OCWEN FINANCIAL CORP
Form 10-Q
November 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

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 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 October 31, 2008: 62,716,530 shares.

OCWEN FINANCIAL CORPORATION
FORM 10-Q

INDEX

PART I – FINANCIAL INFORMATION		**Page**
Item 1.	Interim Consolidated Financial Statements (Unaudited)	2
	Consolidated Balance Sheets at September 30, 2008 and December 31, 2007	2
	Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2008 and 2007	3
	Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2008 and 2007	4
	Consolidated Statement of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2008	5
	Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2008 and 2007	6
	Notes to Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	57
Item 4.	Controls and Procedures	58
PART II – OTHER INFORMATION		
Item 1.	Legal Proceedings	59
Item 1A.	Risk Factors	59
Item 6.	Exhibits	59
Signatures		60

PART I – FINANCIAL INFORMATION
ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	September 30, 2008	December 31, 2007
Assets		
Cash	$ 162,306	$ 114,243
Trading securities, at fair value		
Investment grade auction rate	253,944	—
Other investment grade	—	34,876
Subordinates and residuals	4,239	7,362
Loans held for resale, at lower of cost or fair value	55,642	75,240
Advances	140,079	292,887
Match funded advances	1,070,899	1,126,097
Mortgage servicing rights	150,234	197,295
Receivables	69,307	79,394
Deferred tax assets, net	171,004	178,178
Intangibles, including goodwill of $15,255 and $17,615	52,276	58,301
Premises and equipment, net	32,495	35,572
Investments in unconsolidated entities	32,485	76,465
Other assets	107,505	118,786
Total assets	$ 2,302,415	$ 2,394,696
Liabilities and Stockholders' Equity		
Liabilities		
Match funded liabilities	$ 985,316	$ 1,001,403
Lines of credit and other secured borrowings	144,259	339,976
Investment line	215,220	—
Servicer liabilities	110,297	204,484
Debt securities	135,734	150,279
Other liabilities	98,789	110,429
Total liabilities	1,689,615	1,806,571
Minority interest in subsidiaries	2,124	1,979
Commitments and Contingencies (Note 18)		
Stockholders' Equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 62,716,530 and 62,527,360 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	627	625
Additional paid-in capital	179,726	177,407
Retained earnings	428,424	406,822

Accumulated other comprehensive income, net of income taxes		1,899		1,292
Total stockholders' equity		610,676		586,146
Total liabilities and stockholders' equity	$	2,302,415	$	2,394,696

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

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

	Three months		Nine months	
For the periods ended September 30,	**2008**	**2007**	**2008**	**2007**
Revenue				
Servicing and subservicing fees	$ 91,298	$ 99,077	$ 290,200	$ 283,714
Process management fees	27,453	23,158	81,794	63,708
Other revenues	2,510	3,115	8,743	9,837
Total revenue	121,261	125,350	380,737	357,259
Operating expenses				
Compensation and benefits	33,726	30,515	96,567	75,821
Amortization of servicing rights	12,106	22,022	40,712	81,810
Servicing and origination	11,540	16,738	37,589	45,666
Technology and communications	6,022	6,165	17,713	16,158
Professional services	5,973	5,756	27,058	18,718
Occupancy and equipment	5,131	7,121	17,471	18,009
Other operating expenses	2,960	3,327	9,689	6,918
Total operating expenses	77,458	91,644	246,799	263,100
Income from operations	43,803	33,706	133,938	94,159
Other income (expense)				
Interest income	3,448	5,091	11,492	24,292
Interest expense	(18,418)	(17,494)	(63,698)	(47,744)
Gain (loss) on trading securities	(621)	(1,408)	(22,366)	17,672
Gain (loss) on debt repurchases	—	(3)	3,595	(3)
Loss on loans held for resale, net	(674)	(4,359)	(11,112)	(11,376)
Equity in earnings (losses) of unconsolidated entities	(2,928)	3,537	(10,628)	3,359
Other, net	(201)	(8,928)	72	(8,879)
Other expense, net	(19,394)	(23,564)	(92,645)	(22,679)
Income from continuing operations before income taxes	24,409	10,142	41,293	71,480
Income tax expense	8,662	3,882	14,119	25,015
Income from continuing operations	15,747	6,260	27,174	46,465
Loss from discontinued operations, net of income taxes	(186)	(309)	(5,572)	(943)
Net income	$ 15,561	$ 5,951	$ 21,602	$ 45,522

Basic earnings per share								
Income from continuing operations	$	0.25	$	0.10	$	0.43	$	0.74
Loss from discontinued operations		—		—		(0.09)		(0.01)
Net income	$	0.25	$	0.10	$	0.34	$	0.73
Diluted earnings per share								
Income from continuing operations	$	0.23	$	0.10	$	0.42	$	0.67
Loss from discontinued operations		—		(0.01)		(0.08)		(0.01)
Net income	$	0.23	$	0.09	$	0.34	$	0.66
Weighted average common shares outstanding								
Basic		62,715,551		62,505,269		62,655,655		62,774,324
Diluted		69,750,889		71,130,040		69,664,324		71,638,649

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)

	Three months		Nine months	
For the periods ended September 30,	**2008**	**2007**	**2008**	**2007**
Net income	$ 15,561	$ 5,951	$ 21,602	$ 45,522
Other comprehensive income, net of taxes:				
Change in unrealized foreign currency translation adjustment arising during the period (1)	(88)	440	456	(63)
Less: Reclassification adjustment for foreign currency translation losses included in net income (2)	—	—	—	347
Net change in unrealized foreign currency translation adjustment	(88)	440	456	284
Change in deferred loss on cash flow hedge (3)	—	—	151	—
	(88)	440	607	284
Comprehensive income (loss)	$ 15,473	$ 6,391	$ 22,209	$ 45,806

(1) Net of tax benefit (expense) of $63 and $(258) for the three months ended September 30, 2008 and 2007, respectively, and $(268) and $56 for the nine months ended September 30, 2008 and 2007, respectively.

(2) Net of tax expense of $204 for the nine months ended September 30, 2007.

(3) Net of tax expense of $88 for the nine months ended September 30, 2008.

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008
(Dollars in thousands, except share data)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Total
	Shares	Amount				
Balance at December 31, 2007	62,527,360	$ 625	$ 177,407	$ 406,822	$ 1,292	$ 586,146
Net income	—	—	—	21,602	—	21,602
Issuance of common stock awards to employees	169,632	2	(137)	—	—	(135)
Exercise of common stock options	3,008	—	8	—	—	8
Expiration of common stock options (1)	—	—	1,053	—	—	1,053
Excess tax benefits related to share-based awards	—	—	3	—	—	3
Employee compensation – Share-based awards	—	—	1,324	—	—	1,324
Director's compensation – Common stock	16,530	—	68	—	—	68
Other comprehensive income, net of income taxes	—	—	—	—	607	607
Balance at September 30, 2008	62,716,530	$ 627	$ 179,726	$ 428,424	$ 1,899	$ 610,676

(1) Net of tax effect of $347 resulting from the reduction of the deferred tax asset.

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

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

For the nine months ended September 30,	**2008**	**2007**
Cash flows from operating activities		
Net income	$ 21,602	$ 45,522
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Amortization of mortgage servicing rights	40,712	81,810
Premium amortization (discount accretion) on securities, net	109	(2,847)
Depreciation and other amortization	9,599	6,873
Provision for bad debts	872	784
Impairment of mortgage servicing assets	1,401	—
Impairment of investment in Bankhaus Oswald Kruber GmBH & Co. KG	4,980	—
Loss (gain) on trading securities	22,366	(17,672)
Loss on loans held for resale, net	11,112	11,376
Loss on redemption of certificates of deposit	—	8,673
Equity in (earnings) losses of unconsolidated entities	10,628	(3,359)
Gain on repurchase of debt	(3,595)	—
Net cash provided (used) by trading activities	(238,303)	93,034
Net cash provided by loans held for resale activities	5,641	387
Excess tax benefits related to share-based awards	(3)	(606)
Decrease (increase) in advances and match funded advances	207,405	(240,254)
Decrease in deferred tax asset	7,400	4,663
Decrease (increase) in receivables and other assets, net	19,851	(19,950)
Decrease in servicer liabilities	(94,187)	(213,736)
Decrease in other liabilities, net	(10,241)	(14,301)
Other	3,879	2,433
Net cash provided (used) by operating activities	21,228	(257,170)
Cash flows from investing activities		
Purchase of mortgage servicing rights	(3,638)	(108,668)
Proceeds from the sale of mortgage servicing rights	5,985	—
Redemption of certificates of deposit	—	66,260
Return of investment in BMS Holdings, Inc.	—	45,894
Distributions from Ocwen Structured Investments, LLC and Ocwen Nonperforming Loans, LLC and related entities	32,748	—
Investment in Ocwen Structured Investments, LLC	—	(37,500)
Investment in Ocwen Nonperforming Loans, LLC and related entities	(1,250)	(18,083)
Cash paid to acquire NCI Holdings, Inc., net of cash acquired	—	(48,918)
Additions to premises and equipment	(4,566)	(3,192)
Proceeds from sales of real estate	6,003	1,882
Other	154	1,545
Net cash provided (used) by investing activities	35,436	(100,780)
Cash flows from financing activities		
Proceeds from (repayment of) match funded liabilities, net	(17,313)	184,276
Proceeds from (repayment of) lines of credit and other secured borrowings, net	(195,717)	93,466

Repurchase of debt securities	(10,797)	(50)
Proceeds from investment line, net	215,220	—
Excess tax benefits related to share-based awards	3	606
Repurchase of common stock	—	(14,520)
Exercise of common stock options	3	1,529
Net cash provided (used) by financing activities	(8,601)	265,307
Net increase (decrease) in cash	48,063	(92,643)
Cash at beginning of period	114,243	236,581
Cash at end of period	$ 162,306	$ 143,938

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

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(Dollars in thousands, except share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Ocwen Financial Corporation ("OCN"), through its subsidiaries, is a business process outsourcing ("BPO") provider to the financial services industry specializing in loan servicing, mortgage fulfillment and receivables management services. At September 30, 2008, 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 also owns 70% of Global Servicing Solutions, LLC ("GSS") with the remaining 30% minority interest held by ML IBK Positions, Inc.

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 nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for any other interim period or for the entire year ending December 31, 2008. 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, 2007.

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 2007 consolidated financial statements have been reclassified to conform to the 2008 presentation, including the reclassification of charge-offs of loans held for resale. These charge-offs, totaling $1,885 and $6,209 for the three and nine months ended September 30, 2007, were reclassified from other operating expenses to loss on loans held for resale, net, in the consolidated statements of operations.

