UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76074 / October 5, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3713 / October 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16882

In the Matter of **Home Loan Servicing Solutions, Ltd.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Home Loan Servicing Solutions, Ltd. ("HLSS") ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 21C of the Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. This matter involves two sets of misstatements made by HLSS from 2012 to 2014, one concerning related party transactions and the other concerning valuation of company assets. First, HLSS inaccurately disclosed that it had policies governing conflicts of interest inherent in related party transactions, which included the recusal of its Chairman of the Board (the "Chairman") from negotiating and approving transactions with related parties such as Ocwen Financial Corp. ("Ocwen"), for which the Chairman also served as Executive Chairman. Second, HLSS's erroneous valuations of its primary asset, contributed to HLSS misstating its financial results for the years 2012 and 2013 and the first quarter of 2014. These misstatements resulted from an internal accounting controls failure that allowed the company to adopt a valuation methodology that did not conform to U.S. Generally Accepted Accounting Principles ("GAAP").

2. In its Forms 10-K and 10-KA for the year 2013, HLSS disclosed in the 1A "Risk Factors" section that it had "adopted policies, procedures and practices to avoid potential conflicts with respect to [its] dealings with [Ocwen and other related entities], including [the Chairman] recusing himself from negotiations regarding, and approvals of, transactions with these entities." In the "Business and Related Transactions" section of two 14A proxy statements filed in 2013 and 2014 and incorporated in the Part III Item 10 Section headed "Directors, Executive Officers and Corporate Governance" of its Forms 10-K for the years 2012 and 2013, HLSS likewise disclosed, "Due to the nature of [the Chairman's] obligations to each of the [related entities], he recuses himself from decisions pertaining to related transactions." The purpose of these disclosures was to assure investors that HLSS was safeguarding against potential conflicts due to the Chairman's role as Chairman of Ocwen and other related entities as well as HLSS. Because of HLSS's unique relationship with Ocwen, from which HLSS purchased all of its assets of significance and to which it provided services, the potential for conflicts was a major concern for investors.

3. Contrary to its public disclosures, HLSS had no written policies or procedures concerning recusals for related party transactions. And, although the Chairman had a practice of recusing himself from certain negotiations and approvals of related party transactions, that practice was inconsistent and ad hoc. As a result, HLSS failed to devise and maintain its disclosed internal accounting controls to prevent potential conflicts of interest in its related party transactions. Due to these control failures, the Chairman approved many transactions between HLSS and Ocwen in both his HLSS- and Ocwen-related capacities. Also, due to other internal accounting control

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

deficiencies, for three transactions in late 2013 and early 2014, HLSS had no documentation of approvals.

4. Separately, HLSS misstated its net income for the years 2012 and 2013 and the first quarter of 2014 by adopting an accounting methodology that did not conform to GAAP relating to the valuation of HLSS's most significant asset – rights to mortgage servicing rights ("Rights to MSRs") purchased from Ocwen. HLSS publicly disclosed that it valued these Rights to MSRs at fair value; however, it assigned them a value that was equivalent to their carrying value, and not to its best estimate of fair value, so long as the price reflected in the carrying value was within 5 percent of the price reflected in a fair value estimate provided by a third party. The Chairman warned HLSS senior management that this valuation methodology would inevitably result in differences between the carrying value and the third party fair value estimate that, while within 5 percent, were material to HLSS's financial statements. Despite this warning, HLSS's management and its Audit Committee failed to adequately review whether this valuation methodology complied with GAAP.

Respondent

5. HLSS is a Cayman Islands corporation with its principal executive offices in the Cayman Islands. HLSS's common stock became registered with the Commission pursuant to Section 12(b) of the Exchange Act in February 2012 and, from that date until approximately April 2015, traded on the NASDAQ Global Market. HLSS was founded by its Chairman in 2010 and conducted an initial public offering in February 2012. The Chairman owned 100 percent of HLSS's ordinary shares of common stock prior to the initial public offering, 5 percent after the offering, and approximately 1 percent between 2013 and 2014.

