UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2014-CFPB-0002

In the Matter of: **PHH CORPORATION,** **PHH MORTGAGE CORPORATION,** **PHH HOME LOANS LLC,** **ATRIUM INSURANCE CORPORATION,** **and ATRIUM REINSURANCE CORPORATION**	**ENFORCEMENT COUNSEL'S POST-HEARING BRIEF** **(Filed under Seal)**

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I. Preliminary Statement

This enforcement proceeding is directed at an elaborate captive mortgage reinsurance program devised and operated by Respondents continuously for more than fifteen years in violation of the Real Estate Settlement Procedures Act (RESPA). As a result of this program, mortgage insurance companies (MIs) paid Respondents over $493 million for a sham reinsurance product that was intended to, and did, result in massive gains to Respondents with no corresponding benefit to the MIs other than illegal referrals.

Through their scheme, Respondents engaged in numerous actionable violations of Section 8 of RESPA[1] because:

- As this Tribunal has already held, Respondents' captive arrangements satisfy all of the elements of a prima facie violation of Section 8(b) of RESPA, and there is no dispute that Respondents accepted a split of premiums from loans that closed on or after July 21, 2008;

- The evidence shows that Respondents' agreements to refer business in exchange for ceded premiums and other payments (such as dividends) continued to operate long after July 21, 2008, thus Respondents' actions also satisfy all of the elements necessary to establish a RESPA Section 8(a) violation; and

- Respondents cannot show that they provided bona fide "reinsurance" services actually performed, let alone that the premiums they received – in their entirety – bore any reasonable relationship to the market value of any "reinsurance" they claim to have provided.

[1] In previous briefing, Enforcement has argued that Respondents' arrangements constitute – in their entirety – a single actionable continuing violation of law. In its May 22, 2014 Order on Dispositive Motions, the Tribunal did not accept that argument, and also ruled that the statute of limitations under RESPA Section 8 accrues at the closing of an illegally referred loan. While Enforcement continues to believe the arrangements constitute a continuous violation, in light of the law of the case embodied by that Order, Enforcement sets forth alternative theories of recovery in this brief.

The abundant evidence of the course of dealing between Respondents and the MIs shows that Respondents' captive arrangements had only one purpose: to enrich Respondents in exchange for providing referrals of business to the MIs. Since the payments obtained by Respondents through their captive arrangements were for referrals and not for reinsurance, it follows that they were not bona fide payments for actual services, and thus Respondents have no defense to the charges.

Enforcement respectfully requests that this Tribunal issue an order recommending that Respondents must disgorge all of their ill-gotten gains causally connected to referrals of loans that closed on or after July 21, 2008, which includes illegal payments accepted by Respondent both before and after that date. Enforcement also requests that the Tribunal enter an order recommending an injunction to prevent Respondents from again using their leverage to extract split fees and kickbacks in violation of RESPA. Finally, civil money penalties are available, and should be imposed at the recklessness level.

II. Background

A. Procedural Background

On May 22, 2014, this Tribunal granted partial summary disposition to Enforcement, holding that it had established a prima facie case that Respondents violated Section 8(b) of RESPA, and that nearly all of the elements of Enforcement's claims under Section 8(a) of RESPA were established, subject to proof that

Respondents' "agreement to refer" had persisted beyond July 21, 2008.[2] The only other remaining issues for the hearing in this matter were Respondents' affirmative defenses.

At the hearing, held during March, May, and June of 2014, Enforcement called PHH Mortgage executive Samuel Rosenthal, who testified over three days regarding the mechanics of Respondents' captive mortgage reinsurance arrangements (captive arrangements) and their relationships with the mortgage insurance companies (MIs), mortgage insurer MGIC's longtime chief executive Curt Culver, who testified regarding MGIC's dealings with Respondents and its view of captive arrangements, Enforcement forensic accountant Ryan Thomas, who testified regarding financial details of the captive arrangements, and expert actuary Dr. Mark Crawshaw to render opinions regarding the arrangements. In their case, Respondents called two experts, Michael Cascio and Vincent Burke, followed by Michael Schmitz, an author of a series of commissioned opinions concerning the captive arrangements from Milliman, Inc., and Daniel Walker of mortgage insurer UGI. Respondents did not call a single employee of their own.

B. Respondents' Captive Arrangements

At various times, Respondents Atrium Insurance Corporation and Atrium Reinsurance Corporation (together, Atrium) entered into captive arrangements with four MIs: United Guaranty Residential Insurance Company (UGI), GEMICO (later known as Genworth), Radian Guaranty Inc. (Radian), and CMGMI (CMG). All of

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[2] Order on Dispositive Motions, Document 152, *In re PHH Corporation, et. al.*, File No. 2014-CFPB-0002 (May 22, 2014) (May 22 Order), at 22. In addition to the facts cited in this section and elsewhere in this brief, Enforcement also incorporates by reference the facts in its Statement of Undisputed Facts (SOUF) (Document 102), to the extent those facts are established by citation to admitted evidence, and the facts established under Rule 213 by the Tribunal's March 13 (Document 67) and May 22 Orders.

Atrium's captive structures were excess-of-loss. **ECX 0153** (10/22/2009 Deposition Pursuant to Fed. R. Civ. P. 30(b)(6) of Mark R. Danahy, *Munoz v. PHH Corp.*) (Danahy Dep.) Tr. 76:25-77:7. Some were later altered due to Freddie Mac's February 14, 2008 announcement that it would no longer accept loans on which captive ceding exceeded 25%. *See* **Hearing Transcript (Hrg. Tr.) 461:10-13** (3/26 Rosenthal) (UGI). Although Respondents' first captive arrangement began in 1995, **ECX 0708** at 1, it did not pay its first dollar in claims until 2009, **ECX 0534** (6/30/2009 Milliman "Reinsurance Metrics" for Atrium) at 9.

Atrium's four captive arrangements are generally described below.

1. The UGI Captive

UGI and Atrium entered into a captive agreement designated "3-38"on Nov. 9, 1995. **ECX 0017**. It was the first captive deal in the mortgage industry. **Hrg. Tr. 2184:12-19** (6/4 Walker). That agreement was supplanted by agreement 3-44 in 1997. **ECX 0710**. Ceding under these agreements steadily increased until January 1, 2000, when it reached a height of 40%. *Id.* at CFPB-PHH-1368890-95 (Amendments #1 and 2). Ceding under the UGI deal remained at 40%, with a 4% attachment point and 14% detachment point, until March 1, 2009, when ceding for business written on or after that date was reduced to 25%, and the attachment and detachment points were changed to 4% and 10%, respectively. **ECX 0711** (Amendment #9).

Atrium and UGI commuted Agreement 3-44 effective May 31, 2013. **ECX 0015** (commutation agreement). Over the life of the UGI agreements, Respondents withdrew dividends from the trust account totaling $104.9 million, and a commutation payment of $69.2 million. **ECX 0653** (PHH NORA submission) at Ex. C (Bogansky Decl.) ¶ 14 & Ex. A to Ex. C. Respondents made capital contributions totaling $46.8 million. *Id.* UGI ceded $304.7 million to Respondents under the agreements (net of ceding commission) and Respondents made claim and commutation payments to UGI totaling $176.3 million. *Id.*

2. The Genworth Captive

Genworth's predecessor GEMICO established a captive agreement with Atrium as of October 9, 2000. **RCX 0044**. The deal was designed to match the terms then in place between PHH and UGI, with a 40% cede, and a risk band between 4% and 14% of aggregate risk. *Id*. These terms remained in place until June 2008, when ceding for business written on or after June 1, 2008 was cut to 25%, and the risk band changed to between 5% and 10% of aggregate risk. **RCX 0050** (Amendment #4). In 2010, the risk band for business written on or after June 1, 2008 was retroactively changed to between 4.5% and 9.5% of aggregate risk. **RCX 0051** (Amendment #5).

Atrium's captive agreement with Genworth was terminated as of April 1, 2012. **ECX 0188**. Over the life of the Genworth agreement, Respondents received $13.9 million in dividends from the Genworth trust account, along with a commutation payment of $24.1 million. **ECX 0653** (PHH NORA submission) at Ex. C (Bogansky Decl.) ¶ 14 & Ex. A to Ex. C. Respondents made capital contributions totaling $5.5 million. *Id.* Genworth ceded $136.3 million to Respondents over the life of the arrangement, and Respondents made claim and commutation payments to Genworth totaling $65.7 million. *Id.*

3. The Radian Captive

Radian's captive agreement with Atrium commenced on July 26, 2004. **ECX 0200**. Like the Genworth and UGI agreements at that time, it provided for a 40% net cede rate, with a risk band between 4% and 14%. *Id.*

The Radian agreement was commuted as of July 22, 2009. **ECX 0526**. Under the commutation agreement, Radian received a payment of $4,447,105, or “all funds in the Trust Account.” **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C**; ECX 0526** at 1. Over the life of the arrangement, Radian ceded $3.8 million to Respondents, and Radian recovered $4,750 in paid claims. **ECX 0653** at Ex. A to Ex. C. Respondents' total capital contribution was $452,349. *Id.*

4. The CMG Captive

CMGMI entered into a captive agreement with Atrium as of December 1, 2006. **ECX 0202**. Under the agreement, which covered only credit union loans insured by CMG, Atrium received a 25% net premium cede. *Id.*; *see* **Hrg. Tr. 327:20-25** (3/25 Culver). The risk band was between 2.25% and 6.25%. **ECX 0202**.

The agreement was commuted effective Aug. 1, 2009. **ECX 0190**. Under the commutation agreement, CMG received a payment of $3,233,079, or “all funds in the Trust Account.” **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C; **ECX 0190** at 1**.** Over the life of the arrangement, CMG ceded $2.7 million to Respondents and recovered no paid claims from Atrium. **ECX 0653** at Ex. A to Ex. C. Respondents' total capital contribution was $440,634. *Id.*

III. Argument

A. Respondents Violated RESPA Sections 8(a) and 8(b)

1. Respondents collected unearned fees in violation of RESPA Section 8(b)

On summary disposition, this Tribunal held that Enforcement had established proof of prima facie violations of Section 8(b) of RESPA because Atrium had collected splits of fees from the MIs without providing a settlement service in return. May 22 Order at 20. PHH's own documentation demonstrates that it originated approximately 5,497 federally-related loans on or after July 21, 2008 that were subject to splitting a set percentage of the borrowers' future MI premiums with Atrium.[3] These payments were made to Atrium on a continuous, periodic basis until the governing arrangements were commuted. Each instance where the MIs split a borrower's premium payment with Atrium was an act that perpetuated the violation of Section 8(b) and funneled more unearned fees to PHH. As the Tribunal has noted, "such fee-splitting can be suspicious, and may be indicative of referrals" that also violate Section 8(a) of RESPA. May 22 Order at 19.

[3] *See* May 22 Order at 14 (setting July 21, 2008 cut-off); **EC Demonstrative Ex. 1** at 1 (5,497 loans subject to ceding payments under captive reinsurance arrangements were originated by PHH on or after July 21, 2008); **Hrg. Tr. 1194:10-21** (5/28 Thomas) (explaining calculation); **ECX 0126** (1/3/2012 Enforcement letter to PHH), at 1 (noting that "the company has ... originated fixed and adjustable ... federally related mortgage loans to home buyers"), at 2-3 (requesting data on mortgage loans); **ECX 0158** (3/2/2012 PHH letter responding to Enforcement); **ECX 0159** (spreadsheet attached to 3/2/2012 letter to Enforcement) at tabs 2008, 2009. *See also* **ECX 0158** at 1 (noting that spreadsheet does not include an additional 348 responsive loans).

2. Respondents' captive "reinsurance" activities were conducted pursuant to agreements to refer business to certain MIs in violation of RESPA Section 8(a)

Section 8(a) of RESPA provides that "no person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a). Courts have characterized the elements of a Section 8(a) claim in the context of a private action as requiring "1) a payment or a thing of value; 2) made pursuant to an agreement to refer settlement business; and 3) an actual referral." *Egerer v. Woodland Realty, Inc.*, 556 F.3d 415, 427 (6th Cir. 2009) (internal citations omitted); *see also Galiano v. Fidelity Nat. Title Ins. Co.*, 684 F.3d 309, 314 (2d Cir. 2012) (*citing Egerer*). In its May 22 Order, the Tribunal held that each element of the Section 8(a) claims in this case was beyond dispute (and therefore had been proven), with the exception of potential genuine issues of material fact surrounding one element – the persistence of an "agreement to refer" on or after July 21, 2008 – that precluded complete summary disposition. May 22 Order at 18.

Any doubts have been erased by the evidence. The evidence clearly shows that the opportunity to obtain referrals of business from PHH was a central motivation for MIs to participate in captive arrangements with Atrium, and that in turn, PHH used its ability to steer borrowers to certain MIs over others to extract referral payments from the MIs through the artifice of captive arrangements. The purported "reinsurance" the MIs received in exchange had negligible value, and came at an exceedingly high cost – prices which the MIs themselves were continuously pressured to bid up against their own interests and for PHH's benefit. *See* § III.A.2.c, *infra*. The low value and high price further show that the exceedingly high "premiums" paid by the MIs were not in fact for bona fide reinsurance services, they were kickback payments for referrals; the facts leave no other explanation for otherwise irrational conduct by sophisticated corporate entities. *See* § III.B, *infra*. From their inception through at least the end of 2008, captive arrangements were the price of admission to PHH's dialer and "preferred provider" systems, and drove allocations throughout the life of the arrangements. This decade-long agreement to refer did not evaporate on July 21, 2008. That the agreement persisted at all during this period of extreme distress in the mortgage market demonstrates the strong grasp that captive reinsurance exerted over PHH's MI referral system.

a. Atrium was born of PHH's desire to get a share of mortgage insurance profits

PHH pioneered the practice of captive mortgage reinsurance arrangements. Even from this early history, it was clear that the purpose of the arrangements was to allow the lender to take payments for referrals by sharing in the profits generated by the MIs. In the mid-1990s, PHH created Atrium and entered into the first captive mortgage reinsurance arrangement in the industry with UGI. **ECX 0733** (2006 UGI Proposal to PHH) at 1 ("Together with PHH Mortgage, AIG United Guaranty created the first captive reinsurer for the mortgage industry – PHH's Atrium."); **ECX 0586** (1/4/2005 Memorandum of Walker to UGI personnel) at CFPB-PHH-00352309 ("The first captive formed exclusively to insure mortgage guaranty risk on loans originated by an affiliate was domiciled as a fully regulated insurer in New York. United Guaranty began ceding mortgage guaranty premium to this captive on its 1993 book using a calendar year, excess loss ratio type treaty."). Atrium was the only captive mortgage reinsurer until about 1995 when a new MI market entrant, Amerin Guaranty (a predecessor entity to Radian), created its own captive arrangement. *Id*. The practice proliferated as others in "the market competitively respond[ed]." *Id*.

The spread of captive arrangements throughout the MI industry starting in the mid-1990s was driven by the desire of lenders to take a share of the large profits accruing to the MI industry and the MIs' need for referrals of business from lenders – not any genuine need for reinsurance. In an article entitled "Using a Bank Captive Subsidiary to Reinsure Mortgage Insurance" written by Milliman in the late 1990s and published on Milliman's website, those motivations are succinctly described: "Mortgage insurance has been profitable for the past several years. *Lenders*, who essentially produce the business for the mortgage insurers, *have been seeking ways to share in these profits*." **ECX 0682** (printed on 2/28/14) (emphasis added); **Hrg. Tr. 2072:8-15** (6/3 Schmitz) (article written early in the existence of captive arrangements).

At the time, the market share leader in the industry was MGIC. **Hrg. Tr. 366:2-3** (3/25 Culver). MGIC had no reinsurance at that time, and its last such arrangement – a quota share agreement with a commercial reinsurer unaffiliated with any lender, which MGIC needed due to financial problems the company was experiencing – ended in the 1980s. *Id.* **345:6-22**. Curt Culver, who became the President of MGIC in 1996 and its CEO in 2000, testified at hearing and recalled that when captive arrangements were introduced in the mid-1990s, [redacted] **344:5-10** (3/25). MGIC's position was that [redacted]

MGIC nonetheless participated in captive arrangements because, [redacted] *Id.* **340:9-12**, **341:17-23** (3/25).

Culver's testimony is supported by a detailed record of contemporaneous documents. [redacted] **ECX 0038** (3/6/1996) at CFPB-PHH-00610322. Two months later, Culver "[redacted] **ECX 0811** (5/2/1996) at CFPB-PHH-00609575 (emphasis added); *see also* **ECX 0814** (10/22/1998 MGIC Bd. of Dirs. Mtg.) at 6 ("[redacted]

In the late 1990s, MIs competed with one another to offer increasingly generous deals to lenders, including PHH, known as "deep cede" captive reinsurance arrangements. As captive arrangements proliferated, state regulators and MIs grew concerned about the significant risks they posed to the stability of the MI industry. On November 24, 1997, the Commissioners of the Wisconsin and North Carolina Departments of Insurance wrote a letter to the Commissioner of the South Dakota Department of Insurance, noting: "In their eagerness to gain market share and short-term revenue increases, some mortgage guaranty insurance companies may be willing to give up half or more of their premium income to earn new business." **ECX 0583** (1/24/1997 Letter from Long and Musser to Lyon) at UG001680. They argued that the arrangements were "imprudent" for a variety of reasons, including the fact that premiums ceded by an MI to a captive reinsurer were only available to pay claims covered by the specific captive to which the premiums were ceded, rather than all of the claims incurred by the MI (as would be the case without the captive arrangement). *Id.* at UG001679-80. They explained that as captive arrangements became more widespread "[t]he segmentation of the market by lenders would segregate premiums shared with good lenders from being used to offset losses on the rest of the mortgage insurance company exposure, shared or not" and that "the current AA stability of the primary insurance industry could be undermined seriously." *Id.* at UG001680.

Likewise, in 1998, Mortgage Insurance Companies of American (MICA) – a consortium of the country's major MI companies, then including UGI, Genworth, and Radian's predecessor, Amerin[4] – privately expressed alarm to state insurance regulators regarding captive mortgage reinsurance arrangements. They asked regulators to impose limits on captive arrangements between MIs and lenders, arguing that "if not properly controlled," such arrangements "present a threat to the overall strength and claims-paying ability of the private mortgage insurance industry." *See* **ECX 0035** (1/22/1998 Presentation to Arizona Department of Insurance, "Captive Reinsurance and Other Risk Sharing Arrangements") at MGIC-CFPB00190633, 646-649. The MIs identified "Risk Factors Associated With Captive Reinsurance," including the fact that premiums ceded by the MIs to captive reinsurers were "locked" in the captive and thus only available to

[4] **ECX 0035** at CFPB-PHH-00609411-12 (1/12/1998 BestWeek Insurance News and Analysis, "Mortgage Insurers, Regulators Unite to Urge Curbs on New Bank Ventures") (listing members of MICA).

"support limited segments of the primary mortgage insurer's overall insured portfolio," which "runs counter to the basi[c] insurance principle that an insurer's liability should be supported by all of its assets." *Id.* at MGIC-CFPB00190649.

The MIs in 1998 therefore pushed for "more stringent" risk-to-capital requirements for captives than the MIs themselves were subject to. *Id.* at MGIC-CFPB00190650. They also sought regulatory assurance that captive reinsurance premiums would not be "greater than the cost of comparable coverage with an unrelated insurer," that "dividends and other payments by the captive ... be restricted to ensure the availability of funds to pay claims," and that ceding to captives would "not exceed 25% of premium...." *Id*. The MIs sought these changes to offset the increased risk to the mortgage insurance system posed by captive reinsurance. *Id.* They warned that the "nature of the relationship between the mortgage insurer and the lender is such that, *absent clear regulatory guidance, reinsurance transactions will inevitably become more and more generous to the lender until, ultimately, they are no more than revenue-sharing arrangements, under which no risk is transferred*." *Id.* at MGIC-CFPB00190649 (emphasis added).

The requested limits were not enacted, and the rapid growth of captive reinsurance arrangements increasingly favorable to the lender went unchecked. Ceding rates, initially around 12% of the MI's premiums, rose to 40% for many arrangements by the turn of the century. **Hrg. Tr. 336:18-337:3**, **348:13-349:4** (3/25 Culver); **ECX 0584** (1/1/1997 UGI/Atrium agreement, Amendment # 1) at CFPB-PHH-00116621, ¶¶ 1, 3. Respondents led the way again, negotiating the first captive arrangement in the industry with a 40% ceding rate. **ECX 0733** (2006 UGI Proposal to PHH) at 13 ("Atrium negotiated the first 40% net excess cede in the MI industry.") In a 2003 analyst report, Bear Stearns wrote: "Initially, the MIs ceded 15% of the premiums .... But, recently, lenders have been asking for more. The largest originators are increasingly seeking 'deep-cede' excess of loss arrangements, some of which require that the primary insurance provider part with as much as 40% of a policy's written premium." **ECX 0793** (3/2003 Bear Stearns Equity Research report, "The Trouble with Captive Reinsurance") at 5. Bear Stearns observed that "*most MIs would prefer not to cede premiums to lenders' captive reinsurance operations*," but that they "are not well positioned to fight this trend" because "*[l]enders act as referral sources* for borrowers that require mortgage insurance, so they have considerable control over the allocation of insurance among providers." *Id.* (emphases added).

During an analyst call in 2003, MGIC admitted that on "40% excess of loss treaties [] we virtually see *no return* from our assumptions" for the benefit of the MI. **RCX 1048** at 10 (emphasis added). But MGIC entered into numerous captive arrangements to avoid losing market share. *See* **Hrg. Tr. 341:17-23** (3/25 Culver) ("I think we had ... 80 or 90 relationships under which we did captives."). As Curt Culver, MGIC's CEO, testified, "we don't want to do captive reinsurance if we don't have to . . . . but it impacted business, you lose business. We lost business because of it." **Hrg. Tr.** 340:6-12 (3/25 Culver). Each of the other MIs followed suit. For example, UGI, despite the concerns it expressed through MICA in 1998, steeply increased its participation in captive arrangements. In 2003, UGI ceded $141 million in mortgage guaranty premiums to 59 captives – 20.9 percent of the total ceded premiums in the industry. **ECX 0586** at CFPB-PHH-00352306, -08 (1/4/2005 UGI Interoffice Memo).

Beginning in late 2002, MGIC attempted to lead the industry to resist at least the excesses of deep-cede captive reinsurance arrangements. **ECX 0816** (10/24/2002

MGIC Bd. of Dirs. Minutes) at 2 [redacted] **ECX 0820** (12/18/2003 memorandum, Pierzchalski to Culver) at 1, 5 ([redacted]; **Hrg. Tr. 365:19-66:20** (3/25 Culver) ([redacted]"). These steps caused controversy, and MGIC lost market share in direct response to its limitations on captive reinsurance. **ECX** [redacted]); **ECX 0819** (10/23/2003 MGIC Bd. of Dirs. Mtg.) at 3 ([redacted]); **ECX 0822** (5/13/2004 MGIC Bd. of Dirs. Mtg.) at 3 ([redacted] **Hrg. Tr. 340:9-25** (3/25 Culver) ([redacted]); *id*. **372:20-73:5** (same). No competitors joined them. **ECX 0824** (10/28/2004 MGIC Bd. of Dirs. Mtg.) at MGIC-CFPB00191159. Ultimately, by 2005, MGIC gave in to the market pressure and once again participated in deep-cede captives. **Hrg. Tr. 370:8-16** (3/25 Culver) [redacted]; *id*. **376:15-77:3** ([redacted]

[redacted]

Respondents' arrangements with UGI, Genworth, Radian and CMG were formed against the backdrop of these market dynamics. As discussed at length in Section III.B.2 below, those arrangements provided no genuine benefit to the MIs. The MIs ceded premiums to Respondents to obtain referrals of business.

b. Beginning in 1995, Respondents engaged in a cycle of kickbacks for referrals that violated Section 8(a) of RESPA

The overwhelming documentary evidence of a cycle of kickbacks indicates that PHH and its affiliates continuously violated Section 8(a) for well over a decade. PHH's use of its dialer and preferred provider lists displays a clear pattern and practice: pay PHH through a captive reinsurance arrangement and receive borrower referrals from PHH in exchange. Each of PHH's MI partners was rewarded with substantial business only after forming a captive reinsurance arrangement with PHH and giving PHH ongoing payments and things of value under those arrangements:

- After PHH established the first captive reinsurance arrangement with UGI, PHH essentially established an exclusive referral arrangement with UGI. UGI's share of PHH's business escalated from approximately 30% to virtually 100%, where it consistently remained for six years. *See* Section III.A.2.b.i, *infra*.

- Within ten months of establishing its second captive reinsurance arrangement with Genworth, PHH added Genworth to its dialer and began sending referrals to Genworth. Genworth's share of PHH's business went from virtually zero to a majority share. Following initiation of the captive arrangement, Genworth maintained a substantial share of PHH's referrals for well over a decade. *Id*.

- Before it did any real volume of business with PHH, [redacted] reinsurance arrangement. *See* Section III.A.2.b.ii, *infra*.

- CMG entered into a captive reinsurance arrangement with PHH that coincided closely in time with a written contract committing PHH to send referrals of business to CMG. *Id*.

- Any MI who lacked a captive reinsurance arrangement with PHH was not only denied referrals, but actively blocked from accessing business on PHH loans. **ECX 0288** ("AZ Fed CU wants to use RMIC as their sole MI company. They are a client of PHH .... PHH has told them they will not order MI from RMIC." / "This would impact our economics so I am not encouraging it."); **ECX 0262** (requiring price adjustment to use RMIC even where it was the only MI that would close the loan).

The only reasonable conclusion from this years-long course of conduct is that payments were made pursuant to referral agreements between PHH and the MIs. *See* 12 C.F.R. § 1024.14(e).