Principles of Consolidation

We evaluate each special purpose entity ("SPE") for classification as a "qualifying special purpose entity" ("QSPE") as specified by Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*" ("SFAS No. 140"). When we determine that an SPE is classified as a QSPE, it is excluded from our consolidated financial statements. When we determine that an SPE is not classified as a QSPE, it is further evaluated for classification as a variable interest entity ("VIE") as specified by FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," as revised ("FIN 46(R)"). When an SPE meets the definition of a VIE, and OCN is identified as the primary beneficiary, we include it in our consolidated financial statements.

As of September 30, 2008, we have included six VIEs in our interim consolidated financial statements. Three of these entities are significant to our consolidated financial statements.

We include the assets and liabilities and the results of operations of Ocwen Servicer Advance Receivables Funding Company Ltd. ("OSARFC") in our consolidated financial statements. OSARFC is a special purpose entity, and we are the primary beneficiary. The holders of the debt issued by OSARFC can look only to the assets of OSARFC for satisfaction of the debt and have no recourse against OCN. As of September 30, 2008, OSARFC had assets of $446,036, including $444,672 of servicing advances that were pledged to secure the debt of $392,746 issued by OSARFC.

We also include in our consolidated financial statements two additional SPEs that were created to acquire advances from OLS and to securitize the advances by issuing debt that is secured by the advances: Ocwen Servicer Advance Funding (Wachovia), LLC ("OSAFW") and

Ocwen Servicer Advance Variable Funding Issuer (DB), LLC ("OSAVFI"). We evaluated both entities as VIEs and determined that we are the primary beneficiary. Holders of the debt issued by these two entities can look only to the assets of the entities for satisfaction of the debt and have no recourse against OCN. However, OLS has guaranteed the payment by 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. As of September 30, 2008, OSAFW had total assets of $251,502, including $250,949 of servicing advances that were pledged to secure the $230,976 of debt issued by OSAFW. Similarly, at September 30, 2008, OSAVFI had total assets of $246,758 including $245,168 of servicing advances that were pledged to secure the $217,312 of debt issued by OSAVFI.

OCN holds approximately a 46% 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"). We account for our investments in these entities using the equity method of accounting. We discontinue the equity method of accounting if our share of losses reduces our investment to zero unless we have guaranteed obligations or are otherwise committed to provide further financial support to the investee. If the investee subsequently reports net income, we will only continue the equity method after our share of net income equals the share of net losses not recognized during the periods the equity method was suspended.

We have eliminated all material intercompany accounts and transactions in consolidation. We report minority interests in our majority-owned subsidiaries as a separate item on our consolidated balance sheets. Minority interest in our earnings, which is immaterial, is included in other income (expense), net, on our consolidated statements of operations.

NOTE 2 CURRENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 157, "Fair Value Measurements." The FASB issued SFAS No. 157 in September 2006. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurement. The statement establishes a fair value hierarchy that distinguishes between (1) quoted prices in an active market, (2) observable market data from sources independent of the reporting entity and (3) unobservable inputs. In all instances, the use of an exit price or a sale price is emphasized by the statement. The adoption of SFAS No. 157 on January 1, 2008 did not have a material impact on our consolidated balance sheet or consolidated statement of operations other than the additional disclosures that are contained in Note 3.

In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-2, *"Effective Date of FASB Statement No. 157."* This FSP defers the effective date of Statement 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). In accordance with this FSP, we did not apply the provisions of SFAS No. 157 to goodwill and intangibles.

In October 2008, the FASB issued FSP No. FAS 157-3, *"Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active."* This FSP clarifies, without changing the definition of fair value as defined in SFAS No. 157, that in determining fair value for a financial asset in an inactive market, the use of a reporting entity's own assumptions about future cash flows and appropriately risk-adjusted discount rates is acceptable when relevant observable inputs are not available. The FSP was effective upon issuance, including prior periods for which the financial statements have not been issued. We considered the guidance provided by FSP No. 157-3 in the determination of the estimated fair values of our investments in auction rate securities, subordinate and residual securities and loans held for resale. The adoption of this FSP did not have a material impact on our consolidated balance sheet or consolidated statement of operations.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." In February 2007, the FASB issued SFAS No. 159 which permits entities to choose to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159 on January 1, 2008, we did not elect the fair value option for any instrument we do not currently measure at fair value; therefore, the adoption did not have an impact on our consolidated balance sheet or consolidated statement of operations.

SFAS No. 141 (R), "Business Combination — a replacement of FASB Statement No. 141." SFAS No. 141 (R) retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. 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 eliminates SFAS No. 141's acquisition cost-allocation process. 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. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009 with early adoption prohibited.

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 will be 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, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such a gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. The statement also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, which for us begins with our 2009 fiscal year. We are currently evaluating the impact that SFAS No. 160 will have on our consolidated financial statements; however, because the outstanding

non-controlling interests in our subsidiaries are not significant we do not expect the implementation of SFAS No. 160 to have a material impact 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 and thereby improves the transparency of financial reporting. Under this statement, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The statement must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008, which for us begins with our 2009 fiscal year, with early application encouraged. The adoption of SFAS No. 161 will not have an effect on our consolidated balance sheets or statements of operations but may require additional disclosures.

Proposed amendment of SFAS No. 140 and FIN 46(R) and issuance of FSP No. FAS 140-e and FIN 46(R)-e. In April 2008, the FASB voted to eliminate the QSPE concept from SFAS No. 140 and to remove the scope exception for QSPEs from FIN 46(R). During September 2008, the FASB issued three separate but related exposure drafts for public comment. The proposed FASB Statements address amendments to SFAS No. 140 and to FIN 46(R). Proposed FASB Staff Position FAS 140-e and FIN 46 (R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*, addresses related disclosure requirements for public entities. The proposed changes will require an analysis of VIEs previously accounted for as QSPEs, and therefore currently exempt from the consolidation provisions of FIN 46(R), for consolidation according to the provisions of FIN 46(R). The proposed changes will also require a revision of the current risk and rewards consolidation model to a qualitative model based on control.

The purpose of the proposed FSP is to require improved disclosures by public entities until the pending amendments to FASB Statement No. 140 and FASB Interpretation No. 46(R) are effective. This proposed FSP would amend SFAS No. 140 and FIN 46(R) to require enhanced disclosures by public entities about transfers of financial assets and interests in VIEs. Additionally, the proposed FSP would require certain disclosures by a public entity that is (a) a sponsor that has a variable interest in a VIE (irrespective of the significance of the variable interest) and (b) an enterprise that holds a significant variable interest in a QSPE but was not the transferor of financial assets to the QSPE.

The proposed amendments to SFAS No. 140 are to be applied in fiscal years beginning after November 15, 2009. Transition disclosures would be provided for QSPEs during the one-year deferral period.

We have retained investments in certain subordinate and residual securities in connection with loan securitization transactions completed in prior years (primarily 2006). As a result, if the proposed amendments become final, we will be required to analyze the VIEs previously accounted for as QSPEs to determine if consolidation of the assets and liabilities is appropriate in accordance with the provisions of FIN 46(R) for the year beginning January 1, 2010. Our subordinate and residual securities at September 30, 2008 include retained interests with a fair value of $381.

FSP No. APB-14, "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. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Upon adoption of this FSP, we will recognize a discount to reduce the carrying value of the 3.25% convertible notes component of our debt securities and an offsetting increase to stockholders' equity. Although we have not yet determined the amounts, due to the retrospective accretion of the resulting debt discount to interest expense over the expected life of the notes our consolidated balance sheet will reflect an adjustment to opening retained earnings on January 1, 2009, and our consolidated statements of operations will reflect increased non-cash interest expense.

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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 at September 30, 2008, categorized by input level within the fair value hierarchy:

	Carrying value	Level 1	Level 2	Level 3
Measured at fair value on a recurring basis:				
Trading securities (1):				
Investment grade auction rate	$ 253,944	$ —	$ —	$ 253,944
Subordinates and residuals	4,239	—	—	4,239
Derivative financial instruments, net (2)	1,169	6	—	1,163
Measured at fair value on a non-recurring basis:				
Loans held for resale (3)	55,642	—	37,122	18,520
Residential MSRs (4)	2,655	—	2,655	—

(1) We account for trading securities at fair value. We report changes in fair value in gain (loss) on trading securities in the period of the change.

(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. The interest rate caps are classified within Level 3 of the fair value hierarchy and the futures contracts within Level 1. See Note 16 for additional information on our derivative financial instruments at September 30, 2008.

(3) Loans held for resale are measured at fair value on a non-recurring basis. At September 30, 2008, the carrying value of loans held for resale is net of a valuation allowance of $16,405. We estimate the fair value of uncommitted non-performing loans (those for which we have not received a purchase commitment) based on the expected future cash flows discounted using a rate commensurate with the risks involved.

(4) The carrying value of MSRs at September 30, 2008 is net of a valuation allowance for impairment of $1,401 established during the third quarter of 2008. The valuation allowance related exclusively to the high-loan-to-value stratum of our residential MSRs. The estimated fair value exceeded amortized cost for all other strata. See Note 8 for additional information on MSRs.

The following table sets forth a reconciliation of the changes in fair value during the three and nine months ended September 30, 2008 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)	Transfers in and/or out of Level 3	Fair value at September 30, 2008
Three months:					
Trading securities:					
Investment grade auction rate	$ 254,745	$ (801)	$ —	$ —	$ 253,944
Subordinates and residuals	4,860	—	(621)	—	4,239
Derivative financial instruments	1,326	—	(163)	—	1,163
Nine months:					
Trading securities:					
	$ —	$ 270,313	$ (16,369)	$ —	$ 253,944

Investment grade auction rate					
Subordinates and residuals	7,362	22	(3,145)	—	4,239
Derivative financial instruments	4,867	(7,063)	3,359	—	1,163

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

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, and accordingly, its operations have been reclassified in the accompanying consolidated financial statements as discontinued. For segment reporting purposes, the operations of BOK are included in Corporate Items and Other. We recorded a charge of $4,980 in the second quarter of 2008 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. We recorded no additional write-downs in the third quarter of 2008. We continue to actively market BOK and have received proposals that are in excess of the current book value but are non-binding and subject to due diligence. We expect to reach an agreement of sale (subject to regulatory approval) of our investment in 2008.

