This segment is primarily comprised of our core residential servicing business.
- *Loans and Residuals*. This segment includes our trading and investing activities and our former subprime loan origination operation. Our trading and investing activities include our investments in subprime residual mortgage backed trading securities as well as the results of our whole loan purchase and securitization activities.
- *Asset Management Vehicles*. This segment is comprised of our 25% equity investment in OSI and approximately a 25% equity investment in ONL and OREO, unconsolidated entities engaged in the management of residential assets.

Ocwen Solutions

- *Mortgage Services.* This segment provides due diligence, valuation, real estate sales, default processing services, property inspection and preservation services, homeowner outreach, closing and title services and knowledge process outsourcing services. Services provided span the lifecycle of a mortgage loan from origination through the disposition of real estate owned properties (“REO”). This segment also includes international servicing for commercial loans which we conduct through GSS.
- *Financial Services*. This segment comprises our asset recovery management and customer relationship management offerings to the financial services, consumer products, telecommunications and utilities industries. The primary source of revenues for this segment is, contingency collections and customer relationship management for credit card issuers and other consumer credit providers. This segment includes the operations of NCI.
- *Technology Products.* This segment includes revenues from our REAL suite of applications that support our servicing business as well as the servicing and origination businesses of external customers. These products include REALServicing™, REALResolution™, REALTrans℠, REALSynergy™ and REALRemit™. REALServicing is the core residential loan servicing application used by OCN. This segment also earns fees from providing technology support services to OCN that cover IT enablement, call center services and third-party applications. The results of our 45% equity investment in BMS Holdings, which provides technology-based case management solutions to trustees, law firms and debtor companies that administer cases in the federal bankruptcy system, is also included in this segment.

Corporate Items and Other. We report items of revenue and expense that are not directly related to a business, business activities that are individually insignificant, interest income on short-term investments of cash and the related costs of financing these investments and certain other corporate expenses in Corporate Items and Other. Our Convertible Notes and Capital Securities are also included in Corporate Items and Other.

We allocate interest income and expense to each business segment for funds raised or funding of investments made. We also allocate expenses generated by corporate support services to each business segment.

Financial information for our segments is as follows:

	Ocwen Asset Management			Ocwen Solutions					
	Servicing	Loans and Residuals	Asset Management Vehicles	Mortgage Services	Financial Services	Technology Products	Corporate Items and Other	Corporate Eliminations	Business Segments Consolidated
Results of Operations									
For the three months ended June 30, 2009:									
Revenue (1) (2)	$ 62,726	$ —	$ 460	$ 24,165	$ 16,471	$ 12,108	$ 112	$ (6,863)	$ 109,179
Operating expenses (1) (3)	32,955	747	1,016	16,017	17,557	7,121	3,830	(6,593)	72,650
Income (loss) from operations	29,771	(747)	(556)	8,148	(1,086)	4,987	(3,718)	(270)	36,529
Other income (expense), net:									
Interest income	19	1,991	—	1	—	—	243	—	2,254
Interest expense	(15,982)	(519)	—	(11)	(667)	(118)	(3)	—	(17,300)
Other (1) (2)	1,695	(3,568)	(846)	710	20	66	6,515	270	4,862
Other income (expense), net	(14,268)	(2,096)	(846)	700	(647)	(52)	6,755	270	(10,184)
Income (loss) from continuing operations before income taxes	$ 15,503	$ (2,843)	$ (1,402)	$ 8,848	$ (1,733)	$ 4,935	$ 3,037	$ —	$ 26,345
For the three months ended June 30, 2008:									
Revenue (1) (2)	$ 92,414	$ —	$ 1,127	$ 14,495	$ 19,030	$ 12,410	$ 134	$ (8,385)	$ 131,225
Operating expenses (1) (3)	42,723	551	926	10,945	21,128	9,799	3,344	(8,150)	81,266
Income (loss) from operations	49,691	(551)	201	3,550	(2,098)	2,611	(3,210)	(235)	49,959
Other income (expense), net:									
Interest income	260	2,731	—	42	1	—	197	—	3,231
Interest expense	(18,834)	(423)	—	(57)	(491)	(154)	(1,150)	—	(21,109)
Other (1) (2)	745	(7,198)	(1,479)	693	(4)	(13,489)	(8,472)	235	(28,969)
Other income (expense), net	(17,829)	(4,890)	(1,479)	678	(494)	(13,643)	(9,425)	235	(46,847)
Income (loss) from continuing operations before income taxes	$ 31,862	$ (5,441)	$ (1,278)	$ 4,228	$ (2,592)	$ (11,032)	$ (12,635)	$ —	$ 3,112
For the six months ended June 30, 2009									
Revenue (1) (2)	$ 137,421	$ —	$ 997	$ 42,182	$ 33,787	$ 22,682	$ 365	$ (13,665)	$ 223,769