The extensive history of Respondents' captive arrangements demonstrates that the MIs participated pursuant to an agreement or understanding that they would receive referrals of business from PHH. An "agreement or understanding" for the referral of settlement services (referral agreement) "need not be written or verbalized but may be established by a practice, pattern or course of conduct." 12 C.F.R. § 1024.14(e). Since at least 1995, MIs offered and participated in captive arrangements with Respondents pursuant to an understanding that mortgage insurance business would be referred to them only if they did so. For at least 13 years, PHH referred mortgage insurance business exclusively to MIs that were engaged in a captive reinsurance arrangement with Atrium. Thereafter, Respondents continued to profit from the captive arrangements, held out hope that the arrangements could be reactivated for new loans, and factored the benefits of its longstanding arrangements into its MI referral decisions. The MIs participated in those arrangements based on PHH's continuing agreement to refer.

PHH built an elaborate system to steer borrowers to its favored captive reinsurance partners and to prevent any non-captive MIs from accessing business on PHH loans, including those originated through correspondent lenders. PHH, in its own words, "completely control[led]" the selection of providers of mortgage insurance for borrowers on its retail loans through the use of its "dialer." **ECX 0773**; *see also* **ECX 0153** (Danahy Dep.), Tr. 84:25-85:8 ("Typically a borrower doesn't choose where to select the PMI insurance; the lender does."); **Hrg. Tr. 105:9-106:7** (3/24 Rosenthal) ("[T]here was a word used at PHH as [']controllable business.['] It was business that PHH could choose which MI provided it went to. . . . [I]t refers to retail business and it also can refer to correspondent business because the correspondent sometimes permitted PHH to control the placement of the mortgage insurance . . . .").

Allocation of business to certain MIs over others was managed at the very highest levels of PHH Corporation. *See, e.g.*, **ECX 0432** ("MD [Mark Danahy] agreed with this move – our choice as to % level."); **Hrg. Tr. 224:11-226:1, 263:14-17** (3/25 Rosenthal) (Terry Edwards, CEO of PHH Corporation and President of PHH Mortgage, Joe Suter, head of Capital Markets and later president of PHH Mortgage, and Mark Danahy, Suter's successor as president of PHH Mortgage, were involved in setting the dialer for MI allocations). In addition, PHH maintained a "preferred provider" list for its correspondent lending channel, which was used to steer referrals by influencing the correspondent lender's choice of MI provider. Under this written policy, PHH charged the correspondent lender a 75 basis point "price adjustment" if it opted to refer a borrower to any MI that was not one of PHH's "preferred providers." **ECX 0132** (4/3/2006 Preferred Provider Policy) at CFPB-PHH-00093167; *see* **ECX 0654** (PHH

Suppl. NORA submission) at Ex. O (reducing price adjustment to 40 basis points as of Aug. 8, 2008).

This system allowed PHH to maximize its profits from captive reinsurance and to secure the continued payment of kickbacks for referrals, because MIs understood that without establishing a formal relationship with PHH, one of the top ten mortgage lenders in the nation, they would be virtually blocked out of a huge amount of mortgage insurance business. **Hrg. Tr. 383:25-384:14** (3/25 Culver) (explaining that "like the case of PHH, we [MGIC] weren't an approved insured, so if the borrower wanted that, they probably would have said no."). In return, Respondents reaped "things of value" from the participating MIs throughout the life of the arrangements, from the flow of ceding payments to favors like amendments to reduce risk, dividends from the trusts, and ultimately commutations that resulted in large cash payments to PHH. *See* 12 C.F.R. § 1024.14(d) (defining "thing of value" to include "without limitation, monies, things, ... dividends, ... [and] retained or increased earnings...."). Each of these payments and amendments violated RESPA because they had no purpose other than to pay Respondents in exchange for referrals. *See, e.g., Toldy v. Fifth Third Mortgage Co., et al.*, 721 F.Supp.2d 696, 706 (N.D. Ohio 2010) (observing that HUD regulations specifically recognize "stock, dividends, [and] distributions of partnership profit" as "things of value" and holding that the payment of yearly dividends may violate RESPA).

There is no evidence that Respondents operated their referral scheme strictly on a loan-by-loan basis, with separate agreements tying the referral of each individual loan to the ceding premiums for that specific loan. Rather, the course of dealing shows that Respondents' scheme was far broader – a cycle of kickback payments and referrals operated through numerous interconnected loans over time. The premiums ceded to

Atrium on a particular loan were not only kickback payments for the referral of that specific loan; they were *also* kickback payments required for the ongoing and future referral of *other loans*. This is because the MI's decision to participate in Atrium's captive program generally – including continuing to cede premiums on multiple already-referred loans and to funnel funds out of the trusts to PHH through dividends and other mechanisms – was a significant and necessary factor in its inclusion on the dialer and preferred provider list, which dictated the MI's ability to obtain additional, subsequent referrals from PHH.

Respondents received ceded premiums in proportion with the volume and value of mortgage insurance business that they referred to MIs, further demonstrating the agreements to refer. "When a thing of value is received repeatedly *and is connected in any way with the volume or value of the business referred*, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business." 12 C.F.R. § 1024.14(e) (emphasis added). The contracts themselves dictated that the amount of premiums paid to Respondents by the MIs was in direct proportion to the amount and value of mortgage insurance business that Respondents referred to those same MIs. Under the captive arrangements, the MIs paid a specified percentage – typically 40% – of the premiums received on the business referred by Respondents that PHH elected to have Atrium "reinsure." Thus, the more business Respondents referred to the MIs, the more ceded premiums – *i.e.*, things of value – Respondents received. This close correlation between the magnitude of the referrals by PHH and the amount of money it received from MIs "is evidence that [the premium payment] is made pursuant to an agreement or understanding for the referral of business." 12 C.F.R. § 1024.14(e).

Entering into Respondents' captive arrangements provided no genuine benefit to the MIs – as discussed at length in Section III.B.2, *infra*. The MIs engaged in these unfavorable transactions despite their serious limitations and high cost. As the evidence shows, these transactions were motivated by another purpose entirely: to obtain referrals of business from PHH.

Respondents also had strong incentives to engage in captive reinsurance arrangements. The kickbacks they received were extremely profitable. Even factoring in the most devastating mortgage crisis in decades, Atrium's two major trusts, UGI and Genworth, generated annual internal rates of return of approximately 20% for PHH. **ECX 0147** (UGI and Genworth IRR tabs). **Hrg. Tr. 1168:9-21** (5/28 Thomas) (over the life of the arrangement, the Genworth IRR was 20%, which was quadruple the returns available on the S&P 500 during the same period); **Hrg. Tr. 1169:15-25** (same) (the UGI IRR was 19%, which was double the return of the S&P 500).

i. UGI, Genworth, and the dialer

The dialer, the system that PHH used to automatically allocate loans to MIs according to fixed, pre-programmed percentages, was created to manage referrals in the wake of PHH's expanded use of captive arrangements. *See* **ECX 0654** at 10 (admitting that the dialer was instituted for the first time "in 2001 at the point when PHH entered into a business relationship with Genworth," because prior to that, "PHH relied upon UGI"). From 2001 forward, the dialer was continuously guided by PHH's agreement to refer business in exchange for devising and maintaining captive reinsurance arrangements. Once the dialer was set to a particular configuration, all referrals of retail MI business *thereafter* were controlled by that setting, until the setting was changed. Because the dialer setting "completely" controlled subsequent referrals, **ECX 0773**, any factor that influenced that setting was causally connected to those subsequent referrals. As the MIs entered into captive arrangements, ceded premiums under those arrangements, and endorsed opportunities for Respondents to profit more and more from those arrangements, they sought to secure a coveted share of referrals through the dialer and to hold on to that share for the future.

PHH's use of the dialer system to control its MI referrals illustrates a clear and consistent pattern:

- In the early 1990s, PHH utilized UGI's services on approximately 30% of its business. **Hrg. Tr. 2178:23-2179:12** (6/4 Walker).

- In the mid-1990s, PHH created Atrium and developed the industry's first captive reinsurance structure with UGI. **ECX 0708** (11/9/1995 UGI/Atrium agreement 3-38); **ECX 0733** (2006 UGI RFP Proposal to PHH) at CFPB-PHH-1368936 ("Together with PHH Mortgage, AIG United Guaranty created the first captive reinsurer for the mortgage industry – PHH's Atrium."); **ECX 0586** (1/4/2005 Dan Walker Memo to UGI personnel) at CFPB-PHH-00352309; **Hrg. Tr. 2180:11-25** (6/4 Walker).

- From 1995 until late 2000, PHH had only one captive reinsurance arrangement, with UGI. May 22 Order at 22; **Hrg. Tr. 142:12-15** (3/24 Rosenthal) (UGI deal ran from 1995-2013), **144:5-145:1**; **ECX 0708** (UGI/Atrium agreement 3-38); **ECX 0503** (Oct. 9, 2000 GEMICO/Atrium agreement); **ECX 0584** (UGI/Atrium agreement 3-44).

- UGI's share of PHH's business skyrocketed. From 1995 to 2001, UGI received virtually all of PHH's referred business. **Hrg. Tr. 111:1-12** (3/24 Rosenthal) ("a very heavy market share ... went to United Guaranty before 2001 .... probably in the 80% range."); **ECX 0654** (PHH Suppl. NORA submission) at 3 ("PHH dealt primarily with UGI prior to 2001").

- In January 2001, Genworth signed a captive reinsurance arrangement with PHH with an effective date of October 9, 2000; by May 2001, PHH had added Genworth to its dialer to streamline referrals. **ECX 0503** (GEMICO/Atrium agreement); **ECX 0654** at Ex. M.

- PHH's captive arrangement with Genworth was intended to further enhance its leverage over UGI. **ECX 0153** (Danahy Dep.) Tr. 198:22-199:7 ("We went with Genworth in 2000 . . . and the idea was, okay, so we partnered with UGI, but we don't feel like we have the leverage. So we can't really tell them if you're not doing this stuff, we're going to go somewhere else, because we really didn't have anybody else that we really signed up. So we created two.").

- From 2001 to November 2008, UGI and Genworth were the only two MIs on PHH's dialer. **ECX 0654** at Ex. M; **Hrg. Tr. 111:13-112:5, 113:16-24** (3/24 Rosenthal).

- PHH ensured that it was impossible for an MI to receive any significant amount of business from PHH without being on the dialer. **Hrg. Tr. 108:11-13** (3/24 Rosenthal) ("[T]he only way to get MI in the PHH system is through the automated dialer."), **107:12-108:17**, **113:25-115:12**.

- During this time, MIs who lacked captive arrangements with PHH received no referrals of business from the dialer, and in fact did virtually no business with PHH. **ECX 0654** at 3 & Ex. M ("PHH dealt primarily with UGI, but expanded to include Genworth starting in 2001"); **ECX 0159** (virtually no PHH loans went to MGIC, RMIC, Triad, or PMI); **Hrg. Tr. 378:25-379:11** (3/25 Culver) ("We didn't do business with PHH . . . . [A]ll other customers, MGIC had a strong relationship."); **ECX 0351** (12/12/2007 RMIC email to Rosenthal) ("PHH is the only top 10 MI account [with which] we do no business today.").[5]

These facts alone demonstrate that entering into a captive reinsurance arrangement was a firm pre-condition to obtaining referrals of mortgage insurance business from PHH. *See, e.g.*, **ECX 0193** (Milliman report attaching HUD Letter) at CFPB-PHH-00112654 (HUD Letter at 4) (explaining that captive arrangements will be subject to "particular scrutiny" when the "lender restricts its mortgage insurance business in whole or to a large extent to a primary mortgage insurer that has a reinsurance agreement with the lender's captive reinsurer.").

During the period from May 2001 to November 2008, UGI and Genworth vied for position on PHH's dialer. Although limited documentation is available before 2001, it is clear that once Genworth entered into a captive arrangement matching UGI's terms, it was able to oust UGI from its near-exclusive referral arrangement with PHH, and by

[5] As discussed above, during several of these years, at least from approximately 2003 through 2004, MGIC publicly declined to engage in deep-cede captive reinsurance arrangements.

the end of 2001, the dialer was set to refer 75% of PHH's MI business to Genworth. **ECX 0654** (PHH Suppl. NORA submission) at Ex. M.[6] Genworth maintained this share for nearly two years. But in late September 2003, Bear Stearns analysts reported that Genworth (then GEMICO) wanted to cut back:

> GE confirmed to us, following publication of an article in a trade publication, that GE Mortgage Insurance has decided to limit its use of deep cede captive arrangements. GE would be the second major MI, after MGIC, to publicly state it will limit these lower return business arrangements. GE plans to phase out 4-10-40s by year end 2003, and, going forward, limit the amount of premium it will cede to lenders to 30%.
>
> [**ECX 0794** (9/19/2003 Bear Stearns Equity Research report on MGIC) ("GE Following MGIC and Limiting Deep Cede Captives").]

The very next month, on October 23, 2003, PHH abruptly reversed Genworth's share on the dialer, with 75% now going to UGI and 25% to Genworth. **ECX 0654** at Ex. M. Three weeks later, Genworth's share of PHH business was down to 10%; by February 2004, it was at a nadir of 7%. *Id*. Throughout this time, Genworth publicly maintained that it would discontinue deep cede captive ceding. **RCX 1048** (4/14/2004 Q1 MGIC Analyst Call) at MGIC-CFPB00192335 (Culver: "Relative to the industry itself, really only General Electric [Genworth] has made a movement. There's been rhetoric by others but only General Electric has made a movement as far as what we see. And taking a position somewhat similar to our own."). This circumstantial evidence strongly suggests that PHH used its control over the allocation of business to punish Genworth, and in Danahy's words, to say that "if you're not doing this stuff, we're going to go somewhere

[6] Aside from the occasional email, no actual records tracking the dialer were produced by PHH in the course of this investigation. Exhibit M to PHH's Supplemental NORA Submission consists of a composite created by the company reflecting "the best historical information available regarding the settings on the dialer" in response to Enforcement Counsel's inquiries. *See* **ECX 0654** at 11. We assume its general accuracy, though certain discrepancies in the record are noted where applicable.

else." **ECX 0153** (Danahy Dep.), Tr. 198:22-199:7; *see, e.g.*, **ECX 0495** (recording the history of the PHH/Genworth relationship with no other explanation of this episode).

Ultimately, Genworth did not limit captive ceding. *See, e.g.*, **ECX 0824** at MGIC-CFPB00191159 (10/28/2004) ([redacted]). Genworth maintained its 40% deep-cede captive arrangement with PHH, and by November 2004, its share on the dialer had ticked back up to 20%. Nonetheless, over the next five years, until November 2008, it received only a minority share of PHH's business compared to its primary rival, UGI. **ECX 0654** at Ex. M (from October 2003 to November 2008, Genworth received 25% or less of PHH's dialer share, with the exception of one limited, two-month period in late fall 2007).[7] Genworth's early captive reinsurance statements may well have impacted its share of referrals for years to come.

ii. Radian, CMG, and the preferred provider list for correspondent referrals

To strengthen the leverage it already exerted over the MIs through the dialer, PHH tried to deter correspondent referrals to any MI with whom it lacked a captive by charging a 75 basis point "price adjustment" until August 2008, and continuing a 40 basis point increase thereafter. **ECX 0206** (10/11/2007 email, Bradfield to Danahy); *see also* **ECX 0132** (4/3/2006 Preferred Provider Policy) at CFPB-PHH-00093167; *compare* **ECX 0654** Ex. O (lowering differential from 75 to 40 basis points in August 2008) *with* Ex. N (listing preferred providers without any price adjustment in August

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[7] This brief rise may have been related to events in April 2007. PHH explained that when "one of PHH's preferred MI providers [presumably, UGI] stopped insuring 100% LTV loans, which left PHH with pipeline exposure. Genworth was a great partner and covered PHH's pipeline to reduce customer service issues and avoid disruption in closing loans." **ECX 0495.**

2012); *id*. at 11-13 (declining to answer when the policy first came into use and claiming that PHH "retired" its "Preferred Provider Policy" in June 2009 in favor of a "simplified" policy). The preferred provider list further ensured that in order to be eligible to do business on any PHH loan, let alone actively receive referrals, the MIs needed to agree to a captive reinsurance arrangement with PHH. *See, e.g.*, **ECX 0206** at 1 ("We charge 75 bps to the correspondent if they don't use one of our preferred providers. That would go away if we had a captive with them ...."); **ECX 0403** ("Our ability to negotiate a suitable [captive] arrangement with you will enable you to become a preferred provider.").

An email from June 2008 exposes how PHH disciplined market participants, like credit union correspondent lenders for PHH, to reinforce its agreement to refer business to its captive partners. After learning of PHH's preferred provider policy for the first time, a credit union employee informed her colleagues: "[Y]ou are NOT going to like this . . . Reason: PHH will only accept - (4) Mortgage Insurance Companies. When any other MI company is used, **PHH hits your SRP with .75% . . .** I accused them of discrimination." **ECX 0262** (6/5/2008, 10:55 am email) at 2-3 (emphasis in original). The employee directed her colleagues that they "Must Call PHH to reprice these loans – or they will not settle." *Id*. To quell the credit union's concerns, PHH's account executive for the relationship with the credit union offered to help the correspondent switch to a PHH-preferred MI company. *Id*. Internally at PHH, the head of PHH's Correspondent Channel, Craig Dodds, sought to waive the fee for the loans at issue. *Id*. (6/5/2008, 4:25 pm email); *see* **Hrg. Tr. 531:25-532:12** (3/26 Rosenthal) (Dodds was a leader in correspondent lending). Rich Bradfield, a senior executive at PHH, refused Dodds' request on the grounds that the loan was "not captive eligible yet." **ECX 0263**

(6/5/2008, 8:31 pm email, Levine to Bradfield) (forwarding exchange and asking "Thoughts?"); **ECX 0262** (6/5/2008, 8:35 pm email from Levine communicating response to Dodds); **Hrg. Tr.** 96:4-24 (3/24 Rosenthal) (Richard Bradfield was Senior Vice President of PHH Mortgage and is now also Treasurer of PHH Corporation).

The message to the correspondent lending industry was clear: a captive reinsurance arrangement was a precondition for insuring any loan that went through PHH's doors. Those who didn't comply would be punished. As a result, the only MIs beside UGI and Genworth who received any non-negligible business from PHH in the time prior to late 2008 were Radian and CMG, who each entered into their own captive arrangements with PHH and became preferred providers. The four were the only MIs qualified as "preferred providers" during this time – those who had agreed to cede substantial amounts of borrower premiums as "reinsurance" payments to Atrium. **ECX 0132** (4/3/2006 Preferred Provider Policy) at CFPB-PHH-00093167 (the only preferred providers are Genworth, UGI, Radian, and CMG); **ECX 0654** (PHH Suppl. NORA submission) at Ex. O; **ECX 0159** (3/2/2012 PHH spreadsheet submitted to Enforcement).

Thus, in both the retail and correspondent lending channels in the early 2000s, UGI and Genworth were the only two preferred mortgage insurance providers for PHH. **ECX 0495** (PHH/Genworth memorandum) at 1.

[redacted]

[redacted] At the time, PHH did not do any significant volume of business with Radian.

PHH embraced the pitch. In 2004, Radian entered into a captive reinsurance arrangement with Atrium, and gained access to PHH referrals for correspondent loans through PHH's "preferred provider" list and to loans covered by "lender-paid" mortgage insurance. **ECX 0200** (7/26/2004 Radian/Atrium agreement); **ECX 0132** (PHH PMI Preferred Provider Policy, rev. 4/6/2006) at CFPB-PHH-00093167; **ECX 0159** (3/2/2012 PHH spreadsheet submitted to Enforcement) at tab "2006" (in 2006, Radian was among the top four MIs receiving more than an incidental amount of PHH business). These loans in turn resulted in payments to Atrium under the parties' captive arrangement.

Similarly, CMG, a specialized MI that insured credit union loans, entered into a captive reinsurance arrangement with PHH in December 2006. **ECX 0202** (12/1/2006 CMG/Atrium agreement); **Hrg. Tr. 141:19-142:11** (3/24 Rosenthal). This arrangement coincided with a "License Agreement," which expressly provided that PHH "(i) designate CMGMI as a preferred mortgage insurance provider in its correspondent channel, and (ii) use its commercially reasonable efforts to obtain primary mortgage insurance from CMGMI for loans closed by or for the benefit of credit unions doing business" with PHH. **ECX 0747** (11/29/2007 email thread) at 1 (describing License

Agreement with CMG).[8] Indeed, from the inception of the arrangement, PHH had planned that "[A]ll Net 3 and Net 1 controllable CU MI will be directed to CMG *once the captive agreement is in place*." **ECX 0131** (11/23/2005 email) at 12 (Bradfield describing plans for CMG and noting that the 75 basis point price adjustment had only recently been dropped) (emphasis added). By late 2007, however, PHH determined that "we don't like the captive we have with CMG right now," and contemplated whether CMG could be convinced to take additional steps in exchange for a place on the dialer. **ECX 0747** at 1-2. PHH Senior Vice President Robert Smith opined that CMG "will be willing to re-negotiate the captive terms, since they could be losing the $280k licensing fee and all of the captive business." *Id*. (emphasis in original). He further noted that if PHH opted not to renew this Licensing Agreement in August 2008, PHH would "presumably terminate new business into the captive." *Id*. As the Tribunal has noted, "it is difficult to read ECX 747 as anything other than direct written evidence that referrals from PHH to CMG were made pursuant to an agreement to refer real estate settlement business in consideration of premiums ceded to Atrium." May 22 Order at 17. Respondents brought forth no evidence at the hearing to rebut this powerful inference.

c. *The influence of captive reinsurance over MI selection intensified following PHH's October 2006 RFP*

The evidence that ceding and referrals were tightly intertwined is even more powerful beginning in October 2006, with PHH's issuance of the Request for Proposal (RFP) announcing plans to potentially double its MI-eligible business and inviting MIs to compete for the resulting referrals. Throughout the RFP process, which triggered

[8] Though it would have been responsive to a document request in the Civil Investigative Demand issued to PHH during the investigation leading to the initiation of this proceeding, the License Agreement was not produced to Enforcement.

discussions extending into 2009, PHH repeatedly embraced the *quid pro quo* use of captive arrangements.

The RFP made clear that MIs with the most attractive proposals would receive the expanded volume of business referred from PHH. PHH sent identical letters introducing the RFP to multiple MIs, announcing that it was considering shifting a large volume of self-insured business to private mortgage insurance. *E.g.,* **ECX 0024** (RFP letter to MGIC); **ECX 0713** (RFP letter to UGI); **ECX 0738** (Rosenthal's "RFP Thoughts"). PHH would be allocating these loans to mortgage insurers through the dialer—effectively doubling the amount of PHH volume that could be referred to mortgage insurers. **Hrg. Tr. 176:2-177:21** (3/24 Rosenthal).[9] To capitalize on its leverage, PHH explicitly sought "creative structuring" of captive reinsurance by the MIs, and solicited offers of "any unique opportunities [the MIs] can provide" to PHH and specific discussion of a number of captive features, including "Deep Cede XOL" (excess-of-loss), adjusted risk layers, bases for taking dividends, and relaxed capital requirements. **ECX 0024**.

Through the RFP, PHH intended to "[u]se leverage to renegotiate captives with MIs," where "the leverage would be, we'll send you mortgage insurance, and you give us as good of a deal as is possible." **Hrg. Tr. 270:6-272:11, 272:19-273:1** (3/25 Rosenthal); **168:3-170:7** (3/24 Rosenthal); **181:4-15** (same); **ECX 0737** ("Captive Thoughts"). PHH's leverage over the MIs derived from its power to send future business to MIs. The MIs understood this power dynamic well. As Dan Walker of UGI testified,

[9] By 2009, all of this increased volume had been moved from the self-insured program to the MIs. **Hrg. Tr. 177:22-178:10** (3/24 Rosenthal). Thus, between 2006 and 2008, even as the national mortgage crisis began to accelerate, PHH increased the mortgages it sent to the MIs annually by 37%, from 10,694 to 14,677. **ECX 0159**, tabs "2006" and "2007," column A of each.

lenders such as PHH "have more leverage than, say, a third party reinsurer might have" "because they have the ability to ultimately control whether UGI is a major partner or a minor partner" through referrals. **Hrg. Tr. 2202:23-2203:10** (6/4); *see also id.* **2203:11-13** (agreeing that "[l]enders *always* have that leverage" because "[t]hey're the customer") (emphasis added). In exchange, PHH sought to extract kickback payments under the pretext of captive reinsurance.

In internal discussions relating to the RFP, PHH executives openly discussed the fact that MI allocations were tied to captive reinsurance.[10] Rosenthal, the PHH executive chiefly responsible for the 2006 RFP, described the RFP to one MI as an "RFP for our Captive Mortgage Insurance business." **ECX 0535** (10/6/2006 email to PMI). As a result of the RFP, PHH planned to expand its referral system to new MIs in exchange for receiving a lucrative captive arrangement. *See, e.g.*, **ECX 0206** ("We have an opportunity to get some $ from a few MI providers to open up our dialer and set up a captive with them"). In presenting the business case for expanding the dialer, Bradfield laid bare the mission of the RFP: "In 2007/2008, PHH desires to add additional MI providers to the mix to negotiate more attractive captive re-insurance terms." **ECX 0360** (MI Provider Additions memorandum); *see also* **ECX 0324**, (1/11/2007 internal PHH email) (adding MIs to dialer is "very valuable to the company from an economic perspective. . . Basically what it accomplishes is significantly reduces [sic] our risk in our Captive Re-insurance transactions."); **ECX 0447** (9/13/2007 email proposing

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[10] There is no evidence that anyone at PHH, including Rosenthal, as the person chiefly responsible for the RFP, **Hrg. Tr. 168:9-13** (3/24 Rosenthal), focused any significant amount of time on any aspect of the RFP *other than* captive arrangements, nor that any significant portion of the communications between PHH and the MIs concerning the RFP touched on anything but captives. The RFP letters directed copies of responses to be sent directly to Milliman, who had no role in selecting MIs other than in captive reinsurance. *See, e.g.*, **ECX 0024** (RFP Letter) at 5.

discussion of "which companies we are going to move forward on a *captive* (MGIC/Radian/Genworth/UGI/Triad) *and market share*.") (emphases added).