Results of BOK's operations for the three and nine months ended September 30 are as follows:

	Three months		Nine months	
	2008	2007	2008	2007
Revenue	$ 68	$ 102	$ 339	$ 233
Operating expenses	593	608	6,891	1,728
Loss from operations	(525)	(506)	(6,552)	(1,495)
Other income, net	339	197	980	552
Loss before income taxes	(186)	(309)	(5,572)	(943)
Income tax expense (benefit)	—	—	—	—
Net loss	$ (186)	$ (309)	$ (5,572)	$ (943)

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

	September 30, 2008	December 31, 2007
Cash	$ 5,227	$ 8,338
Trading securities, at fair value	—	537
Receivables	11,232	9,968
Goodwill and intangibles	—	3,423
Other	42	268
Total assets	$ 16,501	$ 22,534
Total liabilities (including customer deposits of $6,983 and $7,439)	$ 7,600	$ 7,866

NOTE 5 TRADING SECURITIES

Trading securities consisted of the following at the dates indicated:

	September 30, 2008	December 31, 2007
Investment grade auction rate (Corporate Items and Other)	$ 253,944	$ —
Other investment grade (Corporate Items and Other):		
Collateralized mortgage obligations ("CMOs")	$ —	$ 33,171
Other	—	1,705
	$ —	$ 34,876

Subordinates and residuals:				
Loans and Residuals:				
Single family residential	$	4,055	$	7,016
Corporate Items and Other:				
Single family residential		184		296
Commercial		—		50
	$	4,239	$	7,362

Gain (loss) on trading securities for the three and nine months ended September 30 was comprised of the following:

	Three months		Nine months	
	2008	**2007**	**2008**	**2007**
Unrealized losses (1)	$ (621)	$ (1,049)	$ (20,670)	$ (7,621)
Realized gains (losses) (2)	—	(359)	(1,696)	25,293
	$ (621)	$ (1,408)	$ (22,366)	$ 17,672

(1) Unrealized losses for 2008 include $15,707 recognized during the first six months related to auction rate securities. We did not record any unrealized losses on auction rate securities during the third quarter of 2008.

(2) During the second quarter of 2007, we sold residual securities that were backed by subprime residential loans originated in the United Kingdom (the "UK residuals") and realized a gain of $25,587 in our Loans and Residuals segment.

Investment Grade Auction Rate Securities

Under our Investment Line agreements, we borrowed funds each month under a revolving demand note equal to our projected average float balance and invested those funds in certain permitted investments. 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.

During the first quarter of 2008, we invested Investment Line borrowings 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 are reset through an auction process that typically occurs every 7 to 35 days. The underlying student loans backing the auction rate securities carry a guarantee of no less than 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 levels of illiquidity, and auctions began to fail because there were not enough orders to purchase all of the securities being sold at the auction. As a result, we have been unable to liquidate our holdings. 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 August 28, 2008, Moody's Investors Services, Inc. announced that it had downgraded several tranches of auction rate securities. Auction rate securities we hold with a par value of $70,350 at September 30, 2008 were affected by this ratings action and were downgraded to a rating of 'Baa'. The AAA ratings from both Standard and Poor's Ratings Services and Fitch Ratings have not been revised. To date we have received all interest payments when due.

Because sufficient liquidity has not returned to the auction rate securities market, we were unable to liquidate our entire investment prior to September 30, 2008. We estimated the fair value of the auction rate securities based on actual sales and redemptions of the auction rate securities that we hold and a discounted cash flow analysis.

The discounted cash flow analysis included the following range of assumptions at September 30, 2008:

• Expected term	15 - 27 months
• Illiquidity premium	1.91% - 2.08%
• Discount rate	3.03% - 6.73%

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.

During the nine months ended September 30, 2008, issuers have called at par notes with a face value of $3,799, including $800 during the third quarter. During the second quarter of 2008, we sold notes with a face value $27,350 at a discount to par of 5.5%. There were no sales during the third quarter. The amount outstanding under the Investment Line term note that finances the auction rate securities represented 80% of the face value of the auction rate securities at September 30, 2008. See Note 13 for a more detailed discussion and status of the Investment Line.

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.

We estimate the fair value of our subordinate and residual securities based on the present value of expected future cash flows. Significant assumptions used in the discounted cash flow model include discount, delinquency and cumulative loss rates as well as prepayment speeds associated with the loans underlying mortgage backed securities. 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 21% to 40%, and loss assumptions range from 13% to 21%. Average prepayment assumptions range from 10% to 15%.

NOTE 6 ADVANCES

During any period in which the borrower is not making payments, we are required under most servicing agreements to advance funds to the investment trust to meet contractual principal and interest remittance requirements for investors. As the servicer, we are obligated to advance funds only to the extent that we believe the advances are recoverable. Most of our advances have the highest standing for reimbursement from payments, repayments and liquidation proceeds at the loan level. In addition, for any advances that are not covered by loan proceeds, the large majority of our pooling and servicing agreements provide for reimbursement at the pool level, either by using collections on other loans or by requesting reimbursement from the securitization trust. We are also required to pay property taxes and insurance premiums, to process foreclosures and to advance funds to maintain, repair and market real estate properties on behalf of investors, and these advances are accorded the same high priority for repayment as principal and interest advances.

Advances consisted of the following at the dates indicated:

	September 30, 2008	December 31, 2007
Servicing:		
Principal and interest	$ 42,554	$ 111,199
Taxes and insurance	38,185	77,431
Foreclosures and bankruptcy costs	31,095	45,269
Real estate servicing costs	13,969	34,537
Other	8,711	17,493
	134,514	285,929
Loans and Residuals	5,451	6,872
Corporate Items and Other	114	86
	$ 140,079	$ 292,887

At September 30, 2008, no advances were pledged under the senior secured credit agreement as this facility was converted to a term note secured only by MSRs in August 2008. See Note 12 for additional information regarding this term note.

NOTE 7 MATCH FUNDED ADVANCES

Match funded advances on residential loans serviced for others are comprised of the following at the dates indicated:

	September 30, 2008	December 31, 2007
Principal and interest	$ 598,858	$ 659,207
Taxes and insurance	301,732	281,062
Foreclosures and bankruptcy costs	74,090	86,384
Real estate servicing costs	76,555	80,785
Other	19,664	18,659
	$ 1,070,899	$ 1,126,097

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 generally 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.

NOTE 8 MORTGAGE SERVICING RIGHTS

	Residential	Commercial	Total
Carrying value of MSRs:			
Balance at December 31, 2007	$ 191,935	$ 5,360	$ 197,295
Purchases	3,638	—	3,638
Sales	—	(5,036)	(5,036)
Servicing transfers and adjustments	(3,500)	(50)	(3,550)
Amortization	(40,438)	(274)	(40,712)
Impairment	(1,401)	—	(1,401)
Balance at September 30, 2008	$ 150,234	$ —	$ 150,234
Estimated fair value of MSRs:			
September 30, 2008	$ 186,159	$ —	$ 186,159
December 31, 2007	$ 271,108	$ 5,781	$ 276,889
Unpaid principal balance of assets serviced:			
September 30, 2008:			
Servicing	$ 31,719,060	$ —	$ 31,719,060
Subservicing (1)	10,729,971	1,320,076	12,050,047
	$ 42,449,031	$ 1,320,076	$ 43,769,107
December 31, 2007:			
Servicing	$ 38,005,999	$ 2,385,343	$ 40,391,342
Subservicing (1)	15,539,986	2,764,634	18,304,620
	$ 53,545,985	$ 5,149,977	$ 58,695,962

(1) Unpaid principal balance (“UPB”) serviced under subservicing agreements includes $694,663 and $798,148 of foreclosed residential properties serviced for the United States Department of Veterans Affairs (“VA”) at September 30, 2008 and December 31, 2007, respectively. We elected to allow our contract with the VA to expire in July 2008. Transition of the remaining properties to the new service provider was completed in October 2008.

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. Assets serviced for others are excluded from our balance sheet. Custodial accounts, which hold funds representing collections of principal and interest plus tax and insurance payments that we have received from borrowers, are escrowed with an unaffiliated bank and excluded from our balance sheet. Custodial accounts amounted to $341,000 and $356,700 at September 30, 2008 and December 31, 2007, respectively. An agreement between the various parties to a mortgage securitization transaction typically specifies the rights and obligations of servicing rights which include guidelines and procedures for servicing the loans including remittance and reporting requirements, among other provisions.

We estimate the fair value of our servicing rights by discounting the future underlying servicing cash flows. The more significant assumptions used in the September 30, 2008 valuation (depending on loan type) include long-term prepayment speeds ranging from 15.2% to 27.5% and delinquency rates ranging from 15.3% to 23.5%. Other assumptions include an interest rate of one-month LIBOR plus 300 basis points for computing the cost of servicing advances, an interest rate equal to one-month LIBOR minus 20 basis points for computing float earnings and a discount rate of 18%.

As of September 30, 2008, we established a valuation allowance for impairment of $1,401 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 experienced by our servicing portfolio. We may adjust this valuation allowance in the future, as the estimated fair value increases or decreases. For all other strata, the external valuation was above the carrying value at September 30, 2008.

As of September 30, 2008, MSRs with a carrying value of $147,735 had been pledged as collateral for borrowings under the senior secured credit agreement.

NOTE 9 INVESTMENT IN UNCONSOLIDATED ENTITIES

	September 30, 2008	December 31, 2007
Asset Management Vehicles:		
Investment in OSI (1)	$ 20,851	$ 37,189
Investment in ONL and affiliates (2)	11,555	33,531
	32,406	70,720
Technology Products:		
Investment in BMS Holdings (4)	—	5,666
Corporate Items and Other	79	79
	$ 32,485	$ 76,465

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

	Three months		Nine months	
	2008	2007	2008	2007
OSI (1) (3)	$ (1,864)	$ 1,169	$ (3,411)	$ 1,169
ONL and affiliates (2) (3)	(1,064)	—	(1,551)	—
BMS Holdings (4)	—	2,368	(5,666)	2,190
	$ (2,928)	$ 3,537	$ (10,628)	$ 3,359

(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 2008, we have received distributions from OSI totaling $12,000, all during the third quarter. Our remaining commitment to invest up to an additional $37,500 in OSI expired on September 18, 2008.

(2) Our investments in ONL and OREO represent equity interests of approximately 25%. On July 18, 2008, Nonperforming Loan Company I, LLC ("NPL") merged with and into ONL, with ONL as the surviving entity. At the time of the transaction, we had a 25% equity interest in NPL. Subsequent to this consolidation, we sold a 0.2% equity interest in both ONL and OREO to another investor. We recognized a gain of $68 on the sale of our ownership interests. 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 nine months of 2008, we have received distributions totaling $20,748 from ONL and OREO and invested an additional $1,250 in OREO. We have a remaining commitment, which expires on September 13, 2010, to invest up to an additional $37,423 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 and ONL and affiliates. During the first nine months of 2008, OLS earned $2,542 and $2,997 of loan servicing fees and management fees, 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) Our investment in BMS Holdings represents an equity interest of approximately 46%. During the second quarter of 2008, our share of the losses of BMS Holdings reduced our investment to zero. Because we are not required to advance funds to BMS Holdings to finance operations, and we are not a guarantor of any obligations of BMS Holdings, we suspended the application of the equity method of accounting for our investment in BMS Holdings. For the third quarter of 2008, BMS Holdings reported a loss, and therefore, we did not resume application of the equity method of accounting.