Other Relevant Entity

6. Ocwen is a Florida corporation with its principal place of business in Atlanta, Georgia. Ocwen's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange. Between 2012 and 2014, HLSS's Chairman served as Ocwen's Executive Chairman and owned approximately 13 percent of Ocwen's common stock.

Background

A. HLSS's Related Party Transactions

HLSS's Relationship with Ocwen

7. Ocwen is a servicer of mortgages that have been securitized and are owned by residential mortgage-backed securities trusts. As one of its obligations as a mortgage servicer, Ocwen advances funds to the trusts to cover payments missed by borrowers.

8. Ocwen's Executive Chairman sought to make Ocwen "capital-light" by creating HLSS and making it responsible for funding Ocwen's servicer advances. HLSS was to purchase Ocwen's mortgage servicing rights ("MSRs"), and thereby receive the future servicing fees owed to Ocwen in connection with those MSRs and, as a result of that purchase, would be responsible for funding servicer advances. As a part of this arrangement, HLSS would retain Ocwen as the subservicer for all mortgages underlying the Rights to MSRs purchased by HLSS. In addition to the Chairman, certain managers and members of the board of directors at Ocwen became executives and board members at HLSS.

9. Due to difficulties encountered with transferring title to the MSRs to HLSS, Ocwen retained title and HLSS agreed to purchase the Rights to the MSRs. On March 5, 2012, HLSS executed a master purchase agreement with Ocwen and completed an initial purchase of Rights to MSRs on mortgages with an unpaid principal balance ("UPB") of $15.2 billion. Simultaneous with the purchase, HLSS entered into a master subservicing agreement with Ocwen for these mortgages. Under this agreement, Ocwen serviced the mortgages, collected the servicing fees from borrowers and remitted the fees to HLSS. From the total servicing fees remitted, HLSS paid Ocwen a base fee for its services and a performance fee when Ocwen met certain targets for advance levels. Because of his role at Ocwen, the Chairman recused himself from negotiating and voting on the approval of the master agreements and initial purchase.

<u>HLSS's Control Breakdowns Relating to Related Party Transactions</u>

10. There were no written policies or procedures governing when an officer or director with a conflict of interest was required to recuse himself from negotiating or approving a related party transaction. While the Chairman routinely recused himself from negotiations with Ocwen and recused himself from approvals of transactions in certain instances, including the master purchase and subservicing agreements and the initial purchase of Rights to MSRs, HLSS personnel never discussed the guidelines under which such recusal would be appropriate. This caused a number of control deficiencies.

11. First, the responsibility for determining whether recusal was appropriate was left largely to the person with the conflict of interest. There was no meaningful oversight of that person's determination.

12. Second, HLSS personnel lacked a clear understanding of when recusals were required. Although HLSS stated that it had "adopted policies, procedures and practices to avoid potential conflicts" present in related party transactions, several individuals within the company believed that recusals were needed only for significant transactions with related parties. Because there was never a discussion of the guidelines governing recusals, HLSS personnel never considered whether that belief was consistent with the company's public disclosures. Also, HLSS personnel had conflicting understandings of what types of transactions could qualify as significant, and they never attempted to reconcile these conflicting understandings. In addition, the Chairman believed that the need to approve transactions in the Cayman Islands for tax reasons may have been grounds

for not recusing himself. HLSS's disclosures, however, do not include this exception, and this belief was not given sufficient consideration internally.

13. Due to these control deficiencies, the practice at HLSS for recusals was not consistent with its public disclosures.

HLSS's Chairman Approved Transactions with Ocwen

14. After Ocwen and HLSS executed the master purchase and subservicing agreements, HLSS disclosed that it anticipated future growth through subsequent acquisitions of rights to Ocwen's MSRs. Accordingly, HLSS purchased additional Rights to MSRs from Ocwen through nine transactions (the "Flow Transactions") during 2012 and 2013. As HLSS's only asset of significance were Rights to MSRs purchased from Ocwen, these transactions were fundamental to its business.