The MIs got PHH's message. They responded to the RFP with captive reinsurance proposals that included a variety of highly favorable features. Particularly for the MIs who previously had no access to PHH referrals, the RFP presented a tremendous opportunity and they eagerly complied. Captive structures were submitted as "bids" to PHH and ranked by Milliman. *See* **Hrg. Tr. 193:21-194:2** (3/24 Rosenthal), **513:19-517:14** (3/26 Rosenthal); **ECX 0014** (1/29/2007 Milliman "Analysis of Proposed Reinsurance Structures") at 3-5. For example:

- RMIC was "prepared to offer PHH Mortgage . . . three . . . captive reinsurance structures," including a 4/10/40 XOL arrangement "offered only to a select group of qualified lenders" and was "willing to accept a letter of credit in lieu of cash or securities" in light of "the capital burden to capitalize a new structure." RMIC also offered "an option to allow for the early termination of a reinsured book of business" which would "accomplish[]" the "accelerat[ion] [of] the distribution of trust assets to the reinsurer." **ECX 0030** (10/2006 RFP response by RMIC) at 12-13.

- MGIC offered various "[redacted] structures – which in prior years, it had strenuously refused to engage in at all. Their features included a [redacted] MGIC also offered a number of "[redacted] including the [redacted]

- PMI touted its "'best-in-class' captive reinsurance capability" which would enable "PHH [to] benefit[] from PMI's knowledge of structures, creativity, reporting analytics and operational capabilities" and "offer[ing] a comprehensive array of captive reinsurance programs, including both excess of loss and quota share;" it noted that "[t]he reinsurance programs outlined herein represent one component of a broader business relationship whose "key drivers" "include the anticipated mix of business," and required "clearly defined agreement with regard to those variables [as] necessary prior to finalizing our proposal." PMI offered an XOL structure with a 39.95% premium cede and a quota share structure with a 42.5% net premium cede; setting loan eligibility so as to "enable[] lender-captives to maximize their captive portfolio"). **ECX 0519** (10/20/2006 RFP response by PMI) at 15-19.

- Triad offered to "discuss" "Deep Cede XOL and/or Max Quota Share" captive arrangements, explaining that "Triad works with lender partners to develop *opportunities for additional income*" (emphasis added) and that "[c]aptive structures" are one of "the ways Triad seeks to *help its lender partners*" (emphasis added). Triad offered to "customize captive structures around your needs," noting that Triad had pioneered XOL arrangements "in excess of 35 percent" and that "*[t]he balance of the industry at the time generally tried to maintain cede levels at 25 percent or lower*" (emphasis added). It declared that "Triad's long-term strategy is to develop *strong partnerships with the industry's top lenders through the delivery of flexible premium cede reinsurance agreements*." To that end, Triad proposed a "Dynamic Captive Structure" that would provide the benefits of, among other things, "[i]mprov[ing] potential internal rates of return" and "[a]lign[ing] potential dividend releases." **ECX 0542** (10/23/2006 "Relationship Proposal" RFP response by Triad) at 9-11.

PHH pressed the MIs to compete against one another in a sort of reverse competition: to pay PHH more and more in ceded premiums for assuming less and less risk. For instance, when PMI offered to "develop some thinking and methodology around the actual risk-based entry point and layer...," Rosenthal cut to the chase, imploring them to "think high cede, late attachment, short corridor, low capital, fast dividend!" **ECX 0739** (10/27/2006 email). In Rosenthal's words, "[t]hese are the things that would make the captive more valuable to Atrium." **Hrg. Tr. 206:18-19** (3/24). He urged PMI to "optimize the transaction from a profit perspective for Atrium ... so we could get the best possible deal," minimize the risk layer Atrium reinsured, "minimize the quantity of capital I'm putting in," and yet, while reducing the risk, demanded a ceded premium "[a]s high as possible" – a factor limited only by Milliman's creativity on PHH's behalf. *Id.* **206:3-208:16**. Every one of these steps reveals the reality of the transactions: the idea that the captive reinsurance arrangements were created to provide a "service" to the MIs is a fallacy designed to mask the funneling of payments to PHH.

The MIs responded to PHH's repeated prodding following their initial RFP "bids." By December of 2006, Rosenthal wrote to Milliman that PMI was "calibrating their captive" in various ways, including a 5.5% attachment point as part of a 5.5/10/40 excess-of-loss structure, described in an attached document. **ECX 0320** (12/22/2006 email with attachment). Rosenthal noted that, according to the document, for the 2003 book year such a structure "would not pass risk transference," but "I am hoping that when they re-run this for the 2006 collateral, they are going to see that the 5.5/**10**/40 would pass the test." *Id.* (emphasis in original). Rosenthal then expressed his approval of the bid, and referenced the anticipated responses of other MIs:

- As I look at your analysis from about 1 month ago, their deal looks ok. A bit higher on the capital, but the PV's and mean returns look attractive. I guess we should discuss this once more – to compare it to MGIC's and Triads [sic].
- Radian and Genworth are both coming back upping their ante.

[*Id.*]

RMIC, while proposing a captive structure to PHH, attempted also to send business referrals to PHH in hopes of getting on the dialer. **ECX 0343** (1/17/2006 to 1/18/2006 PHH email thread) ("Over the past few weeks, RMIC has been feeding us many leads for our business .... We are about to select our Captive Re-Insurance partners for 2007."); *see* **ECX 0030** (10/2006 RFP Response from RMIC) at 3 (offering "three deep cede proposals"), 12-13.

As discussions of the RFP proposals continued, captive reinsurance continued to feature prominently and explicitly in the MIs' efforts to obtain an agreement for PHH's referrals. In a December 2007 email, for example, an RMIC representative appealed to Rosenthal: "Is there anything we can do to break into your account? . . . *I know the captive relationship has driven your MI allocation*, but isn't it about time we do some business?" **ECX 0768** (emphasis added). Later that month, PHH executives explained that Radian would receive allotted referrals "assuming that they continue to match / remain competitive whatever MI captive structure we develop / negotiate with the others (in case we are able to increase the attachment point due to the MI re-pricing or go to a variable structure)." **ECX 0361** (12/27/2007 Rosenthal email to Bradfield).

In one of a series of explicit inducements to enter into a referral agreement, on June 2, 2008, Rosenthal advised sales personnel from MGIC that making their business "captive eligible" was "likely required to play (and we want to play!)." **ECX 0485** at 3. Similarly, on June 4, 2008, Rosenthal told RMIC that "[o]ur ability to negotiate a suitable arrangement with you will enable you to b[e]come a preferred provider." **ECX 0773** at 1. The very next day, PHH personnel noted that plans were in place to set up a captive with RMIC. **ECX 0262** (6/5/2008 email from Dodds) ("we are setting up the RMIC captive").

Atrium's existing captive partners Genworth, UGI, and Radian were also active participants in the RFP process. [redacted]

[redacted]

ECX 0529 (10/20/2006 RFP response by Genworth) at 21-26. Genworth noted that "as of 9/30/2006," Genworth's captive arrangement with PHH had resulted in more than $65 million in ceded premiums while $0 had been paid by Atrium in reinsurance claims. *Id*. Genworth had itself paid more than $15 million in claims over that same period on PHH loans. *Id*. Nonetheless, Genworth soon succumbed to the pressure to offer more. Genworth presented "two options" to Rosenthal on December 20, 2006, including an excess-of-loss deal which they noted "pushes out your first attachment point by 50 bps and reduces your risk layer from 10 to 9," without any reduction in ceding. **ECX 0022** (email thread) at 1. In a December 22, 2006 email, Rosenthal reported to Milliman that Genworth was "coming back upping their ante." **ECX 0320.** A "High Level Captive Review" memo indicates that Genworth had "Multiple deals on the table," including a "5/15/40" and a "4.5/13.5/40" structure – both of which would further reduce any potential for risk to Atrium. **ECX 0749; Hrg. Tr. 188:1-15** (3/24 Rosenthal).

UGI's response to the RFP focused heavily on its captive arrangement, touting the substantial financial benefits to PHH of its existing arrangement as well as UGI's willingness to "explore new captive reinsurance opportunities with PHH." **ECX 0733** at 11**.** UGI was "pleased to observe the results of a simple idea in 1993 accumulating into a significantly capitalized reinsurance entity for PHH." *Id*. at 11. UGI noted that the "net retained value to AIG United Guaranty of the PHH business since 1993" – *i.e.*, the value of referrals from PHH during that period – "has surely been of comparable magnitude as that recorded on the books of Atrium." *Id*.

UGI's response also emphasized multiple aspects of its arrangement with Atrium that were highly favorable to Atrium and disadvantageous to UGI. For example, UGI pointed out that its agreement with Atrium "allows Atrium to request adequate flexibility to request commutations as business conditions dictate," and that a commutation could "reduce risk transfer below required levels." **ECX 0733** at 13**.** UGI noted that there were "alternatives to commutation to free up cash from Atrium" that UGI was "willing to explore." *Id.* UGI explained that ceded premiums from older books provided "more than enough capital ... to fund new books of business," but that it would "work together with PHH to address any developing capital issues." *Id.* at 12. UGI emphasized that "[i]t is the intent of our response to maintain our current share position" at a minimum, with a goal of "expanding our current business partnership." *Id.* at 2. As Walker explained, this was UGI's "standard sales response. We want more of your business." **Hrg. Tr. 2210:1-2** (6/4).

PHH confronted UGI with competitive bids from other MIs in order to pressure UGI to pay more kickbacks. On January 16, 2007, Rosenthal urged UGI to sharpen its pencil on its own bid:

> The request would be to add 50 bps to every [attachment point] number that you can .... If you can't do this, at a minimum add it to any transaction that you know passed risk transference. I would hate to go to Mark [Danahy] & Rich [Bradfield] and propose a worse deal to them than I already have .... This, *along with what I am seeing in the market from some participants*, has led me to believe that the calibration was 0.50 low at all levels. Hence, the "add 50 bps" if possible.
>
> [**ECX 0716** (emphasis added).]

See also **Hrg. Tr. 224:11-226, 263:14-17** (3/25 Rosenthal) (Danahy and other high-level executives were responsible for setting the dialer for MI allocations). Eager to maintain its longstanding agreement to refer, UGI complied, submitting a new proposal to PHH the next day with variable attachment points between 4.0% and 5.5% and detachment points between 14.0% and 15.5%. **ECX 0718** (1/17/2007 email, Marshall to Rosenthal).

Just a few months after the RFP was issued, amid active negotiations over future referrals and captive arrangements, UGI delivered on its promise to "free up cash from Atrium." **ECX 0733**. Starting in early November 2006, less than a month after initiating the RFP, Rosenthal strategized with Milliman to "begin to work the current capital return / book commutation angle" with UGI alongside soliciting UGI's RFP response on captive revisions. **ECX 0745** (11/6/2006 email, Rosenthal to Bjurstrom) at 1 (noting that UGI was encouraged to make an offer "as opposed to us telling them where they have to get to."). By early December 2006, PHH was pressing UGI to release funds from the trusts, initially in the form of a commutation payment, **ECX 0740** (12/8/2006 UGI email to Rosenthal re: "Commutation request"), and then as a "dividend," **Hrg. Tr. 255:22-256:2** (3/25 Rosenthal). *See also* **ECX 0305** (1/2/2007 email from Rosenthal to Walker) (seeking a "quick return of the capital" with a date as to "How quickly can we make this occur?"); **ECX 0033** (Rosenthal / Walker email chain) (noting "creativity and willingness to work on this"). Initially, UGI could not agree to the amount proposed. **ECX 0033.** By February 2007, it was public knowledge that the housing market was beginning to collapse. *See* **ECX 0686-0690** (news articles). The industry was in turmoil, and it was clear that losses due to foreclosures and delinquencies were likely to mount. *Id*. Despite the impending risks looming in the market, on February 6, 2007, UGI agreed to amend its existing captive agreement for the sole purpose of issuing a dividend out of its Atrium "reinsurance" trust account to

Atrium. **ECX 0342** (2/6/2007 email exchange). Though it was "not easy" for UGI to agree, they complied with PHH's demands. *Id*. The same PHH and UGI executives who were then developing revised captive structures negotiated this disbursement of tens of millions of dollars from the UGI trust to Atrium.[11]

Such a dividend was not authorized under the parties' reinsurance agreement. **Hrg. Tr. 258:4-12** (3/25 Rosenthal); **2220:15-221:1** (6/4 Walker). Though UGI had initially protested that the amount was improper, the dividend was ultimately issued in almost precisely the amount PHH requested: $52 million. **ECX 0753** (3/2/2007 PHH email confirming $52 mm wired to Atrium); *see* **ECX 0033** (resisting $52 mm amount). UGI amended the agreement to permit the dividend. **ECX 0752** (1/4/2007 email, UGI proposes $44.9 million "release from the trusts"); **ECX 0584** (UGI/Atrium agreement, Amendment # 7) at CFPB-PHH-01166640. As discussed below, this dividend eliminated all of Atrium's previous capital contributions to the UGI trust account, *see* § III.B.3.a.ii.1, *infra*, and UGI's agreement to allow it represented a complete about-face from the position it expressed to state regulators in 1998 through MICA that "dividends and other payments by the captive must be restricted to ensure the availability of funds to pay claims." **ECX 0035** (1/22/1998 Presentation to Arizona Department of Insurance, "Captive Reinsurance and Other Risk Sharing Arrangements") at MGIC-CFPB00190650.

UGI received nothing in consideration from PHH under the terms of the amendment. **Hrg. Tr. 2221:2-8** (6/4 Walker). But UGI did continue to receive

[11] Sometimes both topics were discussed in the same email message. *See, e.g.*, **ECX 0305**.

referrals from PHH, and to maintain its majority stake on the dialer while the intensely competitive RFP process continued. **ECX 0654** at Ex. M.

Radian, whose captive arrangement was barely two years old but had not yet yielded nearly as many referrals as UGI's and Genworth's, offered to raise the bar to "Radian's maximum excess of loss structure," including a "42.5% net premium cede," and "Radian's maximum quota share structure," including a "50% share." **ECX 0536** (RFP response by Radian) at 38-43. Radian included a "Coverage Matrix" showing that the "Capital to Premium Ratio" – the ratio of capital maintained in the trust to the premium received from Radian – would fall from 95.07% under a 4/10/40 structure to 75.08% under the proposed structure; proposed a "Paid Loss Ratio" structure where "[s]lower prepays [sic] speeds or lower defaults reduces the ratio [and] keeps it below the attached range;" and offered to "consider amending PHH's agreement to refresh the risk in force of each book year to reflect current rather than original risk in force," which would lead to the "possibility of declaring dividends earlier." *Id*. There is no rational explanation for Radian's proposal to further reduce any possible value it might theoretically have received from the captive arrangement – other than the desire for an increase in referrals, secured by a strengthened agreement to pay referral fees.

Nonetheless, PHH expressed displeasure with Radian's bid in December 2006, characterizing it as "worse than our current deal of 4/10/40 in all respects" and criticizing Radian for "going the wrong way" because the captive proposal was "getting less aggressive, not more." **ECX** 0322. Steve Young of Radian responded that he would "have this revaluated." *Id*.; *see also* **ECX 0315** (10/30/2006 Rosenthal email to Milliman) (requesting a "Radian analysis, showing that what they offered to us is a bad deal")**.** On December 7, 2006, after Radian sent "adjustments," Rosenthal commented to Bradfield: "Radian got up to even with the current deal – even after all my gentle nudging. Not looking good for the Philly team [Radian] on this." **ECX 0332.** Rosenthal forwarded the proposal to Milliman, called it "unimpressive" and asked for a status update regarding other MIs. **ECX 0314.** Even so, in January, Radian wrote to Rosenthal in order to "be sure we are getting close to finalizing [captive] terms." **ECX 0317** (1/12/2007 email). Rosenthal responded, confirming the captive structure that Radian was then offering, a "3/15/50" for "Prime Credit," with "Variable corridors" for "the other loans." *Id*. (1/16/2007 email). The next day Rosenthal informed Milliman that "[t]his new deal from Radian moves us back to an inferior than current deal." **ECX 0120**. Sure enough, Radian was unable to access a larger share of PHH's business, settling for holding on to the smaller portion guaranteed by its initial captive agreement. *See* **ECX 0159**, tabs "2007," "2008."[12]

As PHH executives weighed the results of the RFP, they continued to negotiate with the MIs over potential structures for nearly two years, well into fall 2008. **Hrg. Tr. 576:14-24** (3/26 Rosenthal) ([**Q.**] "Did the RFP lead to any additional business? . . . [**A.**][U]tilizing the RFPs, we learned about these companies and we began dialogue with them, and ultimately we began doing business with some of these companies several years later. So the RFP may have been part of our engagement with these companies and eventually we did business.").

In internal discussions, PHH made clear that the existence of a captive arrangement was a prerequisite to accessing PHH's allocation of MI business through the dialer and the preferred provider list. **ECX 0419** (4/10/2007 email, Rosenthal to

[12] Radian received 1.9% (258/13,811) of PHH loans with private mortgage insurance in 2007, and 0.8% (119/14,677) of such loans in 2008. *Id*.

Bradfield) (asking "[w]hen should we revisit the conversations on the captive modifications?" and listing "possible modifications" as moving volume of referrals in relation to captive arrangement decisions); **ECX 0206** (10/11/2007 PHH internal email thread) at 1-3 (In the 5:33 PM email, with subject "Additional MI Vendors to Dialer," Bradfield raises the issue of "adding a couple of MI vendors and setting up captives with them" and notes that "[w]e have an opportunity to get some $ from a few MI providers to open up our dialer and set up a captive with them;" Bradfield notes that doing so would "[a]llow more Net 3 [*i.e.*, correspondent] MI provider choices"[13] and "[i]mprove Variable Captive available through new captive relationships," reflecting the close connection between the dialer, the preferred provider list (dictating Net 3 selections), and captive participation; in the 6:09 PM email, Danahy responds with a discussion about creating a captive arrangement with MGIC, and possibly other MIs, and volumes of MI business; in the 6:15 PM email, Bradfield notes that Radian, which had a captive arrangement with Atrium at the time, "get[s] Net 3 business" and could be added to the dialer; in the 7:03 PM email, Danahy expresses concern that PHH needs to ensure that if it creates two new captive arrangements then enough mortgage insurance business needs to be referred to those two MIs "to make sure we get critical volume to new trusts").

Even though the RFP process did not lead to any new MIs joining PHH's captive arrangements (due to external market factors discussed below), the responses of Genworth, UGI and Radian to the RFP shine a light on their incentives for entering into and continuing with their existing captive arrangements. It was only because PHH had leverage based on its ability to refer a newly-available stock of future business that the

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[13] "[N]et three is correspondent" loans. **Hrg. Tr. 189:25-190:1** (3/24 Rosenthal).

MIs were compelled to propose new structures or transactions that were disadvantageous to them. Even though it was not rational, from an insurance perspective, for the buyers of the purported service (the MIs) to compete with one another to propose reinsurance structures or transactions that exclusively benefited the "seller" (Atrium), they complied because a refusal to play along could jeopardize their share of PHH business in the future. As stated by UGI in the cover letter to its response to the RFP, "the intent of our response" is "to maintain market share." **ECX 0733** at 2**.** That same leverage also explains why those MIs participated in their existing captive arrangements, which were also otherwise irrational and highly disadvantageous to the MIs. Thus, the course of dealing during the RFP process highlights the pre-existing and continuing exchange of ceded premiums for referrals of mortgage insurance business.

3. The "agreement to refer" persisted well beyond July 21, 2008

Respondents' pervasive pattern-and-practice of extracting captive reinsurance payments and promises in exchange for MI referrals endured throughout 2008 and 2009, and continuously thereafter. Although external factors restricted certain captive reinsurance practices and ultimately curtailed new captive originations in 2009, Respondents persisted in using their existing captive arrangements as a significant factor in allocating MI referrals, seeking any possibility of new arrangements, and siphoning funds out of Atrium and its accounts. Even in the face of dire market conditions, conditions which Atrium was purportedly created to "reinsure" against, PHH fought to continue to reap profits from its captive arrangements.

a. Despite market turmoil, Respondents' captive arrangements drove referrals of business to the MIs

In 2008, the economy plummeted into full-blown crisis. Turmoil in the housing markets was at the center of the storm. One of the markets' dominant investors, Freddie Mac, sought ways to stabilize the situation. In February 2008, Freddie Mac effectively disallowed deep-cede captive arrangements, announcing that effective June 1, 2008, it would no longer purchase loans subject to captive arrangements with a cede level higher than 25% "in order to increase the claims-paying and capital retention capacities" of the MIs as they struggled with massive losses.[14] **ECX 0031** (UGI letter attaching press release) at 3; **ECX 0378** (2/14/2008 Walker email) (Walker notes that he is busy "forecasting billion-dollar incurred losses in this industry").[15] Freddie's change stymied the planned agreements flowing from PHH's RFP. Nonetheless, throughout the summer and fall of 2008, PHH continued to lay plans for new captive arrangements with MGIC and RMIC in exchange for opening up referrals to these companies. UGI, Genworth, Radian, and CMG continued to use their captive arrangements with PHH to gain business despite the escalating calamity in the mortgage industry.

[14] Freddie Mac did not regulate the amount of risk transferred, but solely set a maximum across-the-board cap on the amount that could be ceded to lender captives for "reinsurance" irrespective of the amount of risk they assumed. Freddie Mac sought, by limiting the amount of premiums that MIs could cede to lenders, to protect the "claims-paying ... capacit[y]" of the MIs. **ECX 0031** at 3.

[15] This policy change further demonstrates that Respondents' captive reinsurance arrangements were not bona fide transactions. As the catastrophe approached the industry, Freddie Mac recognized that these purported "reinsurance" arrangements did not help protect the security of the industry, the very purpose that reinsurance should be intended to serve.

i. Respondents' agreement to refer business to United Guaranty

PHH reached out to UGI on the same day that Freddie Mac announced its prohibition on premium cedes over 25% for captive arrangements. *See* **ECX 0378**. On behalf of UGI, Walker emphasized to Rosenthal that "some MIs argued with Freddie to preserve at least a 25% cede for captives," suggesting that Freddie Mac may have considered going lower or taking other actions, but that the MIs fought to keep prices for captive reinsurance *high* to appease the lenders. *Id.*; **Hrg. Tr. 2237:13-238:2** (6/4 Walker) (he was "dropping a hint indirectly" in this email because UGI's conversations with Freddie were confidential). To further assuage PHH, Walker reminded Rosenthal that "you got a very nice dividend check last year" of $52 million, and reaffirmed that UGI would continue to engage in captive reinsurance despite the tide of regulations and market turmoil rising against it. **ECX 0378** ("You know that UGI has always favored this universally recognized risk transfer vehicle for insurers."). He foreshadowed that UGI was already "working with Milliman on some alternatives for captives" with higher cedes that would now fall outside the Freddie Mac guidelines. *Id.*

On February 28, 2008, UGI gave formal notice (notably, to PHH Mortgage, not to Atrium) that it was terminating its captive arrangement effective June 1, 2008, to align with the new Freddie Mac cede limitation. **ECX 0031.** A single line in bold print made PHH an offer: **"To comply with this new Freddie Mac requirement, United Guaranty would be pleased to amend its captive reinsurance agreement to reflect the new Freddie Mac requirement."** *Id.* at 1. But a revised agreement could not be resolved in time to dovetail with Freddie's

June 1, 2008 deadline, and the existing contract between UGI and PHH temporarily lapsed. On August 8, 2008, as negotiations over a new captive with UGI continued, PHH executives expressed their displeasure with UGI's captive proposal by further curtailing referrals to UGI. **ECX 0218** (Danahy and Bradfield noted a "low attachment point" with no opportunity to move it up if risk is "greater than expected;" Bradfield responds: "I am calling UGI today to discuss the fact that they will not be a preferred provider for Net 3 [correspondent] business."). Effective that same day, PHH amended its "Preferred Provider" list to exclude UGI, and added MGIC and RMIC. **ECX 0654** at Ex. O. Between June and November 2008, UGI received a negligible amount of business from PHH. **ECX 0159** at tab "2008."

By the fall of 2008, the financial crisis had ravaged the mortgage and financial markets. The United States government seized UGI's parent, AIG, in a historic $85 billion bailout. UGI's operations were disrupted; all efforts were devoted to "trying to save a company." **Hrg. Tr. 2186:12-187:6** (6/4 Walker). By November 2008, UGI attempted to get back on track. Nick Nicholes, a UGI salesperson, reached out to PHH in a message titled "Dialer and Atrium," and immediately offered to discuss "re-establishing Atrium and how soon we can begin receiving business." **ECX 0269** (11/12/2008 email). Within five days, UGI delivered proposed excess-of-loss captive reinsurance contracts to PHH. **ECX 0409** (11/17/2008 UGI/PHH email) (transmitting proposed captive agreements). Within two days, PHH arranged to allocate 40% of its business going forward to UGI. **ECX 0407** (11/19/2008 PHH internal email thread) at 1 (Rosenthal: "I just received Captive XoL contracts from UGI .... I am fine with turning up the dialer."); **ECX 0220** (11/19/2008 email, Bradfield to Rudolph, Subject: Dialer)

("UGI: 40% ... MGIC: 10% ... Genworth: 50% .... This is subject to change, possibly soon, pending the outcome of Genworth's captive decision.").