NOTE 10 OTHER ASSETS

Other assets consisted of the following at the dates indicated:

	September 30, 2008	December 31, 2007
Debt service accounts (1)	$ 68,337	$ 77,819
Interest earning collateral deposits	14,116	8,947
Real estate	10,708	11,483
Deferred debt related costs, net	8,185	11,446
Prepaid expenses and other	6,159	9,091
	$ 107,505	$ 118,786

(1) Under our four match funded 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 11 MATCH FUNDED LIABILITIES

Match funded liabilities are obligations secured by the collateral underlying the related match funded advances and are repaid through the cash proceeds arising from those assets. We account for and report match funded liabilities as secured borrowings with pledges of collateral. All of our match funded liabilities are secured by advances on residential loans serviced for others. The amortization date is the date on which the revolving period ends under our advance facilities and repayment of the outstanding balance must begin if the facility is not renewed or extended. The maturity date is the date on which all outstanding balances must be repaid. After the amortization date, all collections that represent the repayment of advances that have been financed through the facility must be applied to reduce the balance outstanding under the facility, and any new advances under the securitizations pledged to the facility are ineligible to be financed.

Borrowing Type	Interest Rate (1)	Maturity	Amortization Date	Unused Borrowing Capacity	Balance Outstanding September 30, 2008	Balance Outstanding December 31, 2007
Variable Funding Note Series 2007-1	Commercial paper rate + 200 basis points (2)	November 2013	December 2008 (2)	$ 78,198	$ 221,802	$ 218,590
Term Note Series 2004 -1	1-Month LIBOR + 50 basis points	October 2013	January 2008 (3)	—	—	100,000
Term Note Series 2005 -1	1-Month LIBOR + 40 basis points	March 2014	May 2008 (4)	—	—	75,000
Term Note Series 2006 -1	5.335%	November 2015 (5)	November 2009	—	165,000	165,000
Variable Funding Note (6)	Commercial paper rate + 150 basis points (6)	December 2013	December 2010	32,688	217,312	124,038
Variable Funding Note (7)	1-Month LIBOR + 500 basis points (7)	March 2011	March 2008 (7)	—	—	174,581
Advance Receivable Backed Notes	1-Month LIBOR + 200 basis points	February 2011 (8)	February 2009	55,442	144,558	139,752
Advance Receivable Backed Notes	1-Month LIBOR + 250 basis points	April 2009	April 2009	69,024	230,976	—
				235,352	979,648	996,961
Basis adjustment (5)				—	5,668	4,442
				$ 235,352	$ 985,316	$ 1,001,403

(1) 1-Month LIBOR was 3.93% and 4.60% at September 30, 2008 and December 31, 2007, respectively.

(2) 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 which has approximated LIBOR plus 200 basis points over time. On October 30, 2008, the amortization date for this note was extended through December 3, 2008. Following this extension, this note may be renewed for a longer period at the current amount, reduced to a lesser amount or allowed to enter its amortization period.

(3) The amortization period for this note began in January 2008, and by March 2008, we repaid the note in full.

(4) The amortization period for this note began in May 2008, and we repaid the note in full in August 2008.

(5) 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.

(6) 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 which has approximated 1-Month LIBOR plus 150 basis points over time.

(7) In March 2008, we elected not to renew or extend this facility, and the amortization period for this note began. The interest rate increased from 1-Month LIBOR plus 200 basis points to 1-Month LIBOR plus 500 basis points on January 1, 2008. By April 2008, we repaid this note in full and moved all remaining collateral to a new $300,000 match funded advance facility that closed in April 2008.

(8) In February 2008, we negotiated an increase in the maximum borrowing capacity from $140,000 to $200,000 and extended the stated maturity to February 2011 and the amortization date to February 2009.

NOTE 12 LINES OF CREDIT AND OTHER SECURED BORROWINGS

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

					Balance Outstanding	
Borrowings	**Collateral**	**Interest Rate (1)**	**Maturity**	**Unused Borrowing Capacity**	**September 30, 2008**	**December 31, 2007**
Servicing:						
Senior secured credit agreement (2)	MSRs, advances, receivables and mortgage loans	1-Month LIBOR +150 – 200 basis points (2)	February 2010 (2)	$ —	$ 118,985	$ 260,976
Loans and Residuals:						
Repurchase agreement	Loans held for resale or real estate	1-Month LIBOR + 800 basis points (3)	September 2008 (3)	—	—	46,173
Class A-1 notes (3)	Loans held for resale and real estate	1-Month LIBOR + 600 basis points	April 2037	—	20,999	—
Repurchase agreement	Residual trading securities	1-Month LIBOR + 250 basis points	N/A	—	—	170
Repurchase agreement	Residual trading securities	1-Month LIBOR +125 basis points	April 2036	—	—	129
				—	20,999	46,472
Mortgage Services:						
Senior secured credit agreement (4)	Commercial MSRs and advances	Prime or prime + 37.5 basis points	August 2008	—	—	4,090
Financial Services:						
Revolving note	Receivables	1, 3, 6 or 12-Month LIBOR + 200 basis points or Prime less 100 basis points	July 2011	5,725	4,275	—
Senior notes	Various	10.25%	January 2008	—	—	147
				5,725	4,275	147
Corporate Items & Other:						
Repurchase agreement (5)	Securities	5.12 – 5.40%	N/A	—	—	28,291
				$ 5,725	$ 144,259	$ 339,976

(1) 1-Month LIBOR was 3.93% and 4.60% at September 30, 2008 and December 31, 2007, respectively.

(2) The interest incurred on this facility is based on LIBOR plus 150 basis points to 200 basis points depending on the type of collateral pledged but may be reduced to as low as 1.50% to 2.00% to the extent that we have available balances on deposit with the lender. We did not renew this agreement prior to its maturity in August 2008. However, we did exercise the option contained in the facility for an 18-month term note to finance the MSRs. We transferred the advance collateral to existing match funded facilities.

(3) We did not renew this repurchase agreement upon maturity in September 2008. The repurchase agreement was secured by A-rated securities we issued in 2007 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 a discount of $928 which is being amortized to interest expense over the estimated remaining life of the notes.

(4) This facility was terminated in May 2008, when we sold the commercial MSRs that were pledged as collateral.

(5) We repaid this agreement in full in April 2008 when we sold the CMOs that were pledged as collateral.

NOTE 13 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. The custodial funds comprising most of the float balance remained on deposit in bank accounts that meet the requirements of each trust. The terms 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 fully 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 $355,000. We recognized these securities and a corresponding liability on our balance sheet in the first quarter. 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 which is secured by our investment in the auction rate securities. Interest on the term note is 0.35% on that portion of the outstanding balance that does not exceed the amount of demand balances on deposit with the lender. For any portion of the outstanding balance of the term note that is in excess of the demand deposits, the interest rate is 1-month LIBOR plus 35 basis points.

The new term note finances the auction rate securities at a rate of approximately 85% of face value at the time that the note was executed, and it matures on June 30, 2009. The maximum borrowing was reduced to 80% on September 30, 2008 and will be further reduced to 75% on December 31, 2008 and 70% on March 30, 2009. Under the new 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. We intend to fund the two remaining reductions in the maximum borrowing rate using cash generated from operations. Through September 30, 2008, we made payments totaling $84,744 that reduced the Investment Line obligation to $215,220 and the finance rate to 80% of face value.

On September 30, 2008, when the revolving demand note expired, we repaid the borrowings in full using proceeds received from the liquidation of the investments.

NOTE 14 SERVICER LIABILITIES

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

	September 30, 2008	December 31, 2007
Borrower payments due to custodial accounts	$ 23,415	$ 120,507
Escrow payments due to custodial accounts	5,389	7,410
Partial payments and other unapplied balances	81,493	76,567
	$ 110,297	$ 204,484

NOTE 15 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 3.25% Contingent Convertible Senior Unsecured Notes (“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 nine months ended September 30:

	Three months		Nine months	
	2008	2007	2008	2007
Basic EPS:				
Net income	$ 15,561	$ 5,951	$ 21,602	$ 45,522
Weighted average shares of common stock	62,715,551	62,505,269	62,655,655	62,774,324
Basic EPS	$ 0.25	$ 0.10	$ 0.34	$ 0.73
Diluted EPS:				
Net income	$ 15,561	$ 5,951	$ 21,602	$ 45,522
Interest expense on Convertible Notes, net of income tax (1)	545	629	1,751	1,886
Adjusted net income	$ 16,106	$ 6,580	$ 23,353	$ 47,408
Weighted average shares of common stock	62,715,551	62,505,269	62,655,655	62,774,324
Effect of dilutive elements:				
Convertible Notes (1)	6,767,053	7,962,205	6,767,053	7,962,205
Stock options (2)	252,251	548,597	219,214	837,870
Common stock awards	16,034	113,969	22,402	64,250
Dilutive weighted average shares of common stock	69,750,889	71,130,040	69,664,324	71,638,649
Diluted EPS	$ 0.23	$ 0.09	$ 0.34	$ 0.66

(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, is added back to net income.

(2) Excludes an average of 3,412,757 and 1,657,045 of options that were anti-dilutive for the third quarter of 2008 and 2007, respectively, because their exercise price was greater than the average market price of our stock. Year to date, an average of 3,059,532 and 932,130 of options were anti-dilutive for 2008 and 2007, respectively.

On July 14, 2008, the Compensation Committee of OCN’s Board of Directors approved an equity incentive program pursuant to which eight members of our senior management team were granted options to purchase a total of 6,840,000 shares of OCN’s common stock under the 2007 Equity Incentive Plan. Of the 6,840,000 shares granted, the grant of 310,000 shares to one member of senior management is contingent upon the occurrence of certain corporate events. The stock options have a contractual term of ten years.