15. While HLSS and Ocwen based the purchase price for the Rights to MSRs for each Flow Transaction on an appraisal by a third party valuation firm, other terms varied. For example, for each Flow Transaction, HLSS and Ocwen negotiated HLSS's retained fees, which were the servicing fees retained by HLSS from those collected and remitted to it by Ocwen after payment of the base and performance fees owed back to Ocwen. The retained servicing fee for each Flow Transaction was based on the agreed-upon advance target for Ocwen and other assumptions that were jointly set by HLSS and Ocwen such as the prepayment rate on the underlying loan balances, financing cost and advance borrowing rate.

16. HLSS personnel submitted proposals for these transactions to the Credit Committee for approval. Approval by the HLSS Credit Committee was necessary for a Flow Transaction to be approved by the HLSS Board of Directors and ultimately consummated. The Credit Committee was comprised of senior managers and directors appointed by HLSS's Board of Directors. The role of HLSS's Credit Committee, according to its charter, was to provide direction and oversight over all matters concerning HLSS's finance, investment, treasury and financial risk management. In addition to his other roles, the Chairman was a member of HLSS's Credit Committee and was also a member of Ocwen's Credit Committee, which performed an analogous role.

17. The routine process for the Credit Committee to review and approve transactions was to circulate a memorandum that presented analysis of the proposed price of the Rights to MSRs, the retained fees and the varying underlying assumptions. The memoranda circulated typically included a signature page to indicate approval by each of the committee members. The committee members either executed the signature pages or indicated their approval of the transactions by email.

18. In 2012, HLSS entered into five Flow Transactions with Ocwen totaling approximately $67.5 billion in UPB. The Chairman did not participate in the negotiations but approved all of these transactions in his capacity as a member of the HLSS Credit Committee.

19. In 2013, HLSS entered into four Flow Transactions with Ocwen totaling approximately $120 billion UPB. The Chairman recused himself from the first transaction but then approved the second one. Even when the Chairman recused himself, he still received the Credit Committee memorandum because, according to him, "I'm interested in valuation [and] I still thought I had the right to say, 'No, this isn't going to happen.'"

20. When the Chairman reviewed and approved these transactions, he typically did the same on the Ocwen side of the transactions either through Ocwen's Credit Committee or its Executive Committee which acted on behalf of the Board when it was not in session.

21. In 2014, the Chairman approved another type of transaction between Ocwen and HLSS concerning early buy-out loans, which are delinquent loans eligible for purchase by the mortgage servicer. In this transaction, HLSS purchased $672 million that comprised the most delinquent portion of a portfolio of early buy-out loans that Ocwen recently had purchased. In a February 2014 email addressed to members of both HLSS and Ocwen senior management, the Chairman approved this purchase on the condition that it did not trigger losses for HLSS.

HLSS Failure to Document Credit Committee Approvals

22. As to the latter two of the four Flow Transactions between HLSS and Ocwen in 2013, HLSS was unable to locate final executed Credit Committee memoranda or approving emails. Contemporaneous emails for the last of these transactions in October 2013, however, show a request to schedule a phone call for the Credit Committee to discuss the analysis contained in the memorandum and a subsequent modification of the retained servicing fee based on a change to an underlying assumption.

23. Documentation of HLSS's Credit Committee approval process again broke down in February 2014 in connection with the early buy-out loan purchase agreement between HLSS and Ocwen. HLSS was unable to locate any Credit Committee approvals for this transaction.

B. Improper Valuation of Rights to MSRs

24. HLSS's quarterly and annual filings with the Commission stated that its financial statements were prepared in accordance with GAAP. These filings also stated that HLSS recorded the Rights to MSRs that it purchased from Ocwen at fair value.

25. FASB Financial Accounting Standards Codification Topic 820 ("ASC 820") – Fair Value Measurements and Disclosures defines fair value as 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. Because Rights to MSRs are not frequently bought or sold, there rarely are observable market prices for them. Rights to MSRs are therefore considered to be a Level 3 asset in the fair value hierarchy, which are assets that do not have observable inputs for a fair value measurement. While Level 3 assets are more difficult to value, the fair value measurement

objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset.