Discussions in November 2008 made clear that UGI and Atrium would proceed to amend their captive agreement with an XOL arrangement at the maximum price set by Freddie Mac – 25% of borrowers' premiums. **ECX 0220; ECX 0409; ECX 0404** (11/7/2008 internal PHH email) (UGI has "confirmed that an XOL captive is something they are still interested in doing"). Plainly, the renewal of the captive arrangement was offered pursuant to the parties' longstanding agreement to refer business: in one breath, UGI proposed "re-establishing Atrium," and also requested referrals. **ECX 0269**. The existence of a captive arrangement was a significant, and possibly dispositive, factor in setting the dialer in November 2008**.** UGI held on to a 40% share, though PHH executive Rich Bradfield admitted that "[u]nder normal circumstances, I would start out with less going to UGI but since a captive with Genworth is still TBD, I am willing to go higher." **ECX 0407** (11/19/2008 email); **ECX 0654** at Ex. M. As of year-end 2008, UGI was the only MI to offer PHH a renewed excess-of-loss captive reinsurance arrangement continuing beyond the first quarter of 2009. **ECX 0487** (12/24/2008 email) (Rosenthal giving Bradfield the "current state of captive"). As a result, UGI was poised to be "the only ones in the dialer that have a captive" taking loans originated from new borrowers for 2009. **ECX 0405** (12/29/2008 email). UGI started receiving non-negligible amounts of PHH business in December 2008**. ECX 0159** at tabs "2008," "2009." PHH's top executives continued to closely monitor the progress of the reinsurance arrangement. **ECX 0437** (2/2009 emails between Danahy and Rosenthal) (UGI is "drafting up a re-insurance agreement for us right now").

UGI and Atrium formally amended their excess-of-loss captive arrangement in April 2009, effective March 1, 2009, with a premium cede of 25%. **ECX 0520** (Amendment #9 to UGI/Atrium reinsurance agreement)**.** The plans for a new captive amendment with UGI shifted PHH's business towards UGI. **ECX 0159** at tab "2009" (showing a steady increase in UGI-covered originations over early 2009). The dialer setting for UGI increased to 100% on April 6, 2009. **ECX 0654** at Ex. M. UGI received, by far, the largest share of PHH business from May to December 2009. **ECX 0159** at tab "2009."[16] Until March 2010, no other MI had a larger percentage than UGI on the dialer. **ECX 0654** at Ex. M.

Captive reinsurance is the only explanation for this allocation. PHH executives openly discussed steering business referrals to UGI for the explicit purpose of maximizing PHH's gains from captive reinsurance. As late as May 19, 2009, PHH executive Richard Bradfield directed that the company steer referrals to "max ugi b/c of captive so not interested in sending mgic any mi." **ECX 0744**. At the hearing, Rosenthal agreed that he "interpreted [Bradfield's] sentence" to mean that "he wants the most possible MI being sent to UGI because of the captive arrangement." **Hrg. Tr. 555:1-5** (3/26). There is no evidence of any other rationale for PHH's choice. *See also* **ECX 0370**, **0371** (8/3/2009 email from Bradfield on "Captive / Dialer Scenarios" notes first under attachment "MI Allocation Considerations" that "the only captive in place is UGI's").

[16] UGI's share of PHH's MI referrals declined steadily after that time, suggesting that the influence of their captive reinsurance arrangement in garnering future referrals had waned – and demonstrating that without captive, UGI had a hard time competing for PHH's business.

By 2010, no MI was engaging in captive reinsurance for new originations. While UGI retained the theoretical right to cancel the contracts on ongoing ceding, it did not do so. In addition, refinances and other changes in the markets had the potential to disrupt the flow of ongoing ceding. For example, in 2009, PHH executives expressed concern that the new refinance programs for troubled borrowers could have "tremendous downstream implications to captive re-insurance." **ECX 0212** (3/11/2009 email chain). UGI promptly assured PHH that "[l]oans will remain in their original captive." *Id*. By taking steps to maintain the flow of ceding to Atrium and ensure it was not redirected by servicing transfers, UGI continued to garner favor with PHH.

ii. Respondents' agreement to refer business to Genworth

In the wake of Freddie Mac's ceding limitation announcement, Genworth similarly had to adapt its captive reinsurance arrangement with PHH to the new regulations. In June 2008, PHH and Genworth amended their captive contract priced at the Freddie Mac maximum of 25% ceding for loans originated after June 1, 2008. **ECX 0503** (Amendment #4). From May through December 2008, Genworth received the vast majority of PHH's referrals. *See* **ECX 0159** at tab "2008."

By November 7, 2008, PHH executive Richard Bradfield asked Rosenthal for an update regarding Genworth's stance on captive reinsurance. *See* **ECX 0404** (PHH internal email chain). Bradfield advised Edwards and Danahy that UGI, Genworth's longtime competitor, had "confirmed that an XOL captive is something they are still interested in doing." *Id*. Expressing concern that "all of our business being originated today (to close in 09) is not going into a captive with MGIC or Genworth," Bradfield indicated that absent advantages from the Genworth captive, he would rather refer business to United Guaranty. *Id*. ("We want to get UGI back on in the dialer as soon as possible.").

When PHH adjusted the dialer on November 21, 2008, Genworth's share of the referrals was increased from the prior year, but it was kept lower than it might have been "under normal circumstances" "since a captive with Genworth is still TBD." **ECX 0407** (11/19/2008 email); **ECX 0654** at Ex. M. Within a month, Genworth offered a revised captive reinsurance arrangement with PHH for 2009, but only a quota share structure, which PHH did not want. **ECX 0487** (12/24/2008 email from Rosenthal to Bradfield regarding the "current state of captive"); **ECX 0153** (Danahy Dep.) Tr. 110:15-111:13 (referring to quota share deals as an "unattractive alternative" because PHH would "have to invest in the risk assessment"), 123:17-18 ("I have a bias against the quota share"). Only United Guaranty offered PHH an excess-of-loss arrangement for 2009. **ECX 0487**. No additional book years under the arrangement with Genworth were ever placed into the captive, though ceding under the existing agreement persisted.

Genworth's share of the dialer was cut to zero on January 28, 2009 and remained there for the entire year. **ECX 0654** at Ex. M. The 566 loans that Genworth closed with PHH in 2009 were almost entirely originated in the first few months of the year, which may reflect referrals steered to Genworth under the earlier dialer settings but which did not close until a month or two later. *See* **ECX 0159** at tab "2009," cells B18-B30. PHH and Genworth's captive arrangement no longer covered new originations after March 31, 2009. Without offering captive reinsurance on new originations, Genworth struggled for a time to maintain a significant share of PHH referrals as its competitor, UGI, seized the edge with a new captive arrangement. Furthermore, UGI had taken steps to keep refinances with Atrium whereas Genworth suggested that these loans would be considered "payoffs" of the original loans on which ceding to Atrium would discontinue. **ECX 0212** (3/11/2009 internal email) (discussing captive implications). Genworth's finances, in the meantime, were in such dire straits that it requested "slowed down production" from PHH while it was "managing through financial difficulties." **ECX 0495** at 1**.** Even when it recovered in mid-2009, referrals continued to flow to other providers. *Id*.

The first claims in the Atrium/Genworth arrangement had mounted in 2009, but Genworth took prompt steps in 2010 to insulate PHH from any potential risk of an actual loss. In March 2010, PHH reintroduced Genworth to the dialer at a 20% share. **ECX 0654** at Ex. M. Three months later, in June 2010, Genworth allowed Atrium to take a $5 million dividend payment from the Genworth trust account, removing nearly all of PHH's capital contribution to the trust. **ECX 0258** at tab "Contributions and Withdrawals," cell D14; **Crawshaw Rep.** at 45, Table 2; **ECX 0147** at tab "Genworth – Trust Bal," cell B13; **Hrg. Tr. 1183:20-1184:21** (5/28 Thomas).[17] Within weeks, Genworth's dialer setting was increased to 30%. **ECX 0654** at Ex. M. By February 2011, after a steady increase of referrals, it was receiving 45% of PHH's controllable referrals. **ECX 0654** at Ex. M**; ECX 0159** at tabs "2010" and "2011," column B (from January to July 2010, monthly referrals to Genworth ranged from 22 and 55, but from August 2010 through the end of 2011, monthly referrals to Genworth ranged from 91 and 239). This was by far the largest allocation to any MI at the time. **ECX 0654** at Ex. M; **ECX 0159** at tab "2011."

[17] As discussed in Section III.B.2.a.ii, *infra*, in the fourth quarter of 2009, for the first time, a small number of claims came due to Genworth from its arrangement with Atrium. Almost immediately, PHH acted to remove its minimal capital contribution from the trust in order to eliminate any potential for risk.

By 2011, as an internal PHH report noted, PHH knew that Genworth had the worst risk-to-capital ratio of all active MIs. **ECX 0495** at 2. PHH also knew that Genworth charged borrowers higher prices than the other MIs, which was a "challenge" to manage when parties realized that PHH "allocates volume based on factors other than rate competitiveness today." *Id*. But Genworth had two advantages: an active bid to commute its trust with Atrium, and a "streamlined" process to issue dividends from the trust. *Id*. (identifying "Recent Key Successes / Milestones" in the relationship, first that "Genworth streamlines process for dividends from Captive Reinsurance Trust," and "Current Initiatives / Opportunities" including Genworth's "active bid to commute active Atrium captive re-insurance underway with PHH."). Both could give PHH expedited access to its captive reinsurance profits, and ensure that Atrium never actually had any funds at risk. Pursuant to its captive agreement, PHH continued steering referrals to Genworth.

Consistent with its decade-long agreement to refer, Genworth agreed to allow an $8.9 million payment from its trust account in 2011, even though Genworth did not believe the dividend was permitted by its agreement with Atrium. On May 17, 2011, Dave Tubolino of Genworth wrote to Bogansky and Rosenthal, noting that PHH had "requested a dividend from the Atrium captive trust in the amount of $9,000,000" but that Genworth believed that the agreement allowed only $162,879 to be withdrawn. **ECX 0396** at 1. Genworth observed that "funds withdrawn above" the $162,879 amount "could produce a trust balance that is below the minimum capital requirement for the trust" and that "to stay consistent with the requirements outlined in the agreement, it would be our preference to only dividend the allowable amount" of $162,879. *Id.*

Nevertheless, Respondents took an $8.9 million dividend in the fourth quarter of 2011. **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C**; ECX 0258** (3/30/2012 Genworth cession statement) at tab "trust," row 62. By January 2013, its mortgage insurance losses mounting, Genworth admitted its obligations had been downgraded to "Junk" status. Genworth Financial, Inc., Annual Report (Form 10-K) (Feb. 28, 2013), at 37; *see also id.* at 36 (Moody's Ba2 rating indicates "questionable"), at 25 (Genworth's "U.S. mortgage insurance companies currently are permitted by the GSEs to operate as eligible insurers even though not all eligibility criteria have been met."), at 111 (Genworth's MI risk-to-capital ratio increased to 36.9:1 in 2012 from 32.9:1 in 2011, requiring it to obtain waivers in some states and to operate through "alternative" entities in others).[18] Throughout 2012 into at least early 2013 (the last date for which dialer data is available), PHH kept sending 40% or more of its referred business to Genworth, belying the notion that PHH selects MI partners on the basis of their reliability as counter-parties. *See* **ECX 0654** at Ex. M. As Genworth kept finding ways to pass things of value to Atrium to enhance PHH's captive reinsurance profits, PHH's agreement to refer business to Genworth endured.

iii. Respondents' agreement to refer business to Radian

PHH's agreements to refer business to Radian and CMG pursuant to their captive arrangements continued through the end of 2008 and into 2009, but were more limited and short-lived than the agreements with UGI and Genworth. Radian and CMG were already competing against PHH's pre-existing agreements to refer business to UGI and

[18] *See* 12 C.F.R. § 1081.303(c) ("Official notice may be taken of any material fact that is not subject to reasonable dispute in that it is either generally known or capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."). That Genworth made these statements in public filings to the S.E.C. cannot reasonably be disputed.

Genworth. *See, e.g.,* **ECX 0419** (4/10/2007 PHH internal email) (weighing a potential increase in Radian volume against the effect on Genworth and UGI). In 2006, just two years after Radian's captive arrangement commenced, PHH increased competition for providing captive kickbacks by issuing its RFP. Radian's pitch did not fare well. *See* **ECX 0322** (12/4, 6/2006 Rosenthal emails to Radian) (Radian's offer was "worse than our current deal of 4/10/40 in all respects" and "going the wrong way"); **ECX 0332** (12/7/2006 Rosenthal email to Bradfield) ("Not looking good for the Philly team on this.").

By late 2007, Radian offered to meet PHH's captive demands, and even put money on the table to pay for the technology required to get added to the dialer. **ECX 0747** (11/28/2007 Rosenthal email to Smith) at 2 ("MGIC and Radian are on the list to add *(because we are going to get an attractive captive from them (MGIC and Radian)* or they are willing to foot a significant part of the bill (Radian)).") (emphasis added). Simultaneously, Radian continued to seek a larger volume of referrals from PHH, with a goal of a 30% share, and specifically pleaded with PHH for access to the dialer. *See* **ECX 0357** (12/19/2007 Radian email to Rosenthal) (offering rate discounts "in hopes of also receiving a decent portion of your available BPMI business (30%)."). PHH executives realized that "Radian's [rate discount] offer is pretty attractive" but determined that Radian would only receive an increase in allotted referrals "*assuming* that they continue to match / remain competitive whatever MI captive structure we develop / negotiate with the others (in case we are able to increase the attachment point due to the MI re-pricing or go to a variable structure)." **ECX 0361** (12/27/2007 Rosenthal email to Bradfield) (emphasis added). In effect, PHH demanded a *quid pro quo*: higher kickback payments in exchange for agreeing to increase its referrals to Radian.

Radian complied, and in May of 2008, PHH was still working to "re-negotiate the captive arrangement" with Radian. **ECX 0401** (Rosenthal email to Radian). The negotiations were not successful, and PHH appears to have decided to eliminate Radian's preferred provider status. On August 4, 2008, Radian's salesperson, Lora Wasson, wrote to Rosenthal and Bradfield to express that she was "very disappointed" to learn that Radian was not to be selected as a "'preferred' partner of PHH's," and offered to try to "overcome whatever it is and earn your business." **ECX 0294**. Radian's captive reinsurance arrangement drove Bradfield to contemplate softening PHH's position: "since we have a captive with them, why don't we just keep them as a preferred provider even if they aren't in the dialer?" *Id*. Sure enough, PHH honored its agreement to refer business to Radian and kept them on the preferred provider list issued just three days later. **ECX 0654** at Ex. O.

In October 2008, Radian was still vying for more referrals from PHH and particularly, a place on PHH's dialer. When Radian's salesperson followed up with PHH, Bradfield reported that this process was underway, and posed the key question: "What are your latest thoughts regarding XOL captives?" **ECX 0270**. Bradfield further noted that he expected to have Radian on the dialer by April 2009. *Id*. By the end of 2008, Rosenthal reported that he was working on a captive proposal from Radian, but "[t]hey still have not offered us a XOL for 2009." **ECX 0487** (12/24/2008 email to Bradfield) at 1. According to Rosenthal, Radian was attempting to structure an excess-of-loss deal at PHH's request, but "it is possible that *they won't be able to offer XOL's if their lawyers get too uncomfortable*." *Id.* (emphasis added).

In early 2009, PHH executives reviewed a "Competitive Comparison" of Radian's product offerings, which appears to have reflected favorably on Radian. **ECX 0275**.

Among other things, Radian offered a benefit to borrowers called its "Free After Five" program, which allowed a borrower's MI payments to cancel automatically after five years. *Id.* at 1. Bradfield observed that *"[a]bsent a captive* [which would potentially lose ceding premiums if this product were used], I can't see why we wouldn't offer this on all loans that are eligible." *Id*. (emphasis added); *see also* **ECX 0440** (2/3/2009 internal email) (reiterating "[*a]bsent a captive*, I can't see a reason we wouldn't use this for all loans that go to Radian") (emphasis added).[19]

But captive reinsurance remained an overridingly powerful force. Bradfield reported that "final decisions regarding the captive" were still pending, and that PHH "will be able to scope out the plan for directing MI" only after decisions on captives were made. **ECX 0275** at 1. He made clear that "our next step is to establish a final plan re: the UGI captive so that we can determine how to handle CMG and Radian." **ECX 0440** at 2. As Radian's captive status faltered, PHH's agreement to refer business to UGI pursuant to captive reinsurance kickbacks dictated its course of action.

Like all of the MIs other than UGI, Radian never came forward with a revised XOL captive arrangement in 2009. In late July, PHH and Radian agreed to commute Radian's existing captive arrangement. **ECX 0526** (commutation agreement). The commutation allowed PHH to avoid a capital call, and in their words to "put more capital into a business that would never generate profits effectively," while undermining the supposed risk transfer purpose of the arrangement for Radian. **ECX 0153** (Danahy

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[19] Bradfield's discussion of the Free After Five product further demonstrates the manner in which the captive reinsurance referral scheme harmed borrowers by impeding their access to the best providers and dictating referrals according to kickbacks over quality. *See, e.g.*, **ECX 0440** (continuing "Free After Five" discussion and considering whether it could be offered at all because the dialer would make it "randomly offered" to some eligible borrowers but not others because PHH used its own set percentages to decide which MI provider they were referred to).

Dep.) Tr. 140:4-141:24 (explaining PHH's motivations and claiming that the decision was mutual, while conceding that "I don't know [Radian's] logic in commuting"); **ECX 0425** (6/2/2009 internal email) (Atrium has a deficiency of $800,000 owed to the Radian trust though PHH has not been "'formally' requested to deposit the funds;" Rosenthal proposes simply "turn[ing the trust] back to [Radian] if it is legal to do so"); *see* § III.B.2.a.ii, *infra*.

Days later, on August 3, 2009, Bradfield was still charting out "Captive / Dialer Scenarios" "to evaluate how to distribute MI to each provider," and making calls to Radian to "get their latest views on XOL captives." **ECX 0370** (email); **ECX 0371** (attachment) at 1 (headlines that the "[o]nly captive in place is UGI's" and notes that "we have heard that FH is evaluating the restriction of all XOL captive types"). Bradfield acknowledged that lack of a captive arrangement could no longer serve as a total barrier to doing business with PHH; the dire market conditions had made it more imperative to have "all [MI] outlets available to us in case one provider goes away," despite the "lost value." **ECX 0370**. Bradfield's analysis nonetheless shows that as late as August 2009, captive reinsurance remained a potent factor for PHH in distributing referrals among the MIs. Within weeks of its commutation, which enabled PHH to dodge any potential for taking on any significant risk and incurring an $800,000 capital call, Radian finally received its place on PHH's dialer. **ECX 0654** at Ex. M (8/10/2009 dialer change).

iv. Respondents' agreement to refer business to CMG

As discussed in Section III.A.2.b.ii, *supra*, CMG essentially had a referral agreement with PHH in writing during the time that the captive was in place. There is no evidence that it was ever altered. CMG's captive reinsurance arrangement with PHH continued until its commutation in August 2009. Throughout this period, CMG continued to receive referrals from PHH. *See* **ECX 0159** at tab "2008," cell B4 (342 originations), tab "2009," cell B4 (98 originations). But once CMG's captive reinsurance arrangement was commuted, it never received more than a single-digit number of referrals from PHH in any month from July 2009-December 2011. *See id.*

b. Non-captive MIs were used briefly, out of necessity, and only after each pledged to enter captive arrangements

Until November 2008, PHH had only added MIs to its dialer and preferred provider list after first securing a captive reinsurance arrangement with the MI. *See* § III.A.2.a.ii, *supra*. By the fall of 2008, however, PHH's pipeline of loans needing mortgage insurance coverage was on the brink of disaster. *See, e.g.*, **ECX 0153** (Danahy Dep.), Tr. 200:13-201:15. Its core captive reinsurance partners could not cover all of these loans: United Guaranty's parent company, AIG, had been seized in a historic bailout by the federal government and Genworth faced such dire financial circumstances that it soon asked PHH to stop referring borrowers until it could recover. CMG was a specialty provider, solely for credit union loans. Radian was seeking an increase in PHH referrals, and might have been able to pick up the business, but it was tasked by PHH with revising its existing captive structure before it could increase its share. *See* § III.A.3.a.iii, *supra*.

Forced to diversify, PHH reactivated negotiations with contenders from its RFP process, MGIC and RMIC. Throughout 2008 and into 2009, PHH negotiated with each potential new MI partner to shape plans to enter into captive reinsurance agreements. Though these companies were ultimately added to the dialer without first securing captive arrangements, each company had pledged captive reinsurance deals in the course of their negotiations for referrals.[20] For every new MI added to the dialer or preferred provider list in or after 2008, there was an understanding that a captive reinsurance arrangement would be put in place in exchange for access to PHH referrals.[21] Such agreements to refer were made in exchange for a "thing of value" – a plan for future captive arrangements – irrespective of whether or not the deals ultimately came to fruition. *See* 12 C.F.R. § 1024.14(d) (a "thing of value" may include a prospective "opportunity to participate in a money-making program" as well as payments themselves).

Since late 2007, PHH had planned to add MGIC to the dialer for the 2008 year in an express *quid pro quo:* "because we are going to get an attractive captive from them." **ECX 0747** (11/28/2007 internal email). From June until at least October of 2008, MGIC and PHH were deeply engaged in negotiating terms for a captive arrangement. *See, e.g.,* **ECX 0086** (email thread, PHH-MGIC) at 1 (6/10/2008 email Krauter/MGIC to Rosenthal/PHH) ("...did you want to give me some dates and times in which John and I could get on a call with you regarding setting up the new captive agreement."), *id.* (6/10/2008, Rosenthal to Krauter) ("This week looks crazy – perhaps next for the captive conversation?"), **ECX 0073** (7/7/2008 MGIC/PHH email thread); **ECX 0057** (Aug.-Sept. 2008 MGIC/PHH email thread); **ECX 0013** (Oct. 2008 MGIC "PHH Product Discussion"), *see* **Hrg. Tr. 501:6-22** (3/26 Rosenthal) (ECX 0013 is a pitch document). In the midst of these negotiations, in August 2008, MGIC was added to the

[20] Previously, in 2006 and 2007, MGIC and RMIC together received no more than half of one percent of all MI business from PHH. **ECX 0159** (3/2/2012 PHH spreadsheet to Enforcement) at tabs "2006," "2007."

[21] The lone exception appears to be Essent, which was added to the dialer in 2012 without a captive reinsurance agreement. *See* **ECX 0654** at Ex. M. The terms of Essent's addition to the dialer are not known to Enforcement. By then, no new PHH loans were being placed into any captive arrangement.

preferred provider list. **ECX 0654** at Ex. O. By fall 2008, MGIC was added to the dialer. *See* **ECX 0654** at Ex. M (showing MGIC's addition in November 2008); **ECX 0472** (9/26/2008 internal PHH email) at 1 (suggesting that MGIC was already on the dialer in September 2008).

On September 26, 2008, however, MGIC announced that it would no longer engage in XOL captive reinsurance transactions effective January 1, 2009. **ECX 0299** (9/26/2008 press release). It tied this move to a "series of actions [taken] in 2008 to address [MGIC's] financial strength." *Id*. In immediate and direct response, PHH executives directed personnel "to take MGIC's share of dialer-based MI down to 30%. We might go lower." **ECX 0472** (9/26/2008, 8:17 am Bradfield email, responding to Rosenthal and Danahy within 3 minutes after receiving MGIC's press release). Rosenthal responded that he had already contacted Genworth about the change by MGIC, and would do the same with UGI and Radian. *Id*. By November 2008, MGIC was on the dialer – but with only a 10% share. **ECX 0654** at Ex. M. For just over two months in early 2009, MGIC briefly received a 60% share on PHH's dialer, apparently due to the absence of other alternatives and incomplete negotiations over the revival of UGI's captive arrangement to cover new loans. *See* § III.A.3.a.i, *supra*. As soon as UGI's captive agreement was amended, however, PHH cracked down. MGIC's dialer share plummeted to zero. *See* **ECX 0654** at Ex. M; **ECX 0744** ("max ugi b/c of captive so not interested in sending mgic any mi."); **ECX 0432** (5/19/2009 PHH email); *see also* **EC Demonstrative Ex. 1** at 2. Afterward, it regained only a modest 10-25% share of PHH's referrals. **ECX 0654** at Ex. M.

Furthermore, not all referrals were created equal. Even after breaking into PHH's dialer, MGIC was receiving the worst of PHH's originations. Once UGI was able to re-engage in captive reinsurance in 2009, PHH was sending MGIC "100% of 2 unit properties; condo's and coops in Dec [Declining] Mkts" and other riskier loans. **ECX 0432**. Given the low quality, PHH executives noted it "[w]on't be long before they object to what we are sending." *Id*. Rosenthal confirmed that this allocation reflected "some adverse selection of MGIC." **Hrg. Tr. 556:6-11** (3/26). Without a captive reinsurance arrangement, MGIC became a dumping ground for PHH's riskiest loans.