The options have an exercise price of $8.00 per share, which was approximately 40% higher than the closing price of OCN’s stock on the day of the Compensation Committee’s approval. The vesting schedule for the options has a time-based component, in which 25% of the options vest in equal increments over four years, and a market-based component, in which up to 75% of the options could vest in equal increments over four years commencing upon the achievement of certain performance criteria related to OCN’s stock price and annualized rate of return to investors. Two-thirds of the market-based options would begin to vest over four years if the stock price realizes a compounded annual gain of at least 20% over the exercise price, so long as the stock price is at least double the exercise price. The remaining third of the market-based options would begin to vest over four years if the stock price realizes a 25% gain, so long as it is at least triple the exercise price.

Compensation expense related to this option grant totaled $281 for the third quarter of 2008 and was measured based on the grant-date fair value of the options. The fair value of the time-based options was determined using the Black-Scholes options pricing model. A lattice (binomial) model was used to determine the fair value of the market-based options.

NOTE 16 DERIVATIVE FINANCIAL INSTRUMENTS

The following table summarizes our use of derivative financial instruments during the nine months ended September 30, 2008:

	Notional Amounts		
	Interest Rate Caps	Interest Rate Swaps	Euro Currency Futures
Balance at December 31, 2007	$ 250,000	$ 165,000	$ —
Additions	200,000	—	32,899
Maturities	—	—	(22,683)
Terminations	—	(165,000)	—
Balance at September 30, 2008	$ 450,000	$ —	$ 10,216
Fair value at September 30, 2008	$ 1,163	$ —	$ 6
Maturity	February 2011 & December 2013	—	December 2008

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. We did not designate this cap as a hedge. In connection with our issuance of a $165,000 match funded term note in 2006 with a 5.335% fixed rate of interest, we entered into an interest rate swap position with a notional value of $165,000 to hedge our exposure to an increase in the fair value of the note due to declining interest rates. We designated this swap position as a fair value hedge and carried the note on the balance sheet at fair value. During the first quarter of 2008, we terminated this interest rate swap and began amortizing the basis adjustment on the note to earnings over the expected remaining term of the note.

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 hedge. Net gains on these foreign currency futures were $1,075 and $906 for the three and nine months ended September 30, 2008, respectively. These gains were included in the net change in unrealized foreign currency translation adjustment in accumulated other comprehensive income.

Net realized and unrealized gains (losses) included in other income (expense), net related to derivative financial instruments were $(163) and $2,736 for the three months ended September 30, 2008 and 2007, respectively. Year to date, the net realized and unrealized gains were $3,359 and $1,707 for 2008 and 2007, 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 $2,935 for the three months ended September 30, 2007 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 the interest rate swap that we eventually terminated in the first quarter of 2008. For the year to date periods, the portion of the unrealized losses attributed to these fair value basis adjustments were $3,149 and $1,784 for 2008 and 2007, respectively.

NOTE 17 BUSINESS SEGMENT REPORTING

Effective January 1, 2008, we realigned and expanded our business segments in conjunction with implementing our revised business strategy which included managing the business through two distinct lines of business. Our previous segments, Residential Servicing, Ocwen Recovery Group and Residential Origination Services, were realigned into two 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 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 realigned 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, formerly known as Residential Servicing.

- *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. In January 2007, we decided to close our subprime loan origination operation. This segment was previously included in the Residential Origination Services segment.

- *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. This segment was previously included in the Residential Servicing segment.

Ocwen Solutions

- *Technology Products.* This segment includes revenues from the licensing to others of our REAL suite of applications that support mortgage servicing and origination. These products include REALServicing™, REALResolution™, REALTrans℠ and REALSynergy™ and REALRemit™. This segment also earns fees from services that cover IT enablement, call center services and third-party applications. The results of our 46% 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. The results of BMS Holdings were previously included in Corporate Items and Other. During the second quarter of 2008, Technology Products began charging Servicing and other segments for technology services according to a market-based rate card instead of the cost-based method that was previously used. As a result, the revenues of Technology Products are approximately $1,800 and $5,400 greater for the three and nine months ended September 30, 2008, respectively, than they would have been if the cost-based system had continued to be used. This increase in revenues by segment for the three months ended September 30, 2008 was approximately $1,400 for Servicing, $100 for Mortgage Services and $300 for Financial Services.

- *Mortgage Services.* This segment provides fee-based mortgage and default services including residential property valuation, mortgage due diligence, mortgage underwriting and insurance support. These fee-based businesses were previously included in the Residential Origination Services segment. This segment also includes international servicing for commercial loans which we conduct through GSS and which was previously included in Corporate Items and Other.

- *Financial Services*. This segment, formerly known as Ocwen Recovery Group, primarily generates fees by providing collection services for owners of delinquent and charged-off receivables. Effective June 6, 2007, this segment includes the results of NCI, a receivables management company specializing in contingency collections and customer relationship management for credit card issuers and other consumer and credit providers.

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**	**Technology Products**	**Mortgage Services**	**Financial Services**	**Corporate Items and Other**	**Corporate Eliminations**	**Business Segments Consolidated**
Results of Operations									
For the three months ended September 30, 2008:									
Revenue (1)	$ 86,058	$ —	$ 819	$ 11,672	$ 12,331	$ 18,654	$ 12	$ (8,285)	$ 121,261
Operating expenses (1)(2)	39,918	793	1,204	9,528	9,674	22,003	2,225	(7,887)	77,458
Income (loss) from operations	46,140	(793)	(385)	2,144	2,657	(3,349)	(2,213)	(398)	43,803
Other income (expense), net:									
Interest income	195	2,344	—	—	50	—	859	—	3,448
Interest expense	(16,901)	(785)	—	(129)	(11)	(468)	(124)	—	(18,418)
Other (1)	(110)	(1,268)	(3,258)	42	92	1	(321)	398	(4,424)
Other income (expense), net	(16,816)	291	(3,258)	(87)	131	(467)	414	398	(19,394)
Income (loss) from continuing operations before income taxes	$ 29,324	$ (502)	$ (3,643)	$ 2,057	$ 2,788	$ (3,816)	$ (1,799)	$ —	$ 24,409
For the three months ended September 30, 2007:									
Revenue (1)	$ 83,273	$ 7	$ 354	$ 8,969	$ 18,991	$ 16,872	$ 373	$ (3,489)	$ 125,350
Operating expenses (1)(2)	49,796	1,038	74	9,250	14,815	19,046	1,543	(3,918)	91,644
Income (loss) from operations	33,477	(1,031)	280	(281)	4,176	(2,174)	(1,170)	429	33,706
Other income (expense), net:									
Interest income	269	3,690	—	—	18	(3)	1,117	—	5,091
Interest expense	(13,405)	(1,470)	—	(105)	(120)	(712)	(1,682)	—	(17,494)
Other (1)	59	(4,103)	1,219	2,812	(54)	(12)	(10,653)	(429)	(11,161)
Other income (expense), net	(13,077)	(1,883)	1,219	2,707	(156)	(727)	(11,218)	(429)	(23,564)
Income (loss) from continuing operations before income taxes	$ 20,400	$ (2,914)	$ 1,499	$ 2,426	$ 4,020	$ (2,901)	$ (12,388)	$ —	$ 10,142
For the nine months ended September 30, 2008:									
Revenue (1)	$ 264,985	$ —	$ 2,997	$ 34,566	$ 43,580	$ 57,182	$ 154	$ (22,727)	$ 380,737
	124,232	2,225	3,217	28,210	34,137	62,140	14,206	(21,568)	246,799

Operating expenses (1)(2)(3)									
Income (loss) from operations	140,753	(2,225)	(220)	6,356	9,443	(4,958)	(14,052)	(1,159)	133,938
Other income (expense), net:									
Interest income	854	8,731	—	—	132	14	1,761	—	11,492
Interest expense	(58,741)	(2,065)	—	(447)	(190)	(1,451)	(804)	—	(63,698)
Other (1)	110	(14,003)	(6,542)	(5274)	557	8	(16,454)	1,159	(40,439)
Other income (expense), net	(57,777)	(7,337)	(6,542)	(5,721)	499	(1,429)	(15,497)	1,159	(92,645)
Income (loss) from continuing operations before income taxes	$ 82,976	$ (9,562)	$ (6,762)	$ 635	$ 9,942	$ (6,387)	$ (29,549)	$ —	$ 41,293
<u>For the nine months ended September 30, 2007:</u>									
Revenue (1)	$ 262,477	$ 353	$ 354	$ 27,183	$ 52,472	$ 25,002	$ 1,160	$ (11,742)	$ 357,259
Operating expenses (1)(2)	171,568	3,255	234	24,160	43,815	28,511	4,411	(12,854)	263,100
Income (loss) from operations	90,909	(2,902)	120	3,023	8,657	(3,509)	(3,251)	1,112	94,159
Other income (expense), net:									
Interest income	758	16,760	—	—	59	(3)	6,718	—	24,292
Interest expense	(36,703)	(5,190)	—	(375)	(351)	(892)	(4,233)	—	(47,744)
Other (1)	(1,969)	11,110	1,220	3,380	(212)	29	(11,673)	(1,112)	773
Other income (expense), net	(37,914)	22,680	1,220	3,005	(504)	(866)	(9,188)	(1,112)	(22,679)
Income (loss) from continuing operations before income taxes	$ 52,995	$ 19,778	$ 1,340	$ 6,028	$ 8,153	$ (4,375)	$ (12,439)	$ —	$ 71,480
Total Assets									
September 30, 2008	$ 1,450,158	$ 76,106	$ 33,306	$ 9,476	$ 3,996	$ 63,971	$ 671,252	$ (5,850)	$ 2,302,415
December 31, 2007	$ 1,708,504	$ 102,398	$ 74,242	$ 20,328	$ 24,149	$ 66,142	$ 407,901	$ (8,968)	$ 2,394,696
September 30, 2007	$ 1,394,564	$ 137,726	$ 55,473	$ 18,363	$ 20,330	$ 63,495	$ 423,685	$ (3,293)	$ 2,110,343

(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	Technology Products	Mortgage Services	Business Segments Consolidated
For the three months ended September 30, 2008	$ 1,891	$ 204	$ 9,254	$ 24	$ 11,373
For the three months ended September 30, 2007	$ 1,408	$ —	$ 4,777	$ 85	$ 6,270
For the nine months ended September 30, 2008	$ 5,289	$ 749	$ 25,069	$ 128	$ 31,235
For the nine months ended September 30, 2007	$ 2,958	$ —	$ 14,061	$ 320	$ 17,339

(2) Depreciation and amortization expense are as follows:

	Servicing	Loans and Residuals	Technology Products	Mortgage Services	Financial Services	Corporate Items and Other	Business Segments Consolidated
For the three months ended September 30, 2008:							
Depreciation expense	$ 13	$ 8	$ 2,193	$ 11	$ 103	$ 351	$ 2,679
Amortization of MSRs	12,106	—	—	—	—	—	12,106
Amortization of intangibles	—	—	—	—	629	—	629
For the three months ended September 30, 2007:							
Depreciation expense	$ 17	$ 2	$ 1,730	$ 92	$ 221	$ 611	$ 2,673
Amortization of MSRs	21,808	—	—	214	—	—	22,022
Amortization of intangibles	—	—	—	—	820	—	820
For the nine months ended September 30, 2008:							
Depreciation expense	$ 39	$ 10	$ 5,748	$ 62	$ 317	$ 1,394	$ 7,570
Amortization of MSRs	40,438	—	—	274	—	—	40,712
Amortization of intangibles	—	—	—	—	1,925	—	1,925
For the nine months ended September 30, 2007:							
Depreciation expense	$ 68	$ 9	$ 4,625	$ 279	$ 367	$ 1,474	$ 6,822
Amortization of MSRs	81,198	—	—	612	—	—	81,810
Amortization of intangibles	—	—	—	—	820	—	820

(3) Corporate Items and Other operating expenses for 2008 include $9,532 of due diligence and other costs recognized in the first quarter related to the “going private” proposal terminated in March 2008, by mutual agreement of the parties.