26. HLSS retained a third party with expertise in valuing MSRs to calculate the fair value of its Rights to MSRs. Each quarter, the third party valuation firm performed an analysis of the Rights to MSRs and provided HLSS with a valuation report. The valuation reports included an estimate of fair value based on inputs that affected the fair value of the MSRs, such as then-current prepayment rates, pre-tax discount rates, and costs to service. This estimate was represented as a specific price that was reflected in basis points.[2] Multiplying this best-point estimate by the UPB for HLSS's Rights to MSRs would provide a fair value measurement for those Rights to MSRs. In a prefatory note, the valuation reports stated that a sale of the Rights to MSRs in an orderly market should not differ by more than 7.5, or in some instances 10, basis points from the best-point estimate provided.

27. In addition to the fair value measurement provided in the valuation report, HLSS independently determined the carrying value of its Rights to MSRs. As part of this determination, HLSS calculated an "Inception BPS," also reflected in basis points, by dividing the UPB of the mortgages underlying the MSRs as of the date of their acquisition by HLSS's purchase price of the Rights to MSRs. Over time, the UPB of the mortgages generally decreased as borrowers paid down their mortgages. At the end of each quarter, HLSS calculated the carrying value for the Rights to MSRs by multiplying the Inception BPS by the amount of the UPB as of the end of the quarter. This amortization was driven entirely by the decline in size of the mortgages' UPB and did not consider any of the various factors that would also affect a fair value measurement.

<u>HLSS's Valuation Methodology</u>

28. Because the value of the MSRs for which HLSS had obtained the rights historically had been fairly stable, HLSS developed a valuation methodology that used the carrying value of the Rights to MSRs as the presumptive fair value measurement. This methodology was reviewed by HLSS's external auditors. For each reporting date, HLSS compared the carrying value of its Rights to MSRs (as calculated above) to the third party valuation report's best-point estimate and would record an adjustment to the value of the Rights to MSRs, which HLSS disclosed reflected fair value, only if there was a variation in price of at least 5 percent.

29. To illustrate, the third party valuation firm provided a report with a valuation date of November 29, 2013 estimating the price of HLSS's Rights to MSRs, which had underlying mortgages with an UPB of approximately $159.56 billion, at 37.08 basis points. Multiplying the UPB by the estimated price, the third party valued the Rights to these MSRs at approximately $592 million. Under HLSS's valuation methodology, HLSS would apply 5 percent bands around the third party valuation firm's best-point estimate of 37.08 basis points, which would create a range from 35.23 basis points (5 percent below) to 38.93 basis points (5 percent above), and would report

[2] A basis point is one hundredth of one percent.

the carrying value of its Rights to MSRs as their fair value so long as the carrying value was within the range of values created by the 5 percent bands. In other words, so long as HLSS's carrying value was within approximately $562 million (35.23 basis points multiplied by the UPB) and approximately $621 million (38.93 basis points multiplied by the UPB), it would report the carrying value as fair value. Based on HLSS's financial results for the fourth quarter of 2013, this approximately $56 million range was equivalent to 75 percent of its total revenues and 148 percent of its net income.

30. The valuation of Rights to MSRs was listed as a "Critical Accounting Policy" in HLSS's quarterly and annual filings and was highly important to investors. In fact, HLSS repeatedly emphasized the stability of its valuations and its limited asset valuation risk at investor presentations, in press releases, and during earnings calls.

<u>HLSS's Internal Accounting Controls Deficiencies Relating to Valuation</u>

31. Neither HLSS's management nor its Audit Committee adequately reviewed or considered HLSS's valuation methodology for the Rights to MSRs.

32. Before HLSS implemented the valuation methodology, the Chairman perceived a problem with it. Because the 5 percent bands created a very large range in terms of dollars, HLSS easily could have had a difference between the carrying value of the Rights to MSRs and their best-point estimate that was both material to the company's reported results and still within the 5 percent bands. Consequently, the Chairman concluded "the math would never work" and expressed his concerns to a member of HLSS senior management. The Chairman explained to this member of senior management, "if you have a 5 percent change in the asset, you're going to blow through [the threshold for materiality] so fast, it's almost a fait accompli at that particular point." To the Chairman, this problem was apparent from the beginning. As he later commented on the lack of appreciation on this point, "when you launch a ship . . . , the ship is going to hit the water, [so] don't expect the hull to not get wet."