Since the RFP, another competitor, RMIC, had been clamoring for PHH's business and willingly offering up captive reinsurance in exchange for referrals. Through the RFP process, RMIC had presented PHH with "a customized offering of a deep cede structure offered only to a select group of qualified lenders in the market." **ECX 0518** (Oct. 2006 RMIC RFP proposal to PHH); *see* § III.A.3.a.iii, *supra*. RMIC eagerly awaited feedback, as Rosenthal informed them in late 2006 that after he had presented the options to Danahy, PHH "will make a decision on the path of our 2007 captive structures / partners." **ECX 0763** (1/17/2007 Rosenthal email to RMIC) at 1 (further characterizing the decision as one for "the 2007 Captive Business"). For months, RMIC's salesperson, Chris Kennedy, kept at Rosenthal, seeking business for RMIC. *See, e.g.*, **ECX 0336, 0337** (January 2007 emails); **ECX 0420** (March 2007 email); **ECX 0766** (4/23/2007 email) ("RMIC really wants to break into your account. We are just a bit enthusiastic."). In June 2007, RMIC was still hoping for business from PHH, trying, at minimum, to convince PHH to permit its correspondents to do business with RMIC where they so chose. Kennedy told Rosenthal: "AZ Fed CU wants to use RMIC as their sole MI company. They are a client of PHH. . . . PHH has told them they will not order MI from RMIC." **ECX 0288**. Kennedy reflected that since a captive with RMIC was still prospective, "I do understand why you would not want to send business our way, but we can put this MI in the captive going back 6 months look-back option." *Id*. Rosenthal denied the request, saying it "would impact our economics so I am not encouraging it." *Id*. By December 2007, over a year after the RFP was issued, Kennedy pleaded:

> *Is there anything we can do to break into your account?*
>
> There has to be something you need from your MI partners – expanded guides for Agency Alt-A/Sub-prime, unlimited liability for contract underwriting, GSE/SMC pool insurance, fraud coverage, or bulk LPMI? *I know the captive relationship has driven your MI allocation*, but isn't it about time we do some business?
>
> . . . . My point is *there has to be more value added that an MI partner can add than just a good captive execution.* [RMIC CEO] John Britti really, really wants to break into this account so please let me know what we can do to finally print some business. . . .
>
> PHH is the only top 10 MI account [with which] we do no business today. I hope this will change in 2008.
>
> [**ECX 0351** (emphasis added).]

RMIC understood that captive reinsurance was the price of admission, and it was keen to pay-to-play.

In February 2008, PHH executives held a meeting with their counterparts at RMIC. *See* **ECX 0377**, **0387, 0363** (meeting follow up). Again, Kennedy emphasized, "Breaking into PHH is a big priority at RMIC." **ECX 0377**. Finally, in March 2008, RMIC received its chance. Facing the risk that PHH might "have to cancel [certain loans] due to no MI" because its usual partners could not come through, PHH executives saw an opportunity for RMIC to serve as its "other bail out." **ECX 0376** (3/14/2008 PHH internal email thread) at 1. Bradfield proposed that "We could consider setting up a captive with RMIC," and Danahy quickly confirmed "I would go with a captive" as part and parcel of doing any business with RMIC. *Id*. In May 2008, Rosenthal moved forward, sending an email to Kennedy, entitled "Captive," urging that PHH "would like to begin work" on "developing a captive re-insurance arrangement with RMIC." **ECX 0398** (specifying PHH's interest in a "variable excess of loss" agreement). In the course of discussions, Rosenthal explained that "[o]ur ability to negotiate a suitable arrangement with you will enable you to become a preferred provider." **ECX 0403**.

By June 2008, PHH expected to set up a captive reinsurance arrangement with RMIC, and in exchange, agreed to refer RMIC business. *See* **ECX 0262** at 1 (noting that "we are setting up the RMIC captive"). In August 2008, as plans proceeded, PHH admitted RMIC to its preferred provider list. **ECX 0654** at Ex. O. By the end of the year, however, PHH learned that RMIC, like MGIC, would no longer do XOL captive reinsurance, only quota-share. **ECX 0487** (Rosenthal email to Bradfield). In the end, RMIC covered only two loans for PHH in 2008. **ECX 0159** at tab "2008," cell B60. As the future of captives remained uncertain, PHH staved off adding RMIC to the dialer until late June 2009 despite a serious need to diversify its MI offerings. **ECX 0654** at Ex. M; *see also* **ECX 0743** (2/10/2009 Rosenthal internal email) (suggesting RMIC was actually "built into" the dialer in late 2008 as captive discussions were ongoing, though apparently not sent any referrals).

Although market conditions in 2008 forced PHH to accept that captive reinsurance could no longer serve as an absolute precondition for MI referrals, PHH continued to utilize captive reinsurance as a significant factor in its MI referral allocations. PHH was reluctant to begin making referrals until the captive agreements were signed and in place, even where PHH risked being unable to close loans as a result. *See* **ECX 0262** (internal PHH email 6/5/2008) at 1 (where RMIC was the sole MI to approve a particular loan, Dodds writes, "Can we waive the MI hit (75 bps) since we are setting up the RMIC captive or is it too early?"). In the end, MIs' ability to capture PHH referrals without a captive arrangement was limited at best. *See* **EC Demonstrative Ex. 1** at 2 (referrals were heavily steered to PHH's captive MI partners over the period from 2006-2011, with only a brief dip in early 2009).

c. The fact that market conditions compelled PHH to do some business with non-captive MIs does not negate the ongoing agreements to refer

Payments made pursuant to an agreement to refer settlement service business violate RESPA. The referral agreement need not be an exclusive one to violate the law. The evidence shows that the desire to keep strip-mining the value of Atrium continued to motivate PHH to agree to refer business to the MIs who were its captive reinsurance partners throughout the life of the arrangements. In exchange for its referrals, PHH received things of value like continued ceding, dividends from the trusts, amendments to further reduce its risk or avoid capital calls, and ultimately, commutation payments that released cash to PHH. Particularly for PHH's longstanding agreements with UGI and Genworth, the captive arrangements ensured that these parties were tethered together. UGI and Genworth continued to obtain referrals based on PHH's enduring agreements to refer business to them, and based upon the payments they made to PHH through their captive relationships. Such agreements to refer persisted continuously from the inception of the agreements through their ultimate commutations. As long as captive reinsurance influenced PHH's MI allocations, the agreement to refer remained in place.

There is no evidence that PHH's agreements to refer business to UGI, Genworth, Radian, or CMG ended prior to the commutation of those arrangements. While PHH adapted to changing market circumstances, the captive undercurrent persisted. After being completely blocked for over a decade, referrals to non-captive providers were introduced only when unavoidable in late 2008. Captive reinsurance need not be the only, or even the predominant, factor in referrals to prove the existence of a continuous agreement to refer under RESPA; it is sufficient to show that "a thing of value is received repeatedly and is connected *in any way* with the volume or value of the business referred." 12 C.F.R. § 1024.14(e) (emphasis added); *see id.* (an "agreement or understanding" for the referral of settlement services (referral agreement) "need not be written or verbalized but may be established by a practice, pattern or course of conduct").

Similarly, though PHH considered "eliminating the 'PHH to order MI' service" in mid-2009, which would "let the clients get mi themselves," this change never happened. **ECX 0744** at 1. At least until August 2012, PHH continued to offer to order MI on behalf of its correspondent loans. *See* **ECX 0654** at Ex. N. In any event, this discussion involved only the correspondent channel run by PHH executive Craig Dodds. **ECX 0744** at 1 (noting meeting with "Craig"); **ECX 0337** (Craig Dodds is in charge of correspondent channel sales). The dialer remained fully operative, and it appears to continue to operate to this day. *See* **ECX 0654** at Ex. M.

If anything, the fact that PHH considered relinquishing control over the placement of MI on correspondent originations once captive arrangements were declining only demonstrates that there was no other significant, legitimate purpose motivating PHH to select MI for its correspondents. The only contemporaneous documents explaining the rationale for this practice specifically cite its link to captive reinsurance. **ECX 0206** (10/11/2007 PHH internal email thread) at 1 (Bradfield writes to Danahy, "We charge 75 bps to the correspondent if they don't use one of our preferred vendors. That would go away if we had a captive with them ...."); **ECX 0262** (6/5/2008 PHH internal email) at 1 (Dodds writes, "Can we waive the MI hit (75 bps) since we are setting up the RMIC captive or is it too early?" and Levine responds, "Unfortunately no.....not captive eligible yet."); **ECX 0288** ("AZ Fed CU wants to use RMIC as their sole MI company. They are a client of PHH. . . . PHH has told them they will not order MI from RMIC. . . . I do understand why you would not want to send business our way, but we can put this in the captive going back 6 months look-back option."). In fact, PHH has claimed that it "retired" its "Preferred Provider Policy" in June 2009 – right around the time that the Radian and CMG captive arrangements were commuted – replacing it with a "simplified" policy. **ECX 0654** at 11-12. That version of the policy was not produced to the Bureau, so its precise terms are not in evidence. *Id*. Instead, the first policy that appears to reflect no price adjustment is dated August 2012. **ECX 0654** at Ex. N.

In 2009, the majority of PHH MI referrals were still directed to UGI, **ECX 0159**, even though its parent had been taken over by the government and its survival was in jeopardy, **Hrg. Tr. 2186:12-2187:6** (6/4 Walker). In 2011, the vast majority of PHH referrals were sent to Genworth, even though it had the worst risk-to-capital ratio among the MIs and had higher prices. **ECX 0495** at 2. The extensive record of contemporaneous documents explain these seemingly-illogical choices: PHH's captive reinsurance relationships continued to drive its referrals.

Lastly, as discussed in Section III.B, *infra*, there was no legitimacy to the captive arrangements from start to finish. Born of an illegal purpose and lacking risk transfer by design, they were created and operated to funnel kickbacks to PHH. There is no evidence that the arrangements ever shed this illegality over time.

4. Respondents failed to rebut the voluminous evidence of referral agreements

PHH has brought forth no evidence to contradict the voluminous contemporaneous documents that demonstrate its referral agreements. Its only employee to testify in the proceeding, Sam Rosenthal, explained that PHH negotiated its captive arrangements by sending the message that "we'll send you mortgage insurance, and you give us as good of a deal as is possible." **Hrg. Tr. 270:17-273:1** (3/25 Rosenthal); **168:3-170:7** (3/24 Rosenthal); *see* **ECX 0737** ("Captive Thoughts") ("Use leverage to renegotiate captives with MIs"). The only fact witness proffered by PHH with knowledge of these negotiations, United Guaranty's Dan Walker, similarly admitted that referrals played a role in the parties' captive arrangements. **Hrg. Tr. 2206:5-11** (6/4). Despite the many PHH employees involved in MI allocations and captive reinsurance, PHH declined to call *any* of its own executives, directors, or employees in its defense. There can be no question that captive reinsurance substantially influenced PHH's referral decisions, and that the MIs ceded premiums to PHH, permitted dividends, and negotiated payments pursuant to pervasive agreements to refer business to the captive MIs.

Though Rosenthal attempted to obfuscate Respondents' conduct, his extensive record of emails and notes speaks for itself. His evasive testimony that "[m]anagement, at different times, sets a dialer at different percentages to achieve the PHH corporate objectives, which are – you know, there's many reasons to set the dialer at different numbers" cannot obscure the open and notorious pattern in the record. **Hrg. Tr.**

108:17-21 (3/24 Rosenthal). Contemporaneous documents show Rosenthal was tasked with executing Respondents' plan of extracting captive reinsurance kickbacks in exchange for referrals. **Hrg. Tr. 110:1-2** (3/24 Rosenthal) (on dialer settings, "I'm more of a, you know, executor against your wishes here"). Though he attempted to prop up the legitimacy of Atrium, it is clear that Atrium was nothing more than a shell company with a bank account. Rosenthal conceded that he was not aware of any employees at Atrium and that "[t]he business strategy of Atrium was handled by a group of individuals at PHH Mortgage" – which, the evidence demonstrates, were the same executives who controlled MI allocations for referrals. **Hrg. Tr. 126:5-6** (3/24 Rosenthal); *Id*. **125:8-127:7** (3/24) (Rosenthal knows of no employees nor any office for Atrium); **Hrg. Tr. 224:11-226:1, 263:14-17** (3/25 Rosenthal) (top executives such as Terry Edwards, Joe Suter, and Mark Danahy set the dialer); *accord* **ECX 0153,** Tr. 31:24-32:3 (Danahy was responsible for the "day-to-day business of Atrium"), 24:17-18 (Atrium had no employees); 24:19-25:10 (Atrium maintains an unoccupied office in New York); 68:24-69:5 (all of the business of Atrium was conducted solely by employees of PHH Mortgage or PHH Corporation).[22]

[22] Respondents have argued that Atrium must be dismissed from this proceeding because they are neither Covered Persons nor Service Providers to Covered Persons, as required by the CFPA. Enforcement incorporates by reference its response to that argument in its entirety. Enf. Counsel Opp. to Resps.' Renewed Mot. to Dismiss (Document No. 123) at 39-43. In any event, the facts above and throughout this brief establish that the corporate veil should be pierced against PHH. *See, e.g.*, *Culbreth v. Amosa (Pty) Ltd*., 898 F.2d 13, 14-15 (3d Cir. 1990) (corporate veil may be pierced where "controlling corporation wholly ignored the separate status of the controlled corporation and so dominated and controlled its affairs that its separate existence was a mere sham"); *U.S. v. Bestfoods*, 524 U.S. 51, 62 (1998) ("[C]orporate veil may be pierced and the shareholder held liable for the corporation's conduct when, inter alia, the corporate form would otherwise be misused to accomplish certain wrongful purposes …."); *Pricaspian Dev. Corp. v. Martucci*, Civil Action No. 11–cv–1459 (DMC–JBC), 2014 WL 105898, at *2 (D.N.J. Jan. 9, 2014) ("In New Jersey, two elements must be present

Similarly, Rosenthal claimed that the RFP was needed because the captive arrangements were "no longer properly priced for the risk transference, and we were taking on too much risk." **Hrg. Tr. 180:11-181:3** (3/24). The facts belie this explanation. At the time of the RFP, Atrium had not paid a penny in claims under any of its existing structures. *See* **ECX 0147** (UGI and Genworth Trust Balance tabs). The only "risk" Atrium could ever purport to take on was created by the very loans PHH itself originated or acquired. Rather than adjust its origination practices, during that same year, 2006, PHH simply sought to avoid any possibility of risk in its captive that could be caused by its worst loans by ensuring that subprime loans were completely carved out of its captives. **Hrg. Tr. 149:9-162:17** (3/24 Rosenthal); *see, e.g.*, **ECX 0502** (emails reflecting Genworth subprime novation in July 2006).

On re-direct, counsel for PHH resorted to pointing out that Rosenthal was "nervous" and had little experience testifying. **Hrg. Tr. 558:8-559:5** (3/26). Despite asserting that "you will be coming back in our case in chief," Respondents never called Rosenthal, nor any other employee of PHH or its affiliates. *Id*. **559:7-8.**

Nor was Dan Walker able to provide any defense or neutral justification for PHH's actions. To the contrary, Walker explained that "[i]ncreasingly through the 1990s and certainly into the 2000s, very large lenders such as . . . PHH would decide to purchase MI – they wanted a different kind of relationship. They wanted to control [ ] how much MI they purchased and from which companies on an aggregate basis. . . ." **Hrg. Tr. 2143:25-144:7** (6/4). He testified that in choosing MI providers for these

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in order to pierce the corporate veil: First, there must be such a unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist. Second the circumstances must indicate that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice.") (quotation / citation omitted).

controlled, aggregate referrals, the "captive reinsurance program" offered by the MI was a factor. *Id*. **2146:2-3.** Though Walker admitted he had rehearsed questions prior to taking the stand, when asked pointedly by Respondent's counsel on direct "whether or not PHH has ever told UGI, to the best of your knowledge, that it must have a captive arrangement in order to obtain mortgage insurance business," there was a long pause. *Id*. **2147:19-149:1, 2227:4-21.** Mr. Walker finally answered: "I think we could have still done business with PHH without having a captive reinsurer. *I don't know how much.* I don't know whether we would have stayed in the top tier. I just don't know." *Id*. (emphasis added). On cross-examination, Walker affirmed that UGI

> felt compelled – we did feel compelled, you know, to do a captive arrangement. And they [PHH] did have a lot of leverage in it, because ultimately they are providing the mortgage insurance business to us on a direct basis, and, you know, they do have a lot of leverage. I can't say it didn't enter into the considerations.
>
> [*Id*. **2206:5-11**.]

Walker went on to testify that PHH actively used that leverage:

> [**Q.**] Was it typical for Atrium or other lenders to try to get a better deal on reinsurance in exchange for doing more business with the mortgage insurance – on the mortgage insurance side?
>
> [**A.**] I think I've answered that before in terms of the more products, the better services you gave them, the better reinsurance program you gave them. They – it impacted your overall allocation in the cases.
>
> [*Id*. **2207:1-10**.]

Walker further explained that referrals from lenders are valuable to UGI because "that's our business," "it's all that we do." *Id.* **2229:23-230:2.** Without such referrals, Walker conceded, UGI would have no business. *Id.* **2230:3-4.** Walker's testimony confirms what the voluminous record already shows: UGI engaged in captive reinsurance practices with PHH pursuant to an agreement to refer business.

B. Respondents Fail to Meet their Burden of Proof to Establish an Affirmative Defense Under Section 8(c)(2)

Respondents contend that Section 8(c)(2) of RESPA insulates their conduct from liability. Section 8(c)(2) permits "the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C.A. § 2607(c)(2). Respondents have not satisfied their burden, and have no defense under Section 8(c)(2).

1. Respondents must prove that each arrangement as a whole provided a genuine reinsurance service to the MI and that the payments they received were bona fide payments for that service

This Tribunal has held that Section 8(c)(2) provides an affirmative defense to Section 8 liability where the violator demonstrates that the otherwise illegal payments were received for "services actually performed" and those payments were "reasonably related to the value of the ... services actually performed." May 22 Order at 5.

As applied to captive arrangements, Section 8(c)(2) requires Respondents to prove that "the payments to the reinsurer are for reinsurance services actually furnished ... and are bona fide compensation that does not exceed the value of such services." *Id.* at 6. In its 1997 letter to Countrywide, HUD explained: "[S]o long as payments for reinsurance under captive reinsurance arrangements are *solely* payment for goods or facilities actually furnished or for services actually performed, these arrangements are permissible under RESPA." HUD Letter at 1 (Attachment A to **ECX 0193**) (emphasis added). Further, if "the compensation paid for the reinsurance exceeds the value of the reinsurance ... the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA and the payments exceeding the value of the reinsurance a referral fee or unearned fee." *Id.* at 7. HUD's articulation of "[t]his principle is a specific example of the more general principle articulated in Regulation X," and is a "straightforward application of Regulation X to captive reinsurance." May 22 Order (citing 24 C.F.R. § 3500.14(g)(2), now codified at 12 C.F.R. 1024.14(g)(2)).

Thus, to avail themselves of a complete defense under Section 8(c)(2), Respondents must establish that their arrangements provided a genuine reinsurance service to the MI and that the payment was, in its entirety, a "bona fide" payment for that service. As the Tribunal has held: Section 8(c)(2) establishes a safe harbor for salary, compensation, or other payment for services actually performed, but only if such payment is bona fide." March 13 Order at 8. Further, Respondents must "prove that the entirety of the premiums ceded to [Atrium] bore a reasonable relationship to the market value of any reinsurance provided." May 22 Order. at 7. Alternatively, if Respondents can prove that they provided reinsurance with some market value, although not reasonably related to the premiums they received, they may have a partial defense such that "the market value would not be considered a referral fee or unearned fee." *Id.*

2. Because the sole purpose of Respondents' arrangements was to extract kickbacks, Respondents cannot show that they provided a genuine service or that the payments received were "bona fide" payments for reinsurance

All of the evidence supporting Enforcement's claim that Respondents' captive arrangements were illegal kickback schemes in violation of RESPA Section 8(a) also supports a finding that those arrangements did not constitute "services actually performed" for the MIs. The *sole* purpose of the arrangements was to allow Respondents to extract kickback payments from the MIs in exchange for referrals. That purpose is irreconcilable with any notion that the arrangements provided genuine reinsurance services to the MIs.

Indeed, there is no evidence that any of the MIs ever wanted the "reinsurance" that Atrium purported to provide. Rather, the MIs (including UGI, Genworth, and Radian's predecessor) through MICA resisted deep cede captive arrangements, before their widespread proliferation throughout the industry as a mechanism to obtain referrals. *See* § III.A.2.a, *supra*. Culver testified that MGIC did not enter into captive arrangements for any reinsurance benefit, but rather, to avoid losing market share to competitors. MGIC's view at the time was "we don't want to do captive reinsurance if we don't have to," but MGIC participated in captive arrangements to maintain market share. **Hrg. Tr. 340:6-8, 341:17-23** (3/25).

While MGIC did not have a captive arrangement with Atrium, Culver's testimony and these supporting documents are highly informative of the value of captive arrangements perceived by the industry at the time, particularly given that Respondents' 4/10/40 structure became a standard in the industry. *Id.* **337:25-338:17**, **348:13-349:4** (3/25 Culver). Unlike Milliman, MGIC's Risk Management Committee was charged with making a business decision based on a careful assessment of the true "risk transfer" value of captive arrangements. Their conclusion, which is consistent with Enforcement expert Dr. Mark Crawshaw's opinions, should trump the unsupported opinions offered by Respondents' experts in litigation.

Against all of this evidence, Respondents presented no contemporaneous evidence showing that the MIs desired to purchase reinsurance from Atrium. This is fatal to Respondents Section 8(c)(2) defense. Section 8(c)(2) cannot be interpreted to provide protection to a recipient of a kickback who has effectively forced the giver of the kickback to accept a "service" it does not even want.

Similarly, the evidence supporting Enforcement's Section 8(a) claim and the lack of evidence that the MIs wanted reinsurance from Atrium refutes any contention that the payments Respondents received through their captive arrangements were "bona fide" payments for reinsurance. All of the evidence shows that the payments they received were, in their entirety, kickback payments the MIs made in exchange for referrals, for that was the sole purpose of ceding premiums to Atrium. Those payments cannot at the same time be deemed "bona fide" payments. Thus, even if Respondents could show some theoretical reinsurance value to their arrangements (they cannot), because the MIs did not actually want the service, and instead were paying for referrals, none of the payments Respondents received were "bona fide" payments for reinsurance.

3. Respondents' arrangements provided no value to the MIs

To meet their burden to show that their arrangements constituted "services actually performed," Respondents must also prove that their purported reinsurance had economic value to the MIs. The economic value of an arrangement must be assessed with respect to the entirety of the arrangement. The HUD Letter, as a "straightforward application of Regulation X to captive reinsurance," *id.* at 6, speaks only of the permissibility of an "arrangement" or "agreement," never of a "book year" or any other portion that is less than the whole of the arrangement.[23] Milliman, which purported to

[23] *See, e.g.*, HUD Letter (Attachment A to **ECX 0193**) at 3 ("*the arrangements* are permissible under RESPA if …") (emphasis added); *id.* ("any captive reinsurance *arrangement* in which reinsurance services are not actually performed or in which payments to the reinsurer are not bona fide …") (emphasis added); *id.* at 4 ("The Department will analyze captive reinsurance *arrangements* to determine if the *arrangements* comply with RESPA.") (emphasis added); *id.* at 5 (header B is: "Test for

assess Atrium's and the MIs' (and many other lenders') captive arrangements' compliance with the HUD Letter, stated its conclusions as pertaining to the "reinsurance *agreement*" and described its risk transfer test as assessing "whether there is a reasonable probability ... of a loss ... to the reinsurer under the *agreement*."[24] Although Atrium had a single operative reinsurance agreement with each of UGI, Genworth, Radian, and CMG, these agreements covered multiple book years. **Hrg. Tr. 1925:17-1927:9** (6/3 Schmitz).

If it were any other way – if value could be assessed by slicing and dicing the "reinsurance" and evaluating each piece independently without regard to how they are related to one another – then it would be trivially easy for lenders to devise captive reinsurance schemes that amounted to nothing more than profit sharing while satisfying Section 8(c)(2). For example, a lender could offer captive reinsurance to an MI on a book year basis where each individual book year of "reinsurance," considered on its own, exhibits a transfer of risk and reasonable pricing, but where the captive reinsurer's overall responsibility to pay claims to the MI is contractually limited to 50% of the total premiums paid by the MI. In this arrangement, one book year (or more) could experience claims well in excess of 100% of the premiums for that book year (or more),

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Whether a Captive Reinsurance *Arrangement* Violates RESPA) (emphasis added); *id.* ("The Department will first determine whether the reinsurance *arrangement* meets three requirements..." and if not, "the *arrangement* will be regarded as an impermissible captive reinsurance *arrangement* under RESPA") (emphases added); *id.* at 6 ("the *arrangement* will be regarded as an impermissible reinsurance *arrangement* under RESPA") (emphases added); *id.* at 7 (HUD would "[e]xamine other financial transactions between the lender, primary insurer, and captive reinsurer to determine whether they are related to the reinsurance *agreement*") (emphasis added).

[24] *See, e.g.*, **ECX 0124** at 10, 11 (emphases added); **ECX 0177** at 9, 10 (same); **ECX 0178** at 9, 10 (same); **ECX 0192** at 10, 11 (same); **ECX 0193** at 10, 11 (same); **ECX 0194** at 9, 10 (same); **ECX 0195** at 8, 9 (same); **ECX 0466** at 10, 11 (same); **ECX 0467** at 10, 11 (same).

but the greater those claims, the less would remain to satisfy claims from other book years as a result of the aggregate limit. Only by considering the entire arrangement would it be apparent that the lender bears no risk of loss.

Indeed, even a savings account could be said to exhibit significant risk transfer if Section 8(c)(2) allowed it to be evaluated in parts. For example, as long as sufficient funds were deposited in the first year, in any year after the first year, the accountholder could withdraw more in funds than it deposited in that year. The excess of the amount withdrawn in that year over the amount deposited in that year could be paid using funds deposited in other years. Of course, this savings account arrangement as a whole would expose the bank to no risk of loss, even though in any year after the first year, the bank might pay out more than it collects.

Considered in its entirety from the MI's perspective, a captive arrangement with structural features limiting the reinsurer's chance of sustaining a significant overall loss is no better and likely much worse than a savings account. A captive arrangement that provides the MI a remote possibility of recovering only slightly more than the premiums it ceded over the entire life of the arrangement, while exposing the MI to a significant probability of losing some or all of its ceded premiums, offers at best the same potential gain to the MI as interest on a savings account, while presenting a far worse potential loss. Just as with the savings account, it is immaterial to Section 8(c)(2) that such an arrangement, at some point along the way, might involve individual book years for which the MI receives more in claim payments than it cedes in premiums.