NOTE 18 COMMITMENTS AND CONTINGENCIES

Litigation

The liability, if any, for the claims noted below against Ocwen Federal Bank FSB (the “Bank”) has been assumed by OLS as successor in interest under an Assignment and Assumption Agreement, dated June 28, 2005, whereby OLS assumed all of the Bank’s remaining assets and liabilities, including contingent liabilities, in connection with its voluntary termination of its status as a federal savings bank.

On April 13, 2004, the United States Judicial Panel on Multi-district Litigation granted our petition to transfer and consolidate a number of lawsuits against the Bank, OCN and various third parties arising out of the servicing of plaintiffs’ mortgage loans into a single case to proceed in the United States District Court for the Northern District of Illinois under caption styled: In re Ocwen Federal Bank FSB Mortgage Servicing Litigation, MDL Docket No. 1604 (the “MDL Proceeding”). Currently, there are approximately 63 lawsuits against the Bank and/or OCN consolidated in the MDL Proceeding involving 91 mortgage loans that we currently service or previously serviced. Additional similar lawsuits

have been brought in other courts, some of which may be transferred to and consolidated in the MDL Proceeding. The borrowers in many of these lawsuits seek class action certification. Others have brought individual actions. No class has been certified in the MDL Proceeding or any related lawsuits. On May 19, 2006, plaintiffs filed an Amended Consolidated Class Action Complaint ("Amended Complaint") containing various claims under federal statutes, including the Real Estate Settlement Procedures Act, Fair Debt Collection Practices Act and bankruptcy laws, state deceptive trade practices statutes and common law. The claims are generally based on allegations of improper loan servicing practices, including (i) charging borrowers allegedly improper or unnecessary fees such as breach letter fees, hazard insurance premiums, foreclosure-related fees, late fees, property inspection fees and bankruptcy-related fees; (ii) untimely posting and misapplication of borrower payments; and (iii) improperly treating borrowers as in default on their loans. While the Amended Complaint does not set forth any specific amounts of claimed damages, plaintiffs are not precluded from requesting leave to amend further their pleadings or otherwise seek damages should the matter proceed to trial. On April 25, 2005, the trial court entered an Opinion

and Order granting the Bank partial summary judgment finding that, as a matter of law, the mortgage loan contracts signed by plaintiffs authorize the imposition of breach letter fees, foreclosure-related fees and other legitimate default-related fees. The trial court explained that its ruling was in favor of defendants to the specific and limited extent that plaintiffs' claims challenge the propriety of the above-mentioned fees. On May 16, 2006, after having denied a motion to dismiss based on federal preemption, the trial court granted our motion to take an interlocutory appeal on the issue. On July 29, 2006, the United States Court of Appeals for the Seventh Circuit granted our request to hear the appeal. On June 22, 2007, the Seventh Circuit issued its opinion holding that many of the claims were preempted or failed to satisfy the pleading requirements of the applicable rules of procedure and directing the trial judge to seek clarification from the plaintiffs regarding various aspects of the Amended Complaint so as to properly determine which particular claims are to be dismissed. On September 24, 2007, plaintiffs filed their Second Amended Complaint, which contains servicing practices allegations similar to those set forth in the prior version of their Complaint. On November 13, 2007, we filed a motion to dismiss the Second Amended Consolidated Class Action Complaint on the grounds that the claims are preempted and are deficient as a matter of law. On October 31, 2008, a status conference was held by the Court in which the Court set a briefing schedule in respect of Defendant's motion to dismiss the Second Amended Class Action Complaint and ordered limited discovery. We believe the allegations in the MDL Proceeding are without merit and, if an acceptable settlement is not reached, will continue to vigorously defend against them.

On November 3, 2004, the trial judge in litigation brought by Cartel Asset Management, Inc. ("Cartel") against OCN, the Bank and Ocwen Technology Xchange, Inc. ("OTX"), a subsidiary that has been dissolved, in federal court in Denver, Colorado, entered final judgment in the amount of $520 against OTX and nominal damages of two dollars against the Bank. In so doing, the judge reduced a prior jury verdict in the amount of $9,320 after trial on this matter involving allegations of misappropriation of trade secrets and contract-related claims brought by a former vendor. Notwithstanding the nominal damage award against the Bank, it was assessed a statutory award to Cartel of attorneys' fees in an additional amount of $170, and the Bank and OTX were further assessed costs in the amount of $9. On September 18, 2007, the United States Court of Appeals for the Tenth Circuit upheld the damage award against OTX and remanded the case for a new trial on damages against the Bank. On December 10, 2007, we paid the full amount of the judgment against OTX, including accrued interest. On March 24, 2008, the trial court entered an order joining OLS, in its capacity as the Bank's successor-in-interest, and OCN, in its capacity as guarantor of the Bank's obligations, as additional defendants. The trial court has not yet set a date for the new trial against the Bank, OLS and OCN.

On September 13, 2006, the Bankruptcy Trustee in Chapter 7 proceedings involving American Business Financial Services, Inc. ("ABFS") brought an action against multiple defendants, including OLS, in Bankruptcy Court in Delaware. The action arises out of Debtor-in-Possession financing to ABFS by defendant Greenwich Capital Financial Products, Inc. and the subsequent purchases by OLS of MSRs and certain residual interests in mortgage-backed securities previously held by ABFS. OLS brought a separate action against the Trustee, in his representative capacity, seeking damages of approximately $2,500 arising out of the ABFS MSRs purchase transaction. OLS' separate action against the Trustee was dismissed by agreement without prejudice with the right to replead such claims as counterclaims in the Trustee's action or otherwise as a separate action should the Trustee's action be dismissed. By opinion dated February 13, 2007, the Court granted OLS' motion to dismiss some claims but refused to dismiss others. The Court allowed the Trustee leave to file an Amended Complaint, which the Trustee filed on March 13, 2007. The Amended Complaint sets forth claims against all of the original defendants and as against OLS alleges turnover, fraudulent transfers, accounting, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, breach of contract, fraud, civil conspiracy and conversion. The Trustee seeks compensatory damages in excess of $100,000 and punitive damages jointly and severally against all defendants. On March 20, 2008, the Court denied OLS' motion to dismiss. On April 28, 2008, OLS answered the Amended Complaint denying all charges and filed a Counterclaim for breach of contract, fraud, negligent misrepresentation and indemnification in connection with the MSR purchase transaction. Discovery is in progress. We believe that the Trustee's allegations against OLS are without merit and intend to continue to vigorously defend against this matter.

OCN is subject to various other pending legal proceedings. In our opinion, the resolution of these proceedings and those noted above will not have a material effect on our financial condition, results of operations or cash flows.

Tax matters

On December 28, 2006, the India tax authorities issued an income tax assessment order (the "Order") with respect to IT Enabled services performed for OCN by its wholly-owned Indian subsidiary, OFSPL. The Order relates to the assessment year 2004-05 and determined that the percent mark-up on operating costs with respect to the IT enabled and software development services that OFSPL provided to OCN was insufficient. The proposed adjustment would impose upon OFSPL additional tax of INR 45,290 ($965) and interest of INR 14,922 ($318) for the Assessment Year 2004-05. In accordance with standard Indian procedures, penalties may also be assessed in the future in connection with the assessment.

OCN and OFSPL intend to vigorously contest the Order and the imposition of tax and interest and do not believe they have violated any statutory provision or rule. OFSPL has filed a domestic appeal with the India Commissioner of Income Tax (Appeals) in response to the Order, and on March 16, 2007, OCN filed a request for Competent Authority Assistance with the Internal Revenue Service under the United States – India Income Tax Treaty.

In January 2007, OFSPL received an additional notice from the India tax authorities regarding a transfer pricing review of the Assessment Year 2005-06. On September 3, 2007, OFSPL filed a detailed response to the additional notice. This response is currently being reviewed by the India tax authorities. On October 23, 2007, the India Central Board of Direct Taxes issued an instruction stating that all demands for payments raised on disputes that are pending resolution in competent authority proceedings will be stayed. Due to the uncertainties inherent in the Appeals and Competent Authority processes, OCN and OFSPL cannot currently estimate any additional exposure beyond the amount detailed in the Order. We

can also not predict when these tax matters will be resolved. The Competent Authority Assistance filing should preserve OCN's right to credit any potential India taxes against OCN's U.S. taxes.

NOTE 19 SUBSEQUENT EVENTS

A $300,000 variable funding note under one of our match funded advance facilities was scheduled to enter its amortization period in November 2008. On October 30, 2008, we entered into an agreement to extend the amortization date of this note by one month to December 3, 2008.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in thousands, except share data)

The following discussion of our results of operations, consolidated financial condition and capital resources and liquidity should be read in conjunction with our Interim Consolidated Financial Statements and the related notes, all included elsewhere in this Quarterly Report on Form 10-Q.

RISK FACTORS AND CRITICAL ACCOUNTING POLICIES

Risk Factors

We include a discussion of the principal risks and uncertainties that affect or could affect our business operations under Item 1A on pages 7 through 10 of our Annual Report on Form 10-K for the year ended December 31, 2007. In response to recent adverse events in the financial markets, we have updated our discussion of the following risk factors:

Continued economic slowdown and/or continued deterioration of the housing market could increase delinquencies, defaults, foreclosures and advances and could reduce the market for loan servicing rights and origination processing services. During any period in which the borrower is not making payments, we are required under most of our servicing agreements to advance our own funds to meet contractual principal and interest remittance requirements for investors, pay property taxes and insurance premiums and process foreclosures. We also advance funds to maintain, repair and market real estate properties on behalf of investors. We are entitled to recover advances from borrowers for reinstated and performing loans and from investors for foreclosed loans. Advance requirements have increased in 2007 primarily as a result of higher delinquencies and slower prepayments, which has led to higher interest expense on the financing of advances.