Operating expenses (1) (3)	67,173	1,309	1,778	28,909	35,706	15,294	7,813	(13,066)	144,916
Income (loss) from operations	70,248	(1,309)	(781)	13,273	(1,919)	7,388	(7,448)	(599)	78,853
Other income (expense), net									
Interest income	78	3,875	—	2	—	—	464	—	4,419
Interest expense	(31,484)	(1,149)	—	(22)	(1,138)	(250)	80	—	(33,963)
Other (1) (2)	1,858	(8,398)	(1,148)	742	23	121	6,503	599	300
Other income (expense), net	(29,548)	(5,672)	(1,148)	722	(1,115)	(129)	7,047	599	(29,244)
Income (loss) from continuing operations before income taxes	$ 40,700	$ (6,981)	$ (1,929)	$ 13,995	$ (3,034)	$ 7,259	$ (401)	$ —	$ 49,609
<u>For the six months ended June 30, 2008</u>									
Revenue (1) (2)	$ 178,926	$ —	$ 2,178	$ 31,249	$ 38,529	$ 22,895	$ 142	$ (14,443)	$ 259,476
Operating expenses (1) (3) (4)	84,674	1,469	1,616	24,463	40,139	18,681	11,979	(13,680)	169,341
Income (loss) from operations	94,252	(1,469)	562	6,786	(1,610)	4,214	(11,837)	(763)	90,135
Other income (expense), net									
Interest income	659	6,386	—	82	14	—	903	—	8,044
Interest expense	(41,839)	(1,279)	—	(179)	(983)	(318)	(2,581)	—	(47,179)
Other (1) (2)	219	(12,738)	(3,286)	693	7	(5,316)	(19,813)	763	(39,471)
Other income (expense), net	(40,961)	(7,631)	(3,286)	596	(962)	(5,634)	(21,491)	763	(78,606)
Income (loss) from continuing operations before income taxes	$ 53,291	$ (9,100)	$ (2,724)	$ 7,382	$ (2,572)	$ (1,420)	$ (33,328)	$ —	$ 11,529
Total Assets									
June 30, 2009	$ 1,233,929	$ 54,138	$ 21,653	$ 4,958	$ 61,773	$ 8,660	$ 649,420	$ (246)	$ 2,034,285
December 31, 2008	$ 1,416,615	$ 67,317	$ 26,755	$ 3,558	$ 58,707	$ 8,906	$ 655,471	$ (229)	$ 2,237,100
June 30, 2008	$ 1,602,703	$ 82,389	$ 60,967	$ 5,127	$ 65,842	$ 8,978	$ 658,791	$ (236)	$ 2,484,561

(1) Intersegment billings for services rendered to other segments are recorded as revenues, as contra-expense or as other income depending on the type of service that is rendered. Intersegment billings are as follows:

	Servicing	Asset Management Vehicles	Mortgage Services	Technology Products	Business Segments Consolidated
For the three months ended June 30, 2009	$ 1,982	$ 115	$ —	$ 8,160	$ 10,257
For the three months ended June 30, 2008	2,044	174	6	9,802	12,026
For the six months ended June 30, 2009	4,365	256	—	16,553	21,174
For the six months ended June 30, 2008	3,375	545	27	15,915	19,862

(2) Servicing has a contractual right to receive interest income on float balances. However, Corporate controls investment decisions associated with the float balances. Accordingly, Servicing receives revenues generated by those investments that are associated with float balances but are reported in Corporate Items and Other. Gains and losses associated with corporate investment decisions are recognized in Corporate Items and Other.

(3) Depreciation and amortization expense are as follows:

	Servicing	Loans and Residuals	Mortgage Services	Financial Services	Technology Products	Corporate Items and Other	Business Segments Consolidated
For the three months ended June 30, 2009:							
Depreciation expense	$ 14	$ —	$ 7	$ 117	$ 1,245	$ 336	$ 1,719
Amortization of MSRs	8,543	—	—	—	—	—	8,543
Amortization of intangibles	—	—	—	669	—	—	669
For the three months ended June 30, 2008:							
Depreciation expense	$ 13	$ —	$ 14	$ (32)	$ 2,048	$ 369	$ 2,412
Amortization of MSRs	14,529	—	63	—	—	—	14,592
Amortization of intangibles	—	—	—	629	—	—	629
For the six months ended June 30, 2009:							
Depreciation expense	$ 29	$ —	$ 15	$ 234	$ 2,576	$ 672	$ 3,526
Amortization of MSRs	18,584	—	—	—	—	—	18,584
Amortization of intangibles	—	—	—	1,336	—	—	1,336
For the six months ended June 30, 2008:							
Depreciation expense							