In fact, if Section 8(c)(2) did not require analysis of the arrangement as a whole, myriad insurance schemes, entirely lacking in risk transfer yet compliant when individual pieces are assessed in isolation, could be easily devised – including those such as Respondents' captive arrangements that were in fact much worse for the MI than a savings account, *see* § III.B.2.a.ii, *infra*. It would be absurd to contend that arrangements such as these constitute a genuine service or otherwise have any value for the MI.

a. Under each of Respondents' arrangements, it was virtually impossible for Atrium to incur a significant economic loss

i. Multiple risk-limiting features in Respondents' arrangements allowed Atrium to avoid any significant economic loss

Each arrangement contained multiple risk-limiting features that made it nearly impossible for Atrium to sustain a significant loss of capital on the arrangement as a whole – at any point in time. Many of these features were written into the agreements; others are observed from the actual, real-world behavior of the parties. Enforcement's expert Dr. Crawshaw discusses these features in his reports, which are summarized below:

1) Rate of premium accumulation

Under all of Respondents' arrangements, the rate of premium accumulation was so high relative to the probability of substantial claims that it was all but impossible for claims to exceed premiums over the arrangement, thereby resulting in a significant loss of Atrium's capital. Instead, the most likely result by far was that premiums would greatly exceed claims over the arrangement, resulting in an immense transfer of funds from the MI to Atrium. For example, Crawshaw provides calculations showing that the premiums UGI ceded were "so out of proportion to the risk band that Atrium purported to reinsure that even if the deal had been restructured in 2002 so that Atrium *stopped* receiving premiums under any book year after 2002 but would be liable for claims on those future book years (as well as past book years), it would still have made a profit" of at least $79 million, despite the occurrence of the historic real estate crisis. **Crawshaw Rebuttal Rep.** at 61. *See also* **Hrg. Tr. 2168:12-14** (6/4 Walker) [redacted]. Crawshaw also provides calculations showing that, because of the "rapid growth of ceded premiums," Atrium would not have suffered an economic loss even in "the extremely unlikely scenario that the real estate market had been in almost perpetual 'meltdown' throughout the entire arrangement." **Crawshaw Rebuttal Rep.** at 16-20. Neither of Respondents' experts disputed either of these calculations or their implications for risk transfer as explained by Crawshaw.

2) High attachment point

Because Atrium's liability under any given book year was based on aggregate claims and the attachment point was set sufficiently high, it would necessarily take several years for claims to accumulate to the point that Atrium's liability would be triggered, even in the case of high losses on the underlying insurance. **Crawshaw Rep.** at 17-21; **Crawshaw Rebuttal Rep.** at 80-81; **Hrg. Tr. 626:6-630:21** (3/26 Crawshaw). Even at that point, incurred claims were not likely to be substantial, because it would take additional time for claims to accumulate to a higher level within the reinsured layer. Cascio agrees that it was highly unlikely that Atrium could experience claims within three years of the origination of a book year of reinsurance. **Hrg. Tr. 1490:4-12** (5/29). Similarly, Milliman consistently projected that even in a "stress scenario," with only a 10% probability of occurring, claims would not be paid until the fourth year at the earliest, *e.g.*, **ECX 0193** at Ex. 1, and in the "expected scenario" claims would not be paid until the eighth year or later, *e.g.*, **ECX 0194** at Ex. 3, 4. As a result, the MI would already have ceded a considerable amount of premiums before even a single claim would be paid, or even incurred. **Crawshaw Rep.** at 21, 36, 47-48.

This time lag was particularly acute due to long delays inherent to the MI industry. Walker testified that, once a borrower goes into default, "eventually there is a point where finally 18 months later they foreclose on the properties." **Hrg. Tr. 2166:18-2167:13** (6/4). The time period between a delinquency and a foreclosure meant that the development of claims under the primary policy could be monitored, before Atrium could conceivably be responsible for any portion of those claims. *Id.* **2166:10-25** (UGI "monitor[ed]" claims on the primary policy as borrowers proceeded from delinquency to foreclosure).

The long time lag between premiums and claims provided Atrium a tremendous advantage. Respondents' capital contributions were protected from exposure during the first several years of coverage because premiums were rapidly accumulating but aggregate claims remained well below the attachment point. *Id.* Even if the attachment point was finally pierced, the several years of premiums already ceded made it extremely unlikely that any of Respondents' own capital would be called upon to pay any claims, and diminished the magnitude of the capital Respondents had at risk as a percentage of the premiums they had received (and thus diminished Respondents' potential loss ratio). *Id.* Crawshaw explains that as a result of this structure, "it was highly unlikely that there would be any claims paid by Atrium in the first three calendar years of a captive arrangement because no book year was more than three years old during that time (and thus, the attachment point was not likely to be reached for any of the three book years covered by the arrangement in those years, even in a stress scenario)." *Id.* at 20.

Moreover, although the first calendar year under an arrangement was the only year in which Atrium's capital would *necessarily* be called upon if premiums exceeded claims (because there was only one book year covered, and thus no premiums from any other book year in the trust accounts to pay the excess), it was essentially impossible for that scenario to occur, due to the structural features described above.[25] After the first calendar year, the arrangement covered two book years, but by then, any excess of claims over premiums on one of the two book years (which was also very unlikely to occur due to the high attachment point) could almost certainly be paid using premiums from the other book year.

The time lag resulting from the high attachment point also afforded Respondents a significant informational advantage they could leverage to further minimize any risk going forward. During the first several years of each arrangement, before claims pierced the attachment point, Respondents could safely monitor the performance of the covered book years, gaining valuable information to "better project the premiums and claims (if any) it could expect in the future from book years already covered by the arrangement." *Id.* at 37. Respondents "could more accurately evaluate the exposure for those past book years, the type and amount of loans involved, the rate at which policies were being dropped, the amount of claims against the MI to date (which would indicate the remaining distance to the attachment point) and other factors that could refine a projection of final book year outcomes." *Id.* And Respondents, using Milliman, in fact did monitor the development of each book year, including the remaining distance to the

[25] For example, Crawshaw explains that book year 2005 under the UGI arrangement, a book year covered just before housing prices began to decline, had *no* claims incurred as late as March 31, 2008, the fourth year of coverage for that book year and well into the real estate crisis. **Crawshaw Rebuttal Rep.** at 80-81.

attachment point. *See*, *e.g.*, **RCX 0001** (12/31/2005 "Milliman Reinsurance Performance Metrics") at 32 ("Paid and incurred losses are tracking at or below the attachment point for book years 1994 through 2002"); **RCX 0004** (2008 "Milliman Reinsurance Performance Metrics") at CFPB-PHH-00094287, -292, -297, -302 (charts show "Proximity to Attachment Point" for each book year under every arrangement).

During this "trial period," if substantial claims appeared imminent, Respondents could elect to terminate the arrangement with minimal or no loss – at most, their small initial capital contribution was at risk, but that capital was unlikely to be called upon due to the high attachment point and the growing premium buffer. *Id.* at 21, 36, 47-48. This made the potential downside of the arrangements small, both in absolute terms and as a percentage of premiums already ceded and expected to be ceded on the existing reinsurance. *Id.* If substantial claims did not appear imminent, Respondents could elect to continue with the arrangements and make any necessary additional capital contributions with the knowledge that a number of additional years would pass before any claims could be incurred, at which point even more premiums would have been ceded, in turn further diminishing the likelihood and magnitude of any loss of Respondents' capital. *Id.* This made the potential upside very large, as many book years' worth of premiums would be accumulated and Respondents' capital contributions could be withdrawn over time. *Id.*

Moreover, the attachment point was set sufficiently high that MIs expected there would not be substantial claims not only in the first few years, but at any time. Culver testified that "we didn't think the lender would ever get into their layer of the captive." **Hrg. Tr. 339:12-13** (3/25). Likewise, in a 2005 internal memorandum on captive mortgage reinsurance arrangements, UGI noted the following "important difference" between mortgage guaranty captives and traditional property and casualty captives (i.e., captives in other industries): [redacted] **ECX 0586** at 2. *See also* **ECX 0793** at 9, 12 (3/2003 Bear Stearns report, *Mortgage Finance*, "The Trouble with Captive Reinsurance: An Analysis of Excess of Loss Structures") (referring to "3.5%-4.0%" as "common attachment points for many excess of loss captive arrangements" and stating that "lenders have been able to pressure the industry into ceding very high percentages of premium recently while maintaining relatively *high attachment points*") (emphasis added); **ECX 0635** (2/1/1998 Schmitz article titled "Investigating captive mortgage reinsurance") at CFPB-PHH-00611008 ("Regardless of how the reinsurer's layer of risk is specified, it is *typically set at a level sufficiently higher than expected losses* so that the reinsurer is expected to incur no losses in the majority of years.") (emphasis added).

3) Low detachment point

Respondents' arrangements had low detachment points that protected Atrium from catastrophic risk. The prevalent detachment point for most of the time period covered by the UGI, Genworth and Radian arrangements was 14%. In 2008, the detachment point for the UGI arrangement was reduced to 10%. **RCX 0057** (UGI/Atrium agreement, Amendment # 9) at CFPB-PHH-00142260-61, ¶ 6. The detachment point for the Genworth arrangement was reduced to 10% in 2008 and 9.5% in 2010. **RCX 0050** (Genworth/Atrium agreement, Amendment #4) at 1, ¶ 2**; RCX 0051** (Genworth/Atrium agreement, Amendment # 5) at 1, ¶ 1**.** Crawshaw explains that as a result of these detachment points, "Atrium's potential liability was capped at a sufficiently low level that, in the event of a severe real estate crisis, the MIs were likely to have to bear a substantial portion, or even most, of the ensuing losses." **Crawshaw Rebuttal Rep.** at 7. As Cascio acknowledged at the hearing, the MIs bore most of the losses (and even had a higher loss ratio than Atrium) in a majority of the reinsured book years. **Hrg. Tr. 1448:25-1449:12** (eight to ten total book years between Genworth and UGI for which Atrium had a higher loss ratio); **ECX 0839** (16 total book years for UGI) at 5; **RCX 2004** (10 total book years for Genworth) at 26.

4) Limitation of liability to trust accounts

Atrium's liability under each of the arrangements was limited to the amounts in the associated trust account.

Section 13.1 of the Reinsurance Agreement between UGI and Atrium describes the purpose of the trust account as follows: "*To support [Atrium's] obligations under this Agreement*, and in conformity with law, [Atrium] shall enter into a trust agreement (the 'Trust Agreement') to *establish a trust account (the 'Trust Account') for the benefit of [UGI]*." **ECX 0584** (1/1/1997 UGI/Atrium agreement) at 13 (emphases added). The Trust Agreement between Atrium and UGI states that the trust account was created to "hold *assets as security* for the performance by [Atrium] of its Obligations ... under the Reinsurance Agreement."[26] **ECX 0122** (1/1/1997 UGI/Atrium Trust Agreement) at 1 (emphasis added).

No provision of the Reinsurance Agreement or Trust Agreement between UGI and Atrium pledges Atrium assets outside of the trust account as "security" for Atrium's

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[26] Black's Law Dictionary defines "security" as "[c]ollateral given or pledged to guarantee the fulfillment of an obligation; esp., the assurance that a credit will be repaid ..." Black's Law Dictionary 1475 (9th ed. 2009). Therefore, this provision of the UGI/Atrium Trust Agreement shows (at a minimum) that Atrium made no pledge, guarantee or assurance to UGI that any assets outside of the trust account could be used to fulfill Atrium's payment obligations.

performance of its contractual obligations to UGI, including its most basic obligation to pay claims to UGI. **ECX 0122**; **ECX 0584.** Atrium's assets outside of the trust account were controlled by Atrium and PHH, and PHH's ability to remove such assets from Atrium could not be restricted in any way by potential or actual claim payments to UGI. **ECX 0584**. PHH withdrew $74.8 million in dividends from Atrium from 2005 through 2011. **Crawshaw Rebuttal Rep.** at 129, Table 11, column C. Those dividend payments from Atrium to PHH largely coincided with the real estate crisis, when Atrium finally began to return some funds under its agreements. **ECX 0198** (9/30/2012, UGI cession statement) at tab "Trust Deposits," column "Losses Paid."

Section 2.02 of the Genworth agreement, which provides that Atrium was liable for claims within its specified risk corridor, concludes with the following limitation: "Notwithstanding the foregoing, in no event shall the Reinsurer be liable to the Company under this Agreement for any amounts in excess of the sum of the amounts required to be deposited into the Trust pursuant to Sections 12.05 and 12.06." **RCX 0044** (10/9/2000 GEMICO/Atrium agreement) at 4. Likewise, Section 12.02 of the Genworth agreement provides that "any assets not included in Trust Account are not available to support or secure this Agreement." *Id.* at 12. No provision of the Reinsurance Agreement or Trust Agreement between Genworth and Atrium pledges Atrium assets outside of the trust account as "security" for Atrium's performance of its contractual obligations to Genworth. **RCX 0044**; **ECX 0528.**

Section 12.10 of the Radian agreement states that "any assets not included in the Trust are not available to support or secure this Agreement." **ECX 0200** (7/26/2004 Radian/Atrium agreement) at CFPB-PHH-0091633. No provision of the Reinsurance Agreement or Trust Agreement between Radian and Atrium pledges Atrium assets outside of the trust account as “security” for Atrium’s performance of its contractual obligations to Radian. **ECX 0527**; **ECX 0200**.

Section 12.11 of the CMG agreement states that “any assets not included in the Trust are not available to support or secure this Agreement.” **ECX 0202** (12/1/2006 CMG/Atrium agreement) at 20.[27] No provision of the Reinsurance Agreement or Trust Agreement between CMG and Atrium pledges Atrium assets outside of the trust account as “security” for Atrium’s performance of its contractual obligations to CMG. **ECX 0203**; **ECX 0202.**

At the time that the captive arrangements were in place, from 1995 to 2013, all parties believed that the funds available to pay reinsurance claims were limited to those in the trust account designated for the particular MI. When asked at his investigational hearing whether it was his understanding that the funds in the trust accounts “constituted all of Atrium’s liability under the applicable reinsurance policy,” Rosenthal testified: “That’s my understanding. All the premiums and all the capital that’s in – in that trust is the exposure to which Atrium is exposed.” **Hrg. Tr. 267:4-11** (3/25 Rosenthal). He was then asked whether Atrium’s liability would be extinguished if the assets in the applicable trust account were “exhausted by claims,” and he responded:

> If the capital falls below a certain minimum threshold, then Atrium ... could choose to put a capital infusion into the trust, but it’s not a contractual obligation that it must put a capital infusion into the trust .... *So if you choose not to put any more monies into the trust, the most it could lose the money, all the premiums, and all the capital it initially put into the trust ....*
>
> [*Id.* **267:12-268:10** (emphasis added).]

[27] Cascio concedes that the CMG agreement contains a trust cap. **Cascio Rebuttal Rep.** at 5 n.4.

He confirmed that his response applies to "all of Respondents' captive arrangements." *Id.* **268:4-10**.[28]

In every "risk transfer" analysis it performed for the UGI, Genworth and Radian arrangements, Milliman clearly and unequivocally stated that Atrium's liability was limited to the funds in the associated trust account. *E.g.***, ECX 0194** at 7 ("However, Atrium has no liability beyond the funds available in the trust."); **ECX 0124** at 8 (same); **ECX 0593** at 7 ("However, the Reinsurer has no liability beyond the funds available in the trust."). Milliman relied on information provided by Respondents or the MI. *E.g.***, ECX 0194** at 19 ("In performing this analysis, we have relied on data and other information provided and represented to us by or on behalf of PHH."); **ECX 0593** at 19 ("In performing this analysis, we have relied on data and other information provided and represented to us by UGRIC/UGMIC."); **Hrg. Tr. 2195:19-20** (6/4 Walker) ("We often provided [Milliman] the data that they used."). Walker testified that UGI "would review" the Milliman opinions, that he believed Milliman "considered all the important facts and accurately captured those facts," and that "if the agreements had certain terms in them that would impact risk transfer, we felt like their opinion would reflect that." *Id.* **2195:13-15**, **2196:2-16**. Walker believes that "Milliman's analysis comported with UGI's view of the captive arrangements." *Id.* **2196:14-17.** During the life of Respondents' captive arrangements, no one ever asserted to Milliman that Milliman's statement about the limitation of Atrium's liability to the trust account was

[28] At the hearing, Rosenthal attempted to recant this testimony with respect to the UGI and Genworth arrangements, stating that he "changed [his] testimony ever so slightly" and now believes that UGI and Genworth could reach Atrium assets outside of the respective trust accounts. **Hrg. Tr. 268:9-269:19, 285:5-286:2** (3/25**)**. He maintains, however, that Atrium's liability under the Radian and CMG arrangements was limited to the trust accounts. *Id.* **269:8-19**. Rosenthal's self-serving reversal of his own recent testimony is not credible.

wrong, despite its presence in every one of Milliman's risk transfer reports over many years. *Id.* **1985:4-7** (6/3 Schmitz) (Respondents never corrected Milliman's statement); *cf. Id.* **2200:6-8** (6/4 Walker) (Walker deemed the Milliman opinions to be accurate).

Respondents' understanding that Atrium's liability was limited to the assets in the trust accounts is further confirmed by emails in which Respondents' representatives referred to assets within the trust accounts as "at risk," which means that assets outside of the trust accounts were not "at risk." For example, in a February 15, 2009 email, after it had become clear that claims would have to be paid out of the Radian trust, and additional capital would be required to maintain the arrangement, Danahy wrote: "At this point, I do not want to put additional *capital at risk with this trust*." **ECX 0254** (emphasis added). Similarly, in a January 8, 2010 email, Rosenthal asked whether there were any "monies that we could dividend out of the Genworth captive," which would "remove any dividend from an '*at risk*, cross-collateralized' position." **ECX 0443** (emphasis added). There is no evidence that Respondents or the MIs ever discussed any possibility that any other funds within Atrium but outside the trust accounts were ever at risk as a result of claim payments to Radian, Genworth or any other MI.

When the CMG and Radian agreements were terminated, the final commutation payments to CMG and Radian were the exact amount of the funds in their respective trust accounts, even though the projected claim payments were greater. For example, on July 7, 2009, Steve Keleher of Radian sent an "analysis of the Atrium captive" to Bogansky and Rosenthal, estimating that future claims under the Radian arrangement would total $23.7 million. **ECX 0433**; **ECX 0434** (Radian's "Atrium Captive Analysis") (cells J27-N27). Even though the expected claims incurred by Atrium exceeded the amounts in the Radian trust account, when the Radian arrangement was commuted, Radian's commutation payment was limited to the funds in the trust account – $4,447,105. **ECX 0526** (7/22/2009 Radian/Atrium commutation agreement) at 1, ¶ 1 (requiring release of funds in trust account to Radian); **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C (indicating commutation payment to Radian of $4,447,105). When CMG's arrangement was commuted, expected future claim payments was at least $5,014,690.51. **ECX 0429** (7/2009 CMG presentation to PHH) at 6 (reflecting "Loss Reserves" of $5,014,690.51); **RCX 0569** (1/31/2008 letter, Bjurstrom to Danahy) at 3 (noting that loss reserve is for "Future paid losses"); **RCX 0823** (9/4/2008 "Overview of Atrium Insurance Corporation") at 16 (indicating that loss reserve is for unpaid losses). But CMG's commutation payment was limited to the funds in its trust account – $3,233,079. **RCX 0039** (8/31/2009 CMG/Atrium commutation agreement) at 1, ¶ 1 (requiring release of funds in trust account to CMG); **ECX 0653** at Ex. A to Ex. C (indicating commutation payment to CMG of $3,233,079).

Although each of the written agreements limited Atrium's liability to the amounts in the trust account, this extensive course of dealing evidence should resolve any potential ambiguity in the written agreements firmly in Enforcement's favor. Parties can modify their contracts through their conduct.[29] *Kaplan v. Old Mutual PLC*, 526 Fed.

[29] As discussed below, *see* § III.B.2.b.ii, *infra*, Respondents' accounting arguments provide them no defense, but as Crawshaw explains, in evaluating risk transfer, even accounting principles require consideration of agreements or understandings outside of the written contract. **Crawshaw Rebuttal Rep.** at 125-26. FAS No. 113 provides: "Determining whether a contract with a reinsurer provides indemnification against loss or liability relating to insurance risk requires a complete understanding of that contract and other contracts or agreements between the ceding enterprise and the related reinsurers." **ECX 0662** at 6-7. In addition, the Reinsurance Attestation that the ceding company's CEO and CFO must file to support reinsurance accounting includes the following statement: "There are no separate written or oral agreements between the reporting entity and the assuming reinsurer that would reduce, limit, mitigate, or

App'x 70, 72 (2d Cir. 2013) (New York law); *Laplace v. Estate of Laplace ex rel. Laplace*, 220 Fed. App'x 69, 73 (3d Cir. 2007) (New Jersey law). In the event that claims exceeded the funds in the trust account – which was unlikely, given the high premium ceding rate – there is no reason to believe that the MI would have insisted on reaching Atrium's assets outside of the trust accounts. The MIs consistently acquiesced whenever Respondents sought to use their leverage to obtain an advantage against them. *See* §§ III.A, *supra*, III.B.2.a.i.7, *infra*.

The trust caps are relevant to risk transfer in part because Atrium's initial capital contributions to the trust accounts were small in comparison to ceded premiums.[30] For example, Atrium's total contributed capital in the UGI trust account from January 1, 1997 to May of 2000 was just $460,000, in comparison to more than $8 million of total premiums that UGI ceded by 1998 and more than $26 million of total premiums that UGI ceded by 2000. **Crawshaw Rep.** at 16-17. Atrium contributed just $16,120 of capital to the Radian trust account from the inception of the arrangement in 2004 to the

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otherwise affect any actual or potential loss to the parties under the reinsurance contract." **ECX 0632** at 2**.**

[30] Crawshaw's conclusion that there was no significant risk transfer under Respondents' arrangements does not require the existence of a trust cap, which was just one of many risk-limiting features. For example, the premium ceding rate was so high that it was unlikely that claims would ever exceed the premiums in the trust account, so any Atrium capital outside of the trust accounts was largely protected from exposure, regardless of whether there was a trust cap. Walker testified that "the premium is remaining in the trust, and it will be available to us in a catastrophe" so "[e]ven if for some reason we are limited to what's in the trust, that's a substantial amount of recovery for UG on a calendar year, go-forward basis." **Hrg. Tr. 2168:19-22** (6/4 Walker). Many other risk-limiting features were entirely independent of a trust cap, such as the high attachment point and low detachment point. In his rebuttal report, Crawshaw performed a risk transfer analysis that assumed there were no trust caps and concluded that the UGI and Genworth arrangements would still fail to exhibit risk transfer. **Crawshaw Rebuttal Rep.** at 125-39. As he explains, the amounts outside of the trust accounts were not nearly large enough to constitute a significant loss in the unlikely event that the trust accounts were depleted.

first quarter of 2008, even though Radian's total ceded premiums exceeded $1.3 million by the end of 2006. *Id.* at 17. Atrium failed to meet the required minimum capital contributions under all four of its arrangements. **Crawshaw Rebuttal Rep.** at 96-103.

Moreover, since only the funds in the trust account could be used to pay claims, the payment of claims under one book year necessarily reduced the funds available to pay claims under the other book years. Thus, as a result of the trust caps, a relatively high loss ratio for a particular book year necessarily reduced the maximum possible loss ratios on the other book years. [31]

5) Coverage of multiple book years

Respondents' captive arrangements were designed to cover multiple book years. As a result, even if any single book year sustained a loss ratio of more than 100%, the economic result for the entire arrangement would not be limited to that single unprofitable book year.

Respondents cannot credibly argue that their arrangements were not intended to be multiple-book year arrangements. Each of Respondents' arrangements linked all book years together in multiple ways. First, premiums from all book years were pooled into a single trust account for each MI, **Hrg. Tr. 2034:10-14** (6/3 Schmitz), and claims were cross-collateralized across book years, meaning that claims incurred by Atrium under any book year could be paid using premiums ceded under other book years. **Hrg. Tr. 1937:7-25, 2034:17-20** (6/3 Schmitz). Second, as discussed above, Atrium's liability under each arrangement was limited to the funds in the associated trust account, *see* § III.B.1.a.i.4, *infra*. As a result of this limitation, any excess of claims

[31] *See also* Enf. Counsel Opp. to Resps.' Renewed Mot. to Dismiss (Document No. 123) at 10-16. Enforcement incorporates by reference its argument regarding trust caps in its entirety.

incurred by Atrium over premiums ceded for a particular book year necessarily had to be paid using premiums from other book years (rather than Atrium assets outside of the trust account), thereby reducing dollar-for-dollar the premiums available to pay any claims incurred under other book years. Third, for each arrangement, there was a single contract (plus amendments) that covered all book years. **Hrg. Tr. 1925:17-1927:13** (Schmitz). Fourth, in all cases, the agreement had a single "termination" provision that, if triggered, would apply to all book years.[32] Fifth, each agreement contained minimum trust balances, which was determined based on the total risk across all book years.[33] Sixth, under each agreement, Atrium's ability to take dividends was a function of risk across all book years. **Hrg. Tr. 2034:21-2035:16** (6/3 Schmitz).