An increase in the balance of advances outstanding relative to the change in the size of the servicing portfolio can result in substantial strain on our financial resources. This occurs because excess growth of advances increases financing costs with no offsetting increase in revenue, thus reducing profitability. If we are unable to fund additional advances, this could cause us to breach the requirements of our servicing contracts. Such developments could result in our losing our servicing rights, which would have a substantial negative impact on our financial condition and results of operations and could trigger cross-defaults under our various credit agreements.

The significant decline in subprime originations in 2007 and 2008 has had and may continue to have an adverse impact on our ability to maintain or expand further our servicing portfolio. The current period of economic slowdown has been accompanied by a significant decrease in the demand for consumer credit and a reduction in the number of new loans available for servicing and the demand for origination processing services.

We may be unable to obtain sufficient capital to meet the financing requirements of our business. Our financing strategy includes the use of significant leverage. Accordingly, our ability to finance our operations rests in large part on our ability to borrow money. Our ability to borrow money is affected by a variety of factors including:

- limitations imposed on us by existing lending and similar agreements that contain restrictive covenants that may limit our ability to raise additional debt;
- the recent decline in liquidity in the credit markets due in part to the recent turmoil in the subprime mortgage market; and
- the strength of the lenders from whom we borrow.

Our senior secured credit facility was the only source of debt that was available to fund the purchase of MSRs, and it matured in August 2008. In August 2008, we repaid the borrowings under the facility that were secured by advances and converted our remaining borrowings that were secured by MSRs to a term note that matures in February 2010. As a result, our ability to borrow funds to purchase MSRs has substantially decreased. Although we may be able to renew or replace this facility, we are taking steps to provide alternatives to this financing. An event of default, a negative ratings action by a rating agency, the perception of financial weakness, an adverse action by a regulatory authority or a general deterioration in the economy that constricts the availability of credit may increase our cost of funds and make it difficult for us to renew existing credit facilities and obtain new lines of credit. We are currently exploring other methods of raising capital, including bank financing, partnerships with private equity investors, conduit financing or equity or debt offerings. We cannot predict whether any additional financing will be available at all or on acceptable terms.

Our advance facilities are revolving facilities, and in a typical monthly cycle, we repay up to one-third of the borrowings under these facilities from collections. During the remittance cycle, which starts in the middle of each month, we depend on our lenders to provide the cash necessary to make remittances to the Servicing investors where such new advances represent eligible collateral under our advance facilities. If one or more of these lenders were to fail, we may not have sufficient funds to meet our obligations.

Our success is dependent upon our ability to acquire and accurately price MSRs. The primary risk associated with MSRs is that they will lose a portion of their value because of the higher than anticipated prepayments that may be occasioned by declining interest rates or rapidly increasing housing prices. Interest rates, prepayment speeds and the payment performance of the underlying loans significantly affect both our initial and ongoing valuations and the rate of amortization of MSRs. In general, the value of mortgage servicing assets is affected by increased mortgage refinance activity that is, in turn, influenced by changes in borrower credit ratings, shifts in value in the housing market and changes in interest rates.

We acquire servicing rights principally from investment banks and mortgage origination companies. We typically acquire servicing rights through a competitive bidding process. Although the market for the acquisition of servicing rights to subprime mortgage loans grew through 2006, this market slowed dramatically in 2007 and has continued to do so in 2008.

For the remainder of 2008, we do not expect to make any material additions to our servicing rights portfolio unless sufficient advance financing is available other than through the acquisition of special servicing. If this does not occur, and we do not win substantial new subservicing business, our revenues may decline as a result of the net runoff of the portfolio. As a result, we may be unable to acquire sufficient MSRs in future periods to sustain growth or even to maintain our current level of business. In addition, the volume of servicing rights that we acquire may vary over time resulting in significant inter-period variations in our results of operations.

In determining the purchase price for servicing rights, management makes assumptions regarding the following, among other things:

- the rates of prepayment and repayment within the underlying pools of mortgage loans;
- projected rates of delinquencies and defaults;
- amounts of future servicing advances;
- our cost to service the loans;
- ancillary fee income; and
- future interest rates.

If these assumptions are inaccurate or the bases for the assumptions change, the price we pay to acquire servicing rights may prove to be too high. This could result in lower than expected profitability or a loss. Therefore, our success is highly dependent upon accurate pricing of servicing rights.

Critical Accounting Policies

Our ability to measure and report our operating results and financial position is heavily influenced by the need to estimate the impact or outcome of risks in the marketplace or other future events. Our critical accounting policies are those that relate to the estimation and measurement of these risks. Because they inherently involve significant judgments and uncertainties, an understanding of these policies is fundamental to understanding Management’s Discussion and Analysis of Results of Operations and Financial Condition. Our significant accounting policies are discussed in detail on pages 21 through 23 of Management’s Discussion and Analysis of Results of Operations and Financial Condition and in Note 1 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. Other than the adoption of SFAS No. 157, there have been no material changes to this information during 2008. As disclosed in Notes 2 and 3 to the Interim Consolidated Financial Statements, we adopted SFAS No. 157 on January 1, 2008. SFAS No. 157 defines fair value and establishes a framework for measuring fair value in GAAP.

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;
- expectations on the growth of our servicing portfolio;
- assumptions about our ability to grow our business;
- our plans to continue to sell our Vestigial Assets;
- our ability to establish additional asset management vehicles;

- our ability to reduce our cost structure;
- 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 following:

- availability of adequate and timely sources of liquidity,
- delinquencies, advances and availability of servicing,
- general economic and market conditions,
- uncertainty related to market conditions and government programs,
- governmental 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, 2007 and our Forms 10-Q and 8-K filed during 2008. 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.

EXECUTIVE SUMMARY

Strategic Goals and Initiatives

Ocwen Financial Corporation is a business process outsourcing (“BPO”) provider to the financial services industry specializing in loan servicing and receivables management services. Our primary goal is to make our clients’ loans worth more by leveraging our superior processes, innovative technology and high quality, cost effective global human resources. In a recent comparison by Moody’s of servicer performance in servicing non-performing loans, Moody’s determined that we had a “cure and cash flowing rate” that exceeded the average rate for Moody’s highest-rated servicers as a group. Our high cure rate demonstrates that we are among the leaders in our industry in realizing loan values for investors and in keeping Americans in their homes.

Effective January 1, 2008, we realigned our business segments in conjunction with implementing our revised business strategy. Our current business segments, aligned within our two lines of business, are as follows:

Ocwen Asset Management	**Ocwen Solutions**
Servicing	Technology Products
Loans and Residuals	Mortgage Services
Asset Management Vehicles (“AMV”)	Financial Services

In addition to our core residential servicing business, Ocwen Asset Management or “OAM” includes our equity investments in asset management vehicles and our remaining investments in subprime loans and residual securities. Asset management vehicles were previously included in the former Residential Servicing segment. Subprime loans and residuals were components of the former Residential Origination Services segment.

In addition to our unsecured collections business, Ocwen Solutions or “OS” includes our residential fee-based loan processing businesses, all of our technology platforms and our equity interest in BMS Holdings. These fee-based businesses were previously part of the Residential Origination Services segment, and the results of BMS Holdings were included in Corporate Items and Other. OS can best be described as a “knowledge process outsourcer.” Our competitive advantage, which is similar to that of our Servicing business, is our ability to migrate high value, knowledge-based job functions to low cost global platforms while utilizing artificial intelligence, scripting engines, decisioning models and workflow management to improve quality through the elimination of variability. Our plans are to continue to sell the Vestigial Assets, including the German bank, or to finance them. In November 2008, our Board of Directors authorized management to investigate the possible sale of our remaining GSS partnerships. For the nine months ended September 30, 2008, we have raised $20,000 through such sales and financings of Vestigial Assets and have redirected these funds to our core businesses.

Three key issues for Ocwen are as follows:

1. Spinning Ocwen Solutions as a separate company
2. Liquidity and
3. New business.

We are currently conducting an internal analysis to determine whether it would be beneficial to spin Ocwen Solutions as a separate, publicly traded company. We are considering the following benefits in our analysis:

- Ocwen Solutions would be better positioned to pursue business opportunities with other servicers.
- The spin would allow potential investors to choose between the contrasting business models of servicing versus business process outsourcing. Each business model is valued differently by the equity markets.

- The spin would allow Ocwen Solutions flexibility in creating its own capital structure and would allow for a subsequent capital raise when equity markets recover.

- Ocwen Solutions would have the option of offering its stock as consideration to potential acquisition targets.

As for liquidity and new servicing business, we have five key initiatives ranked from highest to lowest in terms of our ability to control the outcome:

First, we are currently in an environment where banks are worried about their own liquidity and capital requirements. We believe that it will take time for banks to repair their balance sheets and for the recent Treasury actions to be effective. During this time of uncertainty, we are continuing to right size our business to the financing currently available to us. While we continue to explore alternative sources of financing, we believe that it is prudent to operate our business assuming that we will receive no new financing and that no existing financing lines will be renewed. Assuming no counterparty failure, we believe that we have sufficient liquidity to sustain our business.

Second, although we currently hold a 60% cost advantage in servicing non-performing loans; we cannot rest on our laurels if we are to maintain profitability with a declining portfolio. Currently, we are rolling out the next generation of technology and processes for a step function improvement in cost and quality. Through the elimination of variability in our processes, we can grow our industry leading position of keeping more people in their homes, generating greater cash flow for investors and reducing costs. First, we are rolling out our next generation of scripting engines in conjunction with new scripts that we have developed. Second, we have enhanced our modeling engines that determine the optimal resolution strategy for each loan with newly expanded capabilities from our Analytics and Econometrics Departments. Our cost structure initiatives seek to improve quality and reduce costs through the automation of manual, repetitive or rules based processes.

Third, we will capture a greater share of third party revenues. We expect to replace certain third party vendors in providing services on behalf of our trustees, including real estate sales, title services, property inspection and preservation and homeowner outreach. This initiative requires little to no capital.

Fourth, we believe that the current environment affords Ocwen a unique opportunity to capitalize upon its best in class loss mitigation capabilities. Accordingly, we are working with guarantors and owners of mortgages to provide special servicing where we accept a reduced servicing fee but share in the savings as compared to their existing servicers' performance. Savings would be measured by a control group of loans remaining with their existing servicer. Two positives associated with this program are: one, if we are able to maintain our current level of performance vis-à-vis other servicers, profitability per UPB should be greater than a standard servicing fee; two, this program requires little to no capital. The negative to this program is that earnings under GAAP will occur at later performance hurdles.