33. The Chairman's concerns were not shared with the rest of HLSS senior management before, during, or after the implementation of the valuation methodology.

34. The Audit Committee of HLSS's Board of Directors also failed to give sufficient consideration to the valuation methodology. The Audit Committee's charter provides that it shall:

> (j) Review with management, the Company's independent auditors and the director of the Company's internal auditing department, the following:
>
> (i) critical accounting policies and such other accounting policies of the Company as are deemed appropriate for review by the Committee prior to any interim or year-end filings with the SEC or other regulatory body, including any

> financial reporting issues which could have a material impact on the Company's financial statements . . . .

35. HLSS's Audit Committee did not review the valuation methodology with HLSS's external auditors, had no discussions of substance concerning the development of the valuation methodology with HLSS management, were not provided any documentation explaining the valuation methodology, and were not apprised of the Chairman's concerns. As a result, the Audit Committee did not consider whether the valuation methodology was an appropriate fair value measurement under GAAP, nor did it consider whether the valuation methodology could result in a variance between the third party valuation firm's best-point estimate and the carrying value that was material to HLSS's reported results.

<u>HLSS Applied Its Valuation Methodology and Then Restated Its Financials</u>

36. The best-point estimate in the valuation reports fluctuated from quarter to quarter; however, under its valuation methodology, HLSS did not make any adjustment to the fair value of its Rights to MSRs because the Inception BPS used to calculate carrying value did not differ by 5 percent or more from the best-point estimate.

37. HLSS revisited the use of the valuation methodology in 2014 and, with the involvement of its external auditors, determined that, while the carrying value is within the 5 percent band, the carrying value was not a fair value measurement under GAAP. Management, therefore, determined that HLSS was required to restate the value of its Rights to MSRs to the best-point estimate of fair value provided in the valuation reports.

38. In August 2014, HLSS restated its Forms 10-K for the years 2012 and 2013 and Form 10-Q for the quarter ended March 31, 2014 as a result of this required adjustment and an unrelated data input error.[3] At the time of the restatement, HLSS disclosed that it concluded the methodology it historically used to assess the value of its Rights to MSRs constituted a departure from GAAP. As per the chart below, HLSS's improper accounting resulted in material errors to HLSS's reported results in quarterly and annual filings and in earnings releases filed on Form 8-K.

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[3] This data input error related to a subset of the Rights to MSRs as of the fourth quarter of 2013 and the first quarter of 2014. The impact of the data error was $5.9 million and $9.3 million as of December 31, 2013 and March 31, 2014, respectively.

Dollars in thousands

	Net Income as Restated ($)	Adjustment Relating to Accounting Error ($)	Adjustment as a % of Restated Net Income
1Q 14	64,360	11,386	18%
FY 2013	117,657	(4,137)	-4%
4Q 13	6,580	(27,617)	-420%
3Q 13	39,166	4,243	11%
2Q 13	43,826	15,940	36%
1Q 13	28,085	3,297	12%
FY 2012	19,617	(7,254)	-37%
4Q 12	7,326	(7,020)	-96%
3Q 12	5,438	(1,134)	-21%
2Q 12	5,901	1,242	21%
1Q 12	952	(342)	-36%

C. Violations

39. As a result of the conduct described above, HLSS violated Section 13(a) of the Exchange Act, Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, which require issuers to file true, accurate, and complete annual, quarterly and current reports with the Commission.

40. As a result of the conduct described above, HLSS violated Section 13(b)(2)(A) of the Exchange Act, which requires public companies to “make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.”

41. As a result of the conduct described above, HLSS violated Section 13(b)(2)(B) of the Exchange Act, which requires public companies to “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that . . . (ii) transactions are recorded

as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets."

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act of 1934 it is hereby ORDERED that:

A. Respondent HLSS cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $1,500,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C § 3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying HLSS as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Michael J. Osnato, Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

By the Commission.

Brent J. Fields
Secretary