Even though they have the burden as to Section 8(c)(2), Respondents presented no testimony or other evidence of their own regarding the *intentions* of Atrium or any MI with respect to whether their arrangement would cover a single book year or multiple book years. Respondents called no witness who testified that any MI or Atrium believed it was likely that their arrangement would terminate after a single book year, or that at any point in time, either the MI or Atrium believed it was more likely that only a single additional book year, rather than more than one additional book year, would be covered. Respondents appear to take the position that their captive arrangements could

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[32] *See* **ECX 0710** (UGI/Atrium agreement 3-44) at 6-8, § 5; **RCX 0044** (GEMICO/Atrium agreement) at 8-10, art. IX; **ECX 0200** (Radian/Atrium agreement) at CFPB-PHH-00091626-28, art. IX; **ECX 0202** (CMG/Atrium agreement) at 12-14, art. IX.

[33] *See* **ECX 0710** (UGI/Atrium agreement 3-44) at 14, § 13.2 ("Total Original Risk in Force" for "all Policy Years" factored in minimum trust balance); **RCX 044** (GEMICO/Atrium agreement) at 2 ("Capital Requirement Amount" based on "Capital Ratio" for all book years, which is based on "Aggregate Risk Exposure"); **ECX 0200** (Radian/Atrium agreement) at CFPB-PHH-00091631, § 12.05 ("Minimum Capital" is based on "the Risk in Force assumed by the Reinsurer pursuant to this Agreement"); **ECX 0202** (CMG/Atrium agreement) at 18, § 12.06 (same).

not have been multiple-book year arrangements unless coverage of multiple book years was unequivocally intended *at the inception of the arrangement*. Nothing in Section 8(c)(2) supports such a narrow and contrived test. For example, even if there were evidence that in 1995, UGI and Atrium intended that their arrangement would cover only a single book year (there is none), surely after the passage of several years, when they had already agreed to coverage of multiple book years and their incentives for participating in the arrangement remained, the arrangement plainly was and would continue to be a multiple-book year arrangement. Thus, regardless of what UGI and Atrium may have intended in 1995, it is inconceivable that they did not – within several years at most, and surely long before October 2006 (the starting point for Enforcement's damages claim) – come to recognize that their arrangement was in fact intended to cover multiple book years. At that point, it would defy reality to continue to believe that a risk transfer analysis that focused only on a single book year (such as Milliman performed) said anything about the economic value of the arrangement to the MI.

That the captive arrangements were multiple-book year arrangements is consistent with the extensive evidence demonstrating the leverage that Respondents exercised over the MIs through referrals. Respondents were able to sell their "reinsurance" to the MIs in the first place only because they controlled the referrals on which the MIs depended for their business. **Hrg. Tr. 2229:23-2230:5** (6/4 Walker). There is no evidence suggesting that this dynamic changed after the first book year of a captive deal. Therefore, both the MIs and Respondents knew, even at the inception of each arrangement, that the cause of the MI's decision to enter into the captive arrangement – the desire to purchase referrals – would remain long after the first book year was purchased.

Having failed to present evidence of the parties' intentions with respect to whether their arrangements would cover a single book year or multiple book years, Respondents take the position that the written contracts themselves preclude viewing the arrangement as multiple-book year arrangements because those contracts allowed annual renewal. **Burke Rebuttal Rep.** at 10. But the written contracts for the Genworth, Radian and CMG arrangements provided that the arrangement would remain in effect unless and until either party elected to terminate it. **RCX 0044** (Genworth/Atrium agreement) at 8, § 9.01 ("The term of this Agreement ... *except as otherwise provided herein*, shall be unlimited in duration.") (emphasis added); **ECX 0200** (Radian/Atrium agreement) at CFPB-PHH-00091626, § 9.01 ("The term of this Agreement ... *except as otherwise provided herein*, shall be unlimited in duration.") (emphasis added); **ECX 0202** (CMG/Atrium agreement) at 12, § 9.01 ("The term of this Agreement ... shall remain in effect *until terminated ...*") (emphasis added). Under each of those contracts, Atrium was responsible for covering "Reinsured Loans" on "Covered Business." **RCX 0044** (Genworth/Atrium agreement) at 4, § 2.01; **ECX 0200** (Radian/Atrium agreement) at CFPB-PHH-00091620, § 2.01; **ECX 0202** (CMG/Atrium agreement) at 6, § 2.01. Neither the definitions of "Reinsured Loans" or "Covered Business," nor any other provision of those contracts, required the affirmative agreement of the parties before each book year could be added to the captive; rather, the book years were automatically added to the captive as long as the agreement remained in effect. **RCX 0044** at 1, 3, §§ 1.05, 1.31 (definitions of "Reinsured Loan" and "Covered Business"); **ECX 0200** at CFPB-PHH-00091617, -19, §§ 1.10, 1.28 (definitions of "Reinsured Loan" and "Covered Business"); **ECX 0200** at *3*, 6, §§ 1.12, 1.30 (definitions of "Reinsured Loan" and "Covered Business"). Thus, the written contracts for the

Genworth, Radian and CMG arrangements do not at all preclude viewing those arrangements as multiple-book year arrangements; they allowed the parties to agree to cover either a single book year or multiple book years under the same terms.

The UGI written contract required that the arrangement cover a minimum of two book years. Section 5.1 provides: "This Agreement shall be effective as of 12:01 a.m., Eastern Time, on January 1, 1997, and shall remain in force until 11:59 p.m. on December 31, 1998 …." **ECX 0584** (UGI/Atrium agreement) at 6, § 5.1. Atrium was responsible for covering "Reinsured Loans" while the agreement was in effect, *id.* at 5, § 2.1, but neither the definition of "Reinsured Loan" nor any other provision required the affirmative agreement of the parties for an additional book year to be covered. Rather, loans with an effective date on or after November 9, 2005 were automatically added to the captive as long as the agreement was in effect.[34] Thus, Atrium was contractually required to cover at least book years 1997 and 1998. Thereafter, the UGI agreement could be "renewed annually … for additional one year terms commencing January 1 and terminating on the following December 31 if both parties mutually agree to such renewal on or before September 1, 1998 in the case of the first year, or any subsequent September 1 in the event of a renewal year." *Id.* at 6, § 5.1. Thus, after the first two book years, the contact allowed the parties to agree to cover either a single additional book year or multiple additional book years.

[34] Under the UGI/Atrium agreement, "Reinsured Loan" is defined as "a loan originally insured under a Policy issued by a Ceding Company to an Approved Originator, provided that the effective date of coverage for such loan is (a) (i) *on or after November 9, 1995* or (ii) on or after October 1, 1993, if there is an additional premium paid by the Insured to Ceding Company for coverage for such loan on or after November 9, 1995, (b) *before the termination of this Agreement*." **ECX 0584** at 5, § 1.24.

None of the written contracts reflects an intention to cover only a single book year, and in some respects, they strongly suggest an intention to cover multiple-book years (and in the case of UGI, the contract requires multiple book years). Respondents cannot rely on the contracts to compensate for their failure to present evidence of the parties' intentions on this issue.

6) Segregation of premiums, claims, and risk by MI

Respondents segregated premiums, claims and risk by MI by establishing a separate trust account for each MI. Funds from the trust account for one MI could not be used to pay claims incurred by another MI. According to Crawshaw, this is not consistent with one of the fundamental principles of insurance: the pooling of risk across multiple insured entities. Crawshaw explains: "The segregation of premiums by MI substantially reduced the probability and extent of potential recovery for each MI compared to a situation in which premiums from all MIs were pooled together and available to pay claims incurred by any MI."[35] **Crawshaw Rep.** at 15.

7) Respondents' ability to extract one-sided concessions from the MIs

Respondents had the ability to extract agreements from the MIs to amend their respective captive arrangements in utterly one-sided ways that further shielded Respondents from any risk of loss. In early 2007, when the likelihood of losses on

[35] In his rebuttal report, Cascio responded to Crawshaw's opinion by asserting that if risks were pooled across MIs, "such a structure would benefit the first MI to suffer losses to the detriment of the other MIs" and that if the MI "happens not to be the 'first in line' then there might not be sufficient funds available to pay its claims." **Cascio Rebuttal Rep.** at 12. But as Crawshaw explained, Cascio's response assumes there is insufficient contributed capital to pay all claims in the first place: "[I]f it was sufficient capital, then the idea of running out of money to pay claims wouldn't occur." **Hrg. Tr. 2276:3-2277:12** (6/4). Thus, Cascio's response requires him to concede the effectiveness of another risk-limiting feature (insufficient contributed capital).

mortgage loans became increasingly evident, Respondents extracted from UGI permission to amend their captive agreement in order to allow them to withdraw more than $52 million from the UGI trust account. **Crawshaw Rep.** at 40-43. Respondents also obtained several amendments from UGI and Genworth altering the coverage parameters, excluding loans that were more likely to default and thus cause the operative measure of losses to reach the attachment point. **Hrg. Tr. 149:9-167:25** (3/24 Rosenthal). Respondents' demonstrated ability to change the terms of the arrangements to limit their exposure to the MIs' losses renders even the slight probability of a small loss entirely illusory. In the unlikely event that a theoretically possible loss became probable, Respondents had the leverage to change the rules to ensure the scheme stayed profitable.

ii. The most likely result under Respondents' arrangements was a significant loss to the MI and the best-case scenario was not materially better than a savings account

If Section 8(c)(2) allowed captive mortgage reinsurance arrangements to be analyzed only through the distorting lens of a single book year, risk-limiting features such as those described above could be employed to ensure (or at least make it extremely likely) that the lender and its captive reinsurer are guaranteed to profit from the arrangement without running afoul of RESPA, so long as individual book years have the potential to be "unprofitable," even though the arrangement as a whole cannot result in a significant loss.

In practice, the features described above had their intended effect. Crawshaw conducted a detailed analysis of each of Respondents' captive arrangements and concluded that, as a result of their risk-avoiding features, none reflected a genuine reinsurance service to the MIs because it was virtually impossible for Atrium to suffer a significant loss of its own capital.

1) *United Guaranty*

Respondents contributed no capital to the UGI trust account from the inception of the arrangement in November 1995 through November 1997. **ECX 0653** (PHH NORA response) at Ex. C (Boganksy Decl.) ¶ 14; *id.* Ex. A to Ex. C. Respondents' first capital contribution was $460,000 in December 1997. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," cell F11**; ECX 0653** (PHH NORA submission) at Ex. A to Ex. C. This was the only capital contribution Respondents made during the 4.5 year period from the inception of the arrangement until May 2000, when they finally began to make additional capital contributions – a total of $44 million from May 2000 through December 2002. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," cells F38, F49, F69**; ECX 0653** at Ex. A to Ex. C. Atrium's $460,000 capital contribution did not meet the minimum capitalization requirements of the written agreement from 1997 through at least 2002, and was more than $20 million short for several years. **Crawshaw Rebuttal Rep.** at 96-98.

Crawshaw explains that from 1995 through May of 2000, the maximum amount that UGI could gain was Atrium's $460,000 capital contribution, whereas the amount that UGI stood to lose was orders of magnitude greater – tens of millions of dollars of premiums it had already ceded, or would be required to cede, to Atrium for the first several book years covered under the arrangement. **Crawshaw Rep.** at 34-37 & n. 84. For book years 1995 through 1999, UGI ceded a total of $106.6 million in premiums to Atrium. **ECX 0198** (9/30/2012 UGI cession statement) at tab "WrittenPrem," column F; **Crawshaw Rebuttal Rep.** Attachment 3. Had Atrium terminated the arrangement on a run-off basis in 2000, it would ultimately have collected $106.6 million of premiums, whereas its maximum possible loss would have been just $460,000. The likelihood of the UGI losing most or all of the premiums ceded to Atrium was far greater than the likelihood of UGI gaining the $460,000 capital contribution, largely because claims were extremely unlikely to pierce the attachment point in the first several years of the arrangement (even in a stress scenario). **Crawshaw Rep.** at 35. As a result, the arrangement from the start was a lopsided bet stacked heavily in Atrium's favor. Crawshaw concludes that from an insurance perspective, there was no reasonable business justification for UGI to enter into such an arrangement. *Id.* at 36.

By mid-2000, when Atrium had to decide whether to contribute additional capital, substantial premiums had already accumulated in the UGI trust account, providing a buffer against the risk of loss of any additional capital. *Id.* at 36. Although Respondents elected to continue with the UGI arrangement, they did so at a time when the housing boom was in full swing and with the knowledge that continuing to accept 40% of UGI's premiums was likely to be highly profitable to Atrium and would only add to the premium buffer. *Id.* at 37-38. But not long after it had completed making additional capital contributions to the UGI trust account, Atrium began to take a series of dividends from the trust account that rapidly diminished, and ultimately eliminated, their net capital contributions, making it impossible for Atrium to incur a significant economic loss under the arrangement. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," column "Capital Deposit".

As a result of $30.1 million of dividends taken by the end of 2006, Respondents' net capital contribution (which reflected its maximum possible loss) fell to only 8% of the total premiums *already* ceded to the UGI trust account. **Crawshaw Rep.** at 33

(Table 1); **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," columns "Premium Deposits" and "Excess Funds." Because Respondents never contributed capital after that, the 10/10 test could not possibly be met from that point forward.[36] **Crawshaw Rep.** at 33 (Table 1); **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," column "Capital Deposit." Had Atrium exercised its contractual right to terminate the arrangement on a run-off basis after taking those dividends in 2005 and 2006, it would have continued to receive premiums on 2006 and prior book years until their natural expiration, making the remaining capital contributions (which represent its maximum loss) an even smaller percentage of total ceded premiums[37] – just 6% by the end of 2006.[38]

In February 2007, the month before Respondents took the $52.6 million dividend, their total capital contributions to the UGI trust account from its inception were approximately $46.8 million and Respondents had previously withdrawn more

[36] Because the 10/10 test requires at least a 10% chance that claims will exceed premiums by at least 10%, for that test to be met, the reinsurer must have contributed capital equal to at least 10% of total ceded premiums. Respondents' net capital contribution of $16,670,000 as of the end of 2006 was just 8% of the $202,915,675 of total premiums already ceded by UGI by the end of 2006. **Crawshaw Rep.** at 33.

[37] The figures in column E of Table 1 on p. 33 of Crawshaw's initial report reflect Atrium's net capital contributions as a percentage of premiums *already* ceded. Those percentages would be substantially smaller if Respondents' net capital contribution were compared to total ceded premiums, *including premiums not yet ceded but which Atrium would eventually collect* if the arrangement were terminated on a run-off basis. For example, the 28% figure for 2004 would be reduced to 18%, because (according to Milliman) the total ceded premiums for book years 1994-2004, including future ceded premiums, would be $244.3 million – much more than the $161.4 million of premiums already ceded by the end of 2004. **Crawshaw Rebuttal Rep.** Attachment 3, column 4; **ECX 0839** at 5; **ECX 0198** (9/30/2012 UGI cession statement) at tab "WrittenPrem," column F**.**

[38] According to Milliman's latest projections, the total ceded premiums for book years 1994-2006 would be $285,214,923. **Crawshaw Rebuttal Rep**. Attachment 3, column 4; **ECX 0839** at 5; **ECX 0198** at tab "WrittenPrem," column F. Atrium's net capital contribution of $16,670,000 as of the end of 2006 was just 6% of that amount.

than $44 million in dividends. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," columns "Capital Deposit" and "Excess Funds." Thus, the $52.6 million that Respondents removed from the trust account in March 2007 eclipsed the less than $3 million in Respondents' capital contributions remaining at that time.

As a result, from then on the only funds that could be used to pay claims were premiums previously ceded by UGI and investment income. Thus, during the financial crisis, when funds were actually needed to pay claims to cover catastrophic losses, UGI could merely obtain a return of what remained of its ceded premiums in the trust account and no more. Indeed, the first claim payments to UGI were made in 2009, after all of Atrium's contributed capital had been safely removed from the trust account. **Crawshaw Rep.** at 33.

2) Genworth

Respondents contributed $5.5 million of capital to the Genworth trust account in 2001 and 2002. **Crawshaw Rep.** at 45; **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C. This was the only capital Respondents ever contributed to the Genworth trust account. *Id*. This capital contribution did not meet the minimum capitalization requirements of the written agreement from 2001 through at least 2003. **Crawshaw Rebuttal Rep.** at 98-101.

In the first several years of the arrangement, Atrium faced no significant risk of losing the $5.5 million of contributed capital because claims were extremely unlikely to pierce the attachment point. **Crawshaw Rep.** at 46-47. By the third quarter of 2005, the $5.5 million of capital fell to less than 10% of the $57 million of total premiums *already* ceded to the trust account. *Id.* at 48. But if *future* ceded premiums are included in the comparison, Respondents' contributed capital fell below 10% of premiums much earlier than 2005.[39] If Atrium had exercised its contractual right to terminate the Genworth arrangement on a run-off basis at any time, it would have continued to collect premiums on all book years then covered, while its maximum possible loss remained fixed at $5.5 million. According to Milliman's latest projections, the total ceded premiums for book years 2000-2003 would be $86.3 million. **Crawshaw Rebuttal Rep.** Attachment 3, column 5; **ECX 0656** ("Atrium Insurance Corporation Reinsurance Performance Metrics: 1st Quarter 2012") at 5. Thus, Respondents' contributed capital fell below 10% of total premiums (including future premiums) by the end of 2003.[40] As a result, only three years after the arrangement began (as soon as the "trial period" ended), the 10/10 test could not possibly be met because premiums had already accumulated to the point that it was impossible for Atrium to incur a loss of 10% of ceded premiums.

Respondents removed all of their capital contributions from the Genworth trust account just as significant losses were mounting. 2009 was the first year in which Genworth received any payments from its trust account – less than $1 million that year, out of more than $100 million in total premiums that Genworth had ceded since 2001. **ECX 0257** (3/31/2012 Genworth cession statement) at tab "Settlement," cell AW16; **Crawshaw Rep.** at 45, 49. In 2010, paid losses to Genworth increased to over $10 million, and Respondents took a $5 million dividend from the trust account. **ECX 0257** (3/31/2012 Genworth cession statement) at tab "Settlement," cell BB16; **ECX 0653** at

[39] The figures in column E of Table 2 on p. 45 of Crawshaw's initial report reflect Atrium's net capital contributions as a percentage of premiums already ceded. Those percentages would be substantially smaller if Atrium's net capital contribution were compared to total ceded premiums, including premiums not yet ceded but which Atrium would eventually collect if the arrangement was terminated on a run-off basis.

[40] By the end of 2003, Atrium's contributed capital was just 6% of premiums, including future ceded premiums ($5.5 million divided by $86.3 million).

Ex. A to Ex. C; **Crawshaw Rep.** at 45, 49. The removal of those funds reduced Respondents' net capital contribution in the trust account to just $500,000. **Crawshaw Rep.** at 45, 49. In 2011, paid losses to Genworth grew to over $12 million, and Respondents withdrew another $8.9 million from the trust account, eliminating Respondents' entire capital contribution. **ECX 0257** (3/31/2012 Genworth cession statement) at tab "Settlement," cell BG16; **ECX 0653** at Ex. A to Ex. C; **Crawshaw Rep.** at 45, 49.

3) Radian and CMG

Respondents' conduct in its arrangements with Radian and CMG (which commenced in 2004 and 2006, respectively) presents a revealing contrast with their conduct under the UGI and Genworth arrangements. As the mortgage crisis escalated, Atrium was faced with the prospect of significant claims, but unlike its experience with UGI and Genworth, Respondents' arrangements with Radian and CMG had not been in existence for a sufficiently long period of time for the trust accounts to accumulate a large premium buffer against the risk of loss of Atrium's capital. *Id.* at 51-59. Respondents were therefore confronted with a choice – contribute additional capital that might actually be exposed to some non-trivial risk, or terminate the arrangement. In 2009, they chose to terminate. *Id.*

Earlier in 2009, Respondents' capital contributions fell far short of minimum contractual requirements. On May 30, 2008, Bogansky emailed colleagues that "[w]e never made the minimum capital requirements for Radian's trust from inception ...." **ECX 0246**. On June 2, 2009, Bogansky emailed that "we have a deficiency of approximately $800K in Atrium's Radian Trust Account." **ECX 0425.** As to CMG, in a presentation to PHH in July 2009, CMG explained that the funds in the trust account were at least $1.7 million short of the minimum capital required by the contract. **ECX 0429** at 5-7.

Respondents terminated the Radian arrangement to avoid "put[ting] additional capital at risk with this trust," **ECX 0254** (2/15/2009 email, Danahy to Bogansky), and declined to fund the CMG trust account to the minimum capital level. This terminated the arrangement and shifted to CMG "reinsured" liabilities that substantially exceeded the commutation payment CMG obtained (which was itself comprised mostly of CMG's own ceded premiums). **Crawshaw Rep.** at 54; **ECX 0372** (8/13/2009 email, Bahr (CMG) to Rosenthal).

As shown above, the effect of the risk-limiting features described in Crawshaw's reports was to limit Respondents' maximum potential liability 1) to slightly more than 100% of ceded premiums early in the life of the arrangements – when Respondents' investment was small and the risk of loss was exceedingly remote (as shown by the Radian and CMG arrangements), and 2) to significantly less than 100% of ceded premiums later on – when Respondents had the opportunity to withdraw their capital contributions as well as ceded premiums, and to protect their profits through the many features described above (as shown by the UGI and Genworth arrangements). The only conceivable "value" of Respondents' arrangements to the MI was a remote possibility of a small gain, which could only occur in the event of a major housing crisis severe enough to exhaust the reinsurance layer on existing book years sufficiently early in the arrangement that Respondents would not yet have had the opportunity to withdraw their capital. The likelihood of such a benefit was remote, as it required a perfectly timed historic meltdown, and the magnitude of the benefit would necessarily be small, both as a percentage of premiums paid and in the absolute, as it would be limited to the capital initially contributed by Atrium, which often represented a paltry payment for the MIs whose balance sheets tended to be many orders of magnitude larger (and for whom such potential gains were therefore essentially meaningless).

This outcome, reflected in the results of the CMG and Radian arrangements, was the best-case scenario for the MI and worst-case scenario for Atrium. The amount of Atrium capital gained by Radian and CMG through their commutation payments reflected a total return on the premiums ceded to Atrium of 16% and 17%, respectively, over the life of their arrangements – less than 10% on a present value basis.[41] **Crawshaw Rep.** Attachment 2; **Hrg. Tr. 2281:23-2282:24** (6/4 Crawshaw). That is not a significant loss; it is comparable to the return available from a savings account. *Id.* Respondents' experts did not argue that these returns were superior to interest on a savings account, nor did they contend that it was reasonably possible for the MI to obtain a result significantly better than what Radian and CMG attained. On the other hand, the potential loss to Radian and CMG, as detailed above, was highly probable and large in magnitude – whereas a savings account would guarantee a return of the deposited funds.

The more probable outcome occurred with the UGI and Genworth arrangements. Because Respondents had the benefit of several profitable book years of "reinsurance" to more than offset the unprofitable ones, both resulted in large losses to the MIs. Even though a historic mortgage crisis resulted in the full exhaustion of the reinsurance layer in several book years in both arrangements, Atrium was able to pay all claims using

[41] The 16% and 17% figures (and the less than 10% present value figure) reflect total returns over the life of the arrangements, not annual returns. **Crawshaw Rep.** Attachment 2. Because those returns, on a present value basis, are less than 10% of ceded premiums, even if the best-case scenario had a 10% chance of occurring, the Atrium arrangements would fail the 10/10 test.

premiums ceded from other book years. UGI and Genworth would nonetheless have been much better off had they not entered into those arrangements, because the real estate crisis did not happen to occur during the very brief period when a marginal gain to UGI and Genworth was even theoretically possible.

An arrangement that, in an exceedingly unlikely best-case scenario, provides a return to the MI that is not materially better than a savings account, is not a "service actually performed." An arrangement in which the MIs, not Atrium, faced a significant risk of a substantial loss by entering into captive arrangements with Respondents is not a "service actually performed." An arrangement in which the reinsurer is never in danger of incurring a significant loss of its own capital is not a "service actually performed." The only value to the MI in entering into captive arrangements with Respondents was the receipt of referrals of business.

b. Respondents presented no evidence that their arrangements, assessed in their entirety, had any value to the MIs

Nearly all of the evidence that Respondents presented to establish the value of their arrangements pertained to individual book years. While Cascio offered some opinions regarding the arrangements as a whole, he concedes those opinions do not establish risk transfer. To the contrary, as discussed below, those opinions show that the arrangements had negative value to the MIs. Respondents rely instead solely on the Milliman reports, which analyzed risk transfer only under individual book years. Milliman's analyses suffer from numerous fatal flaws, and they are irrelevant because Respondents do not even contend that Milliman's single-book year risk transfer analyses can demonstrate that the arrangements as a whole provided any economic value to the MIs.

i. The limited evidence Respondents presented tends to show the arrangements as a whole had negative value to the MIs

The few times that Respondents addressed their captive arrangements in their entirety, the evidence they presented at best corroborates a finding that there was no risk transferred to Atrium and, if anything, shows that the arrangements had a significant negative value for the MIs. For example, in his rebuttal report, Cascio noted that Atrium's overall loss ratios in connection with the Genworth and UGI arrangements were 53.60% and 51.5%, respectively. **Cascio Rebuttal Rep.** at 8, 10. These loss ratios correspond to actual profit margins to Atrium over the course of those arrangements of well over 40% of ceded premiums.[42] Since Atrium's profits came at the MIs' expense, these profit margins reflect massive transfers of money from Genworth and UGI to Respondents. Similarly, Milliman repeatedly projected that, even in a "stress scenario," Respondents' captive arrangements would be tremendously profitable for Atrium. *E.g.*, **ECX 0192** (analysis of UGI 2004 book year) at Ex. 1 (projecting 36% overall loss ratio in the stress scenario); **ECX 0193** (analysis of UGI 2005 book year) at Ex. 1 (projecting 24% overall loss ratio in the stress scenario); **ECX 0466** (analysis of Genworth 2004 book year) at Ex. 1 (projecting overall 58% loss ratio in the stress scenario); **ECX 0467** (analysis of Genworth 2005 book year) (projecting 21% loss ratio in the stress scenario) at Ex. 1.[43]

In his rebuttal report, Cascio "agree[d] that such an aggregate analysis will significantly lower the uncertainty or volatility (and thus risk transfer) of the projected

[42] Crawshaw explains that an "underwriting profit margin is the percentage of premiums received by an insurer or reinsurer left over after claim payments and all other expenses have been deducted." **Crawshaw Rep.** at 59.
[43] Every Milliman report in evidence projected an overall loss ratio of less than 100% in the stress scenario.

possible outcomes," and that "it would be very difficult to ever show risk transfer as the number of [book] years being considered increases." **Cascio Rebuttal Rep.** at 3. In light of the need to evaluate the arrangements holistically, as described above, when Cascio admitted that it "would be very difficult to ever show risk transfer" for any of Respondents' arrangements as a whole, he in effect conceded that Respondents' captive arrangements had no value.[44]

Cascio confirmed that the MIs would have been better off economically if they had not purchased Atrium's "reinsurance" because "anytime the reinsurer makes money with hindsight, the insurer would have been better off retaining the business 100 percent." **Hrg. Tr. 1453:11-23** (5/29 Cascio). Respondents made a profit on their captive arrangements not only "with hindsight," but as a foreseeable consequence of entering into structured multi-year arrangements in which "the actual results observed will trend towards the expected result," **Cascio Rebuttal Rep.** at 3, with expected results of large profits for Atrium. Cascio also remarked that Atrium's overall loss ratios were comparable to those of Genworth and UGI under their respective arrangements. **Cascio Rep.** at 5 ("the Atrium estimated ultimate loss ratio is significantly higher than the ceding company's retained loss ratio");[45] **Cascio Rebuttal Rep.** at 8-9 ("the

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[44] It is entirely possible for a multiple-book year arrangement, properly structured, to transfer significant risk. In the same report, Cascio admits that such arrangements are possible. **Cascio Rebuttal Rep.** at 3-4. It is true that as the number of book years covered increases, risk transfer decreases due to the diversification effect of covering a larger number of loans, *see* **Crawshaw Rep.** at 28, but due to the array of risk-limiting features described in Crawshaw's reports, Respondents' arrangements were so deficient in risk transfer – even with respect to individual book years – that any minimal risk to Atrium could be easily diversified away by covering additional book years.

[45] Cascio later retracted this loss ratio comparison, along with every other loss ratio calculation he made in his initial report. *See* **Cascio Rebuttal Rep.** at 15; **Hrg. Tr. 1422:15-20** (5/29).

difference between [Genworth's loss ratio and Atrium's loss ratio] is inconsequential," and UGI's loss ratio and Atrium's loss ratio "are remarkably close").

Apparently, Cascio's view is that if the reinsurer sustains a loss ratio similar to the insurer's loss ratio, the reinsurer has provided value. Therefore, even if the reinsurer is guaranteed a sub-100% loss ratio – that is, a profit – Cascio believes that the reinsurer still provides value to the insurer whose loss ratio is lower. For example, even if a reinsurer is able to limit its maximum loss ratio to 75% – which represents a minimum profit of approximately 25% of the premiums paid by the insurer – the reinsurer provides value to the insurer simply by virtue of having a higher loss ratio, even though the insurer is guaranteed to lose money. **Hrg. Tr. 1551:5-1554:16** (5/30 Cascio). Essentially, because the insurer lost a smaller percentage of a much smaller income, Cascio believes that it benefited from the reinsurance, even though its resulting income was less than it otherwise would have been. This renders "value" meaningless. It would permit any lender to engage in sham "reinsurance" in which it receives large sums from an MI in "premiums," returns 75% (or any less-than-100% portion) of those funds to the MI in the form of "claims," and declares itself to have provided value because it sustained a 75% loss ratio.[46] The percentage of the MI's money that the lender's captive does not keep for itself is characterized as a "loss ratio." Under this "analysis," it is irrelevant that the arrangement is equivalent to the MI writing a check to the lender's captive equal to 25% of the "reinsurance" premiums. Surely, Section 8(c)(2) does not permit such a blatant give-away simply because it involves passing money back and

[46] This is essentially how Respondents structured their captive "reinsurance" service. The arrangements all but ensured that Atrium would have loss ratios below 100%. The money passing back and forth between the MIs and Atrium obfuscates the simple fact that, in the end, the MIs were making payments to Respondents.

forth in a manner that can be described as resulting in a loss ratio of a particular magnitude.[47]

ii. Milliman's risk transfer analyses cannot establish that the Atrium arrangements had value

The Milliman reports are Respondents' sole basis for asserting that Respondents' arrangements transferred significant risk. Unlike Crawshaw, neither of Respondents' experts performed any risk transfer analysis of their own. Although in his report Cascio claimed to analyze risk transfer using historical loss ratio data, at the hearing he testified that it would be wrong to use those loss ratios as a basis to assess risk transfer. *See* § III.B.3.b.iii, *infra*. At the hearing, Cascio admitted that he performed no risk transfer analysis of his own, and simply claimed that Milliman properly analyzed risk transfer. **Hrg. Tr. 1364:19-20** (5/29) ("My role was to look at this [Milliman] report and say, you know, was this done to actuarial standards?"), **1459:13-16** ("All I did is I reviewed the work that Milliman did. ... But I didn't do anything independently, no."). Cascio did not verify any of Milliman's work. *Id.* **1364 14-17**, **1477:7-1478:17**. It just "seemed" to him that what Milliman did was reasonable, and that was the extent of his work, at least as of the time of his initial report. *Id.* **1478:18-22**. Burke also did not perform any risk transfer analysis; he simply opined that it was reasonable for Atrium to rely on the Milliman reports. *Id.* **1701:12-14** (5/30 Burke) (Burke has never performed a risk transfer analysis); **Burke Rebuttal Rep.** at 14.

Milliman's risk transfer analyses should be disregarded because their failure to analyze entire arrangements renders them irrelevant to the Section 8(c)(2) inquiry.

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[47] In his rebuttal report, Crawshaw explains in further detail why Cascio's loss ratio comparisons do not establish that the arrangements transferred significant risk to Atrium. **Crawshaw Rebuttal Rep.** at 31-48.

Milliman's analyses are nothing more than a shell game, focusing the reader's attention on a purported potential "loss" in a single book year while carefully obscuring the many features of the captive arrangement that all but guaranteed that any such "loss" would be outweighed by large gains on other book years.

1) *Respondents' accounting arguments do not justify the use of Milliman's single-book year analyses to establish that Respondents' arrangements had value to the MIs*

Milliman analyzed only isolated book years under Respondents' captive arrangements. Even though Milliman modeled many scenarios in each of its reports, it never assumed in even one of those scenarios that the arrangement would cover more than one book year. Milliman's risk transfer analyses were all limited to the question of whether there was a "reasonable probability" of a "loss" of a certain magnitude with respect to the particular book year analyzed in the report.[48] *E.g.*, **ECX 0193** at 11, 12 ("[O]ur transfer of risk test focuses on the premium and losses for the 2005 book year"); **ECX 0194** at 10, 13. Milliman projected a "loss" whenever the present value of projected claims for the book year under review was greater than the present value of projected premiums for that book year. *E.g.*, **ECX 0193** at 12, Ex. 1. Milliman did not analyze the probability that any of Atrium's arrangements as a whole would result in a loss to Respondents. **Hrg. Tr. 1936:14-1937:2** (6/3 Schmitz).

Respondents' sole argument justifying the use of Milliman's single-book year approach to risk transfer is that accounting principles, as they interpret them, allow such an approach for purposes of "reinsurance accounting." They argue that the Atrium

[48] Milliman's risk transfer analyses implemented this test by applying the so-called "10-10" test. That test is satisfied if there is at least a 10% probability of a 10% loss (which corresponds to a loss ratio of 110%). One of Milliman's analyses also evaluates the Expected Reinsurance Deficit. Milliman applied both of these tests only to individual book years within Atrium's captive arrangements.

arrangements qualified for "reinsurance accounting" because the risk transfer analysis performed by Milliman purportedly demonstrated risk transfer for individual book years. The Tribunal need not decide whether Respondents' interpretation of accounting principles is correct – even if Atrium's arrangements could have qualified for reinsurance accounting based on risk transfer analyses that did not even purport to account for the arrangements in their entirety (they could not, *see* § III.B.2.b.ii, *infra*), that would not establish compliance with RESPA. Section 8(c)(2) is not an accounting principle. Under Section 8(c)(2), Respondents must establish that each arrangement as a whole provided economic value to the MI. If it did not, Section 8(c)(2) does not apply, regardless of the treatment under accounting principles.

Neither Cascio nor Schmitz contended that Milliman's single-book year analyses measured the actual economic value of the arrangement as a whole. Schmitz disavowed any such conclusion, testifying that Milliman's analyses did not bear on whether any of Atrium's captive arrangements as a whole could result in an economic loss to Respondents (*i.e.*, value to the MIs). **Hrg. Tr. 1936:14-1937:2** (6/3). Milliman's analyses are therefore irrelevant to the Section 8(c)(2) inquiry.

Indeed, Respondents' expert Vincent Burke emphasizes that "the economic outcome" of a purported reinsurance contract "is not impacted by the accounting treatment" of that contract. **Burke Rebuttal Rep.** at 6. Similarly, he testified that "the accounting for a transaction does not drive the economics of the transaction," and agreed that different accounting models could be applied to the same reinsurance arrangement, but that the choice of accounting model does not change the economic substance of the arrangement. **Hrg. Tr. 1771:25-1772:3**, **1785:18-1786:3** (5/30). He emphasized that his own opinions deal solely with whether each of Respondents' arrangements "meets the reinsurance accounting requirements" and are unrelated to "what [Atrium's] exposure to loss is" and "doesn't affect the potential losses that [Atrium] could incur under the terms of the contract." *Id.* **1809:6-1810:4.** Most important, Burke believes that whether reinsurance services were actually furnished to the MI – the issue under Section 8(c)(2) – is a different concept from the proper accounting treatment for a transaction. *Id.* **1782:6-11**.

Burke's opinions are consistent with the view of the Emerging Issues Task Force of the American Institute of CPAs (EITF) expressed in a paper that, according to Burke, concerns "*accounting issues* relating to mortgage reinsurance captive arrangements." **RCX 0809**; **Hrg. Tr. 1779:2-5** (5/30) (emphasis added); **Burke Rebuttal Rep.** at 11**.** In discussing various unsettled accounting issues, the EITF cautioned that "[c]onsiderations affecting the permissibility of contracts under RESPA are not within the scope of this paper," including whether an arrangement satisfies the standard set forth in the HUD letter that "arrangements are permissible under RESPA if payments to the reinsurer: (1) are for reinsurance services actually furnished or for services performed and (2) are bona fide compensation that does not exceed the value of such services." **RCX 0809** at 6**.** According to Respondents' experts, one of the accounting issues discussed in the EITF paper is whether a risk transfer analysis for a captive mortgage reinsurance contract can be performed for individual book years. **Hrg. Tr. 1826:23-1827:15** (5/30 Cascio), **1779:6-25** (5/30 Burke); **RCX 0809** at 5**.** According to Crawshaw, the EITF discussion of this issue allows a multi-book year risk transfer analysis for captive arrangements. **Hrg. Tr. 1125:6-1126:17** (5/28)[49] But regardless of

[49] Respondents contend that their single-book year approach to analyzing risk transfer is supported by the statement in the EITF paper that the "Task Force has concluded the

whether the EITF paper espouses a single-book year analysis or not, it is strictly concerned with accounting, and if it allowed an accounting result did not reflect the economic substance of the arrangement, it would have no relevance to whether a multi-book year arrangement, such as Respondents' arrangements, actually provides a genuine reinsurance service. At the hearing, Burke agreed that "whether a transaction is ... an actual service for the mortgage insurance company under the Real Estate Settlement Procedures Act is not covered by the discussion of the accounting issues in" the EITF paper. **Hrg. Tr. 1780:19-25** (5/30).

Thus, in assessing Respondents' Section 8(c)(2) defense, it is irrelevant that the label of "reinsurance" as used under accounting principles might have applied to Respondents' purported reinsurance based on Respondents' single-book year risk transfer analyses. Such an accounting label cannot establish that there was any particular value – or any value at all – to the purported service.

All of the Milliman reports state that its opinions involve "financial and actuarial analysis and judgment," but with respect to RESPA compliance, that "nothing in this report is intended to provide legal assurance that the requirements of these laws are

contract is a series of individual book year contracts, renewable indefinitely." **RCX 0809** at 5**.** That reliance is misplaced. First, as discussed above, this document exclusively concerns accounting issues, and it explicitly carved out from its scope whether an arrangement is "for reinsurance services actually furnished or for services performed" – the issue relevant to Section 8(c)(2). Second, as Burke stated in his report, even as to accounting issues, the EITF "never actually resolved any of the Issues discussed in this Committee report," so nothing in this paper is binding. **Burke Rebuttal Rep.** at 11. Third, even if the EITF document constituted a rule dictating that the Atrium arrangements, as an accounting matter, be viewed as "a series of individual book year contracts," that would not mean that a risk transfer analysis can properly ignore the relationship among those individual book years. To the contrary, as discussed below, SSAP No. 62 would require that the interconnection among book years through cross-collateralization be accounted for in determining whether the arrangement "in the aggregate" transferred risk. *See* § III.B.2.b.ii.2, *infra*.

met." *E.g.*, **ECX 0194** at 19; **ECX 0466** at 20; **RCX 0025** at 17. The Milliman opinions therefore preclude their own use as a legal defense for conduct under RESPA. The reports also observe that in assessing RESPA compliance, HUD "may consider items not specifically addressed in our tests in determining the permissibility of a particular reinsurance arrangement." *Id.* Thus, as Milliman itself recognized, in evaluating the economic substance of Atrium's arrangements for purposes of determining whether they qualify for the Section 8(c)(2) safe harbor, HUD (and now the Bureau) was not constrained by the single-book year accounting model that Milliman employed. For example, among many other factors not addressed in the Milliman reports, the Bureau – and this Tribunal – are permitted to consider the full range of evidence regarding the course of dealing between Atrium and the MIs to determine whether their arrangements were intended to cover multiple book years, and if so, whether any semblance of an actual service to the MIs was reduced or eliminated by the coverage of multiple book years.

The work of an actuary such as Milliman may be relevant to determining whether an arrangement can be *accounted for* as reinsurance on a company's financial statements. But Respondents misuse the Milliman reports even for that purpose. The American Academy of Actuaries explains that "while actuaries may take the lead role in quantifying a contract's risk, it is important to remember that the determination of whether that risk is sufficient for a given accounting treatment is typically an accounting rather than an actuarial decision." **ECX 0632** at 21**.** Milliman recognized this limitation by stating in all of its reports: "We are also not accountants or auditors. We therefore do not offer opinions as to whether there is compliance with any applicable accounting or auditing standards." *E.g.*, **ECX 0194** at 19**; ECX 0466** at 20; **RCX 0025** at 17**.** Cascio, also an actuary, similarly emphasized that "[i]t's not the purv[iew] of the actuaries to assess risk transfer," **Hrg. Tr. 1362:17-18** (5/29), and that "at the end of the day, it's the accountant's call. It's not the actuary's call," *id.* **1363:2-3**. And while it is the role of the accountants to make the determination, the *ultimate* responsibility for the correctness of the accountant's determination rests solely on the company's management. As Respondents' expert Burke explains: "*Management of an entity is charged with the final responsibility* for the preparation and fair presentation of the financial statements in accordance with applicable accounting standards, in this case statutory accounting principles as promulgated by the National Association of Insurance Commissioners ('NAIC')." **Burke Rebuttal Rep.** at 8 (emphasis added). Burke testified that no entity other than company management bears this ultimate responsibility – not the actuaries, not the accountants, and not state insurance regulators. **Hrg. Tr. 1736:23-1739:12** (5/30).

In a 2009 email, Atrium's accountant KPMG specified "several reasons [the Milliman reports] can't be taken to constitute management's documentation of risk transfer," including:

- "Milliman specifically disavows that these reports document satisfaction of SSAP62 and FAS113 ('any applicable accounting standards or auditing standards') on page 17."
- "Milliman also specifically lists items that they don't cover but management should, such as existence of separate agreements or related transactions."
- "In addition, management should review the Milliman work and state why they conclude satisfaction with SSAP62/FAS113 based on it and additional considerations not in the report. PHH/Atrium should consider doing this in a memo."

[**ECX 0459** (3/23/2009 email, Morris to Prime and Brittingham).]

Thus, as even KPMG recognized, Milliman's risk transfer opinions were not even sufficient to establish that Respondents' arrangements were properly accounted for as reinsurance – much less to answer the different question of whether Respondents can establish a legal defense under Section 8(c)(2).[50] But given Respondents' argument that Section 8(c)(2) applies because the arrangements were properly determined to have sufficient risk transfer to justify reinsurance accounting, it is remarkable that they did not call a single representative from their own management – who alone can make that ultimate determination.

No representative from management, for example, explained why Atrium continued to use a risk transfer analysis limited to a single book year, even after the arrangements had already covered many book years and there was no reason to believe that the parties' incentives for entering into and continuing with the arrangement would change. Burke explains that management's ultimate responsibility includes "selecting and applying accounting principles," **Burke Rebuttal Rep.** at 8, but no management representative testified that, or why, they believe it was proper to apply a single-book year approach to risk transfer. Respondents also failed to provide any testimony from management about what assumptions were provided to Milliman regarding factors clearly relevant to risk transfer, such as: (1) whether they believed Atrium's liability was limited to the assets in the Trust Account; (2) the timing and magnitude of dividends from the Trust Account; (3) the probability of commutation; and (4) whether Atrium believed it was likely that the arrangement would cover more than one additional book

[50] KPMG's email was forwarded to Bogansky, who did not dispute KPMG's concerns, which were expressed in the third numbered paragraph of KPMG's email. Bogansky wrote: "The only comment that I disagree with is" a statement in the second numbered paragraph. **ECX 0459.**

year. No one testified about any actions Respondents' management took to address the concerns expressed in KPMG's email, such as preparing a memorandum explaining "why they conclude satisfaction with SSAP62/FAS113 based on [the Milliman report] and additional considerations not in the report." **ECX 0459** (3/23/2009 email). Nor did Respondents' management testify about what assumptions were provided to their accountants with regard to risk transfer.

2) Even accounting principles required that Milliman's risk transfer analyses be performed for the arrangements as a whole

Although Respondents' interpretation of accounting principles, even if correct, provides them no defense, given a risk transfer analysis that artificially subdivided those arrangements, the applicable accounting principles did not even allow Atrium's arrangements to be accounted for as reinsurance. Statement of Statutory Accounting Principle No. 62 (SSAP No. 62), which applies to property and casualty reinsurance, brushes aside such formalistic distinctions:

> Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?
>
> A: ***A contract is not defined, but is essentially a question of substance.*** It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing provisions of one contract may refer to experience on other contracts, and therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. ***Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.***

[**ECX 0790** (SSAP No. 62) at 22-23 (emphases added).]

This principle directly contradicts Respondents' contention that the Atrium arrangements could be accounted for as reinsurance on the basis of a risk transfer analysis performed for each book year in isolation. Respondents contend that each book year constitutes an "individual contract." *See*, *e.g.*, **Burke Rebuttal Rep.** at 10. Even if that characterization were correct (it is not), the single-book year approach would still be improper because SSAP No. 62 requires that "features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk." **ECX 0790** at 23. When all such contracts or agreements "in the aggregate, do not transfer risk," the individual contracts "also would not be considered to transfer risk, regardless of how they are structured." *Id.* This guidance is particularly appropriate for analyzing risk transfer under the Atrium arrangements because, even if each book year is viewed as an individual contract (it should not be), the risk-limiting features described in Section III.B.2.a.i, above, allowed Atrium to condition the payment of any excess of claims over premiums for a particular book year on the presence of premiums from other book years. In other words, even if the excess of claims over premiums for a given book year could be characterized as an accounting "loss" for that book year, Atrium avoided paying that purported "loss" unless it could compensate itself using premiums from other book years, and thereby totally avoid any *actual economic loss* under the arrangement. Under SSAP No. 62, any risk transfer analysis of the Atrium arrangements should have measured whether Atrium faced a reasonable possibility of incurring a significant loss "in the aggregate."

This is especially true because the trust caps inextricably linked all book years together, such that claims in excess of premiums under one book year were *necessarily* paid using premiums from other book years – since Atrium assets outside of the trust accounts were not reachable. Moreover, as a result of the trust caps, any money spent paying claims in excess of premiums for one book year necessarily reduced the availability of premiums ceded from other book years, making it impossible to pay claims in excess of premiums on the other book years (taken together). Thus, the trust caps in effect directly compensated Atrium for losses under one book year with funds from another book year. The trust caps render risk transfer analyses for individual book years meaningless.

Respondents mistakenly contend that it was proper for Milliman to analyze risk transfer under a single book year because it was not certain at the outset of each arrangement that the parties would agree to more than a single book year of coverage, and because the total number of book years ultimately covered could not be precisely predicted at the outset. First, all projections are inherently uncertain, and even at the outset of an arrangement, projecting that the arrangement would cover only one book year was at least as likely (and probably more likely) to be an incorrect assumption as projecting that it would cover two or more book years, given the lack of evidence that the parties ever intended their arrangements to be limited to just one book year and the substantial evidence that a long-term arrangement was intended. As the arrangement progressed, and book year after book year was added as a matter of course, the assumption that only one additional book year would be covered became insupportable.

But more importantly, accounting principles make clear that a risk transfer analysis is not limited to a *single* projected scenario requiring the actuary to predict the future with 100% certainty:

> The ceding entity's evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of *all cash flows between the ceding and assuming companies under reasonably possible outcomes*, without regard to how the individual cash flows are described or characterized. *An outcome is reasonably possible if its probability is more than remote.*
>
> [**ECX 0790** (SSAP No. 62) at 6, ¶ 14 (emphases added).]

This, no doubt, is why Milliman modeled multiple scenarios in its risk transfer analyses. Even if coverage of multiple book years was not 100% certain at the outset of each arrangement, it was "more than remote" and clearly a "reasonably possible outcome." A risk transfer analysis should therefore have assumed in at least *some* of the scenarios that the parties would agree to cover more than one book year. And as the arrangement progressed and many book years were already covered with no reason to expect that the parties' incentives for continuing with the arrangement would change, it made no sense for Milliman to continue to assume in *all* of the scenarios it modeled that only a single *additional* book year would be covered.

The absurdity of Milliman's insistence on a single-book year analysis in the face of any facts to the contrary, even at the beginning of the arrangements, is demonstrated by its report for the Radian 2004 book year. [redacted]

[redacted]
Milliman's risk transfer analysis for the 2004 book year assumed in every scenario that the arrangement would cover only one book year. **RCX 0026** at 13 (Milliman assumed that "no subsequent book years would be insured").[51]

Milliman also failed to consider in any of its risk transfer opinions whether the single-book year "stress scenarios" it used to justify its conclusions were compatible with one another – a factor that would have to be considered in determining whether the arrangement "in the aggregate" transferred significant risk, as required by SSAP No. 62. In fact, precisely as a result of the risk-limiting features described above, those scenarios are mutually exclusive. Had Atrium sustained loss ratios significantly greater than 100% in a large enough number of book years, it could not have made good on all of the claims because the trust account would have been depleted before they could be paid. This is primarily because Atrium's failure to contribute sufficient capital to the trust accounts – resulting from both low initial capital contributions and dividend withdrawals – meant the trust accounts were composed mostly of premiums (and entirely of premiums, after dividends removed all of the initial capital). Thus, even though each book year, according to Milliman, was capable of sustaining loss ratios far greater than 100%, in fact it was impossible for all of them to do so.

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[51] As discussed below, Milliman's insistence on a single-book year analysis for the Radian 2004 book year is even more remarkable because the report is dated March 23, 2007, **RCX 0026**, at which point the parties had *already* agreed to cover three additional book years. *See* § III.B.3.b.ii.4, *infra*.

Indeed, Milliman acknowledged as much in its single-book year analyses, by accounting for "cut-off" due to the depletion of the trust account from high claims payments on multiple book years. This possibility affected Milliman's assessment of risk transfer for the lone book year under review. But Milliman failed to consider whether the scenarios in which that book year had a high loss ratio, which in turn had a negative impact on the trust account, affected risk transfer with respect to the other book years in the arrangements, all of which would also be limited in their ability to sustain high loss ratios. Had it done so, Milliman would have been forced to concede that the payment of claims in excess of premiums on one book year limited the possibility of such payments on other book years, and that the structure of the arrangement made it nearly impossible for total payments of claims to significantly exceed total receipt of ceded premiums.[52]

Milliman also did not account for the fact that later book years existed only because their existence was conditioned on the profitability of earlier book years. There were later book years in the UGI and Genworth arrangements only because the early book years were performing well after the "trial period," when the decision about whether to continue the arrangement had to be made. Had the trial period gone poorly, Atrium could have terminated the arrangements before it had to commit significant

[52] Schmitz contended that if Milliman had concluded that every single book year of a captive agreement individually transferred risk (there is no evidence that it did so), then the entire agreement also transferred risk. **Hrg. Tr. 1935:9-17** (6/3). That is transparently false. Milliman's single book year analysis does not capture the multitude of risk-limiting features described above. Milliman's reports are limited to asserting that, with respect to a small portion of the overall arrangement, claims relating to that portion may exceed premiums relating to that portion. This is akin to asserting that a lottery winner whose winnings are paid in equal installments over ten days and who will be required on one of those days to pay 20% of the total winnings in taxes (double a single day's payment) bears a risk of "loss" because there is at least a 10% chance that on any given day she may be required to pay out twice as much as she receives that day.

amounts of capital relative