Finally, a great deal of senior management's time is focused on financing. The majority of our balance sheet is comprised of advances which have an imputed if not actual AAA rating, are short term in duration and for which cost approximates fair value. When the credit markets become liquid, advances should be a highly fungible asset. The first firm to be able to expand its financing has a unique opportunity to acquire other platforms. Therefore, we are working hard on several different structures and sources of financing.

Results of Operations

Operating income for the third quarter of 2008 was $43,803, a $10,097, or 30%, improvement over the third quarter of 2007 as a result of a 15% decline in operating expenses partially offset by a 3% decline in revenues. Pre-tax income before discontinued operations for the third quarter of 2008 of $24,409 represents an increase of $14,267, or 141%, as compared to the third quarter of 2007. This improvement occurred primarily because of a loss of $8,673 that we incurred in the third quarter of 2007 on the early termination of long-term discounted certificates of deposit and a $3,685 decline in losses on loans held for resale in the third quarter of 2008, partially offset by a $6,465 decline in earnings of unconsolidated entities. Net income was $15,561 for the third quarter of 2008, a $9,610 increase as compared to the third quarter of 2007.

In Servicing, our largest and most profitable segment, the trend of stabilizing delinquencies and declining advance receivables that we began to see in the second quarter of 2008 has continued in the third quarter. This is due to a decline in the UPB of loans that we service for others aided by our success in stabilizing the delinquency rate of these loans. Management initiatives that are designed to maximize the return to the loan investors resulted in increased loan modifications and faster sales of foreclosed real estate and were the primary factor in stabilizing delinquencies. The number of non-performing loans serviced has fallen in each of the first three quarters of 2008, declining by 5,707, 4,678 and 4,155 loans in the first, second and third quarters, respectively. The UPB of non-performing loans as a percentage of the portfolio serviced increased slightly during the third quarter to 22.7% at September 30, 2008 from 22.4% at June 30, 2008. Servicing advances declined by 11% during the third quarter of 2008 and by 15% year to date. Interest expense on borrowings of the Servicing segment for the third quarter of 2008 was 12% lower than the second quarter of 2008, the second consecutive quarterly decline in 2008. Servicing and subservicing fees, excluding float and ancillary income, declined by 6% in the third quarter of 2008 as compared to the second quarter of 2008 due to the decline in UPB serviced. Prepayment speeds averaged 26% in the third quarter of 2008 as compared to 22% in the third quarter of 2007. Prepayment speed has increased in 2008 due to a larger number of real estate sales. Such involuntary liquidations accounted for approximately 75% of prepayments during the third quarter of 2008 as compared to approximately 25% for the third quarter of 2007. We expect prepayment speed to decline in the future as the number of loans in foreclosure and properties awaiting liquidation decrease. Another factor expected to contribute to a decline in prepayment speed is an increase in the fixed rate portion of our loan portfolio as ARM loans continue to prepay at a faster rate and become a smaller portion of total loans.

The following table summarizes our consolidated operating results for the periods ended September 30, 2008 and 2007. We have provided a more complete discussion of operating results by line of business in the Segments section beginning on page 34.

	Three months			Nine months		
	2008	2007	% Change	2008	2007	% Change
Consolidated:						
Revenue	$ 121,261	$ 125,350	(3)	$ 380,737	$ 357,259	7
Operating expenses	77,458	91,644	(15)	246,799	263,100	(6)
Income from operations	43,803	33,706	30	133,938	94,159	42
Other income (expense), net	(19,394)	(23,564)	(18)	(92,645)	(22,679)	309
Income from continuing operations before taxes	24,409	10,142	141	41,293	71,480	(42)
Income tax expense	8,662	3,882	123	14,119	25,015	(44)
Income from continuing operations	15,747	6,260	152	27,174	46,465	(42)
Loss from discontinued operations, net of taxes	(186)	(309)	(40)	(5,572)	(943)	491
Net income	$ 15,561	$ 5,951	161	$ 21,602	$ 45,522	(53)
Segment income (loss) from continuing operations before taxes:						
Servicing	$ 29,324	$ 20,400	44	$ 82,976	$ 52,995	57
Loans and Residuals	(502)	(2,914)	(83)	(9,562)	19,778	(148)
Asset Management Vehicles	(3,643)	1,499	(343)	(6,762)	1,340	(605)
Technology Products	2,057	2,426	(15)	635	6,028	(89)
Mortgage Services	2,788	4,020	(31)	9,942	8,153	22
Financial Services	(3,816)	(2,901)	32	(6,387)	(4,375)	46
Corporate Items and Other	(1,799)	(12,388)	(85)	(29,549)	(12,439)	138
	$ 24,409	$ 10,142	141	$ 41,293	$ 71,480	(42)

Ocwen Asset Management

Servicing continues to be our most profitable segment, despite absorbing the negative impact of higher delinquencies, lower float balances and increased interest expense that was driven by our need to finance higher servicing advance balances. Lower amortization of MSRs due to higher projected delinquencies and declines in both projected prepayment speeds and the average balance of MSRs offset these negative effects. We expect delinquency rates to remain flat which will lead to further reductions in advances as our seasoned portfolio matures. The 2008 results for Loans and Residuals continue to be impacted by declining values, although to a lesser degree in the third quarter because of resolutions of non-performing assets. The 2007 results for Loans and Residuals include a gain on the sale of the UK residuals in the second quarter. The 2008 results for Asset Management Vehicles primarily reflect our approximately 25% share of the net losses incurred by OSI and ONL and affiliates largely resulting from charges to reduce loans, real estate and residual securities to their fair values.

Ocwen Solutions

The year to date 2008 results for Technology Products include our approximately 46% share of the losses of BMS Holdings that primarily reflect unrealized losses on auction rate securities. We suspended the equity method of accounting for our investment in BMS Holdings when our share of accumulated losses reduced the investment to zero. Since BMS Holdings reported additional losses for the third quarter, we have

not resumed the equity method. BMS Holdings reported profits for the third quarter and first nine months of 2007. The results of the Mortgage Services segment in 2008 primarily reflect declines in revenues as a result of declining loan originations volumes. Because of our success in reducing operating expenses, the operating margin percentage for the 2008 periods was unchanged in the third quarter and improved for the year to date. The results for Financial Services include the operations of NCI, which we acquired on June 6, 2007.

Corporate Items and Other

Corporate Items and Other results for 2008 include unrealized losses on auction rate securities in both the first and second quarters, a gain on the repurchase of debt securities in the second quarter and expenses related to the terminated "going private" transaction in the first quarter. The 2007 results for Corporate Items and Other include the loss on the redemption of long-term discounted certificates of deposit in the third quarter.

Consolidated

Total revenues declined by $4,089, or 3%, in the third quarter of 2008 as compared to the third quarter of 2007 principally because of a decline in Mortgage Services revenue partially offset by an increase in Servicing revenue. Revenue of the Mortgage Services segment declined by $6,659, or 35%, primarily because of the low volume of loan origination activity, the scaling back of our mortgage due diligence activities and the sale of our international servicing rights during the second quarter of 2008. Revenue of the Servicing segment increased by $2,785, or 3%, primarily due to increases in late charges and commissions from sales of foreclosed real estate, offset partly by declines in float earnings and servicing fees. Late

charges, which are not recognized as revenue until collected, have increased to normal levels as delinquency rates have stabilized. Float earnings declined because of lower interest rates and lower average float balances because of higher delinquencies and a smaller servicing portfolio.

Total operating expenses were $14,186, or 15%, lower in the third quarter of 2008 as compared to the third quarter of 2007. Operating expenses of the Servicing segment declined by $9,879, or 20%, primarily due to a $9,702 decline in the amortization of MSRs. Slower projected prepayment speeds and higher projected delinquency rates used to compute amortization expense for the 2008 periods have reduced the rate of MSR amortization as we expect to earn servicing income for a longer period of time. In addition, the average balance of our investment in MSRs has declined in 2008 as a result of fewer acquisitions. Operating expenses of the Mortgage Services segment declined by $5,141, or 35%, largely because of the low volume of loan origination activity and the scaling back of our mortgage due diligence activities.

Income from operations for the third quarter of 2008 improved by $10,097, or 30%, as compared to the third quarter of 2007, including a $12,664, or 38%, improvement in the Servicing segment.

Other expense, net for the third quarter of 2008 and 2007 was $19,394 and $23,564 respectively, a favorable variance of $4,170. This improvement is the result of several factors, primarily the loss on the early redemption of certificates of deposit in the third quarter of 2007 and a decline in losses on loans held for resale, offset by a decline in our share of earnings of unconsolidated entities and a decline in interest income:

- In the Loans and Residuals segment, charges to write-off or reduce loans to fair value were $3,685 lower in the third quarter of 2008. This was partially offset by a $1,346 decline in interest income on loans and residual securities.
- In the AMV segment, our consolidated share of the losses of OSI and ONL and affiliates for the third quarter of 2008 was $2,928 as compared to earnings of $1,169 for the third quarter of 2007. The losses in the third quarter of 2008 reflect charges to reduce residual securities, loans and real estate to fair value.
- In the Technology Products segment, our share of the earnings of BMS Holdings was zero in the third quarter of 2008 as compared to $2,368 in the third quarter of 2007. We suspended the equity method of accounting for our investment in the second quarter of 2008 when our investment was reduced to zero as a result of significant unrealized losses on derivative financial instruments and auction rate securities. BMS' unrealized gains on derivatives in the first quarter of 2008 were largely reversed in the second quarter. The derivatives held at BMS are intended to hedge against the effects of a decline in interest rates on BMS' revenue earned through its deposit referral relationship.
- In Corporate Items and Other, we realized a loss of $8,673 in the third quarter of 2007 on the early termination of long-term discounted certificates of deposit.

Changes in Financial Condition

Total assets declined by $92,281, or 4%, in the first nine months of 2008. This decrease was due to declines in all asset categories other than trading securities and cash:

- Advances and match funded advances declined by $208,006 due to declining UPB serviced and a stabilization of the rate of loan delinquencies.
- Although the rate of amortization has slowed, mortgage servicing rights declined by $47,061 largely because of the relatively small additions to our residential servicing portfolio. We sold our commercial MSRs, which had a carrying value of $5,360 at December 31, 2007, during the second quarter of 2008.
- Investment in unconsolidated entities declined by $43,980 primarily due to $32,748 of distributions received from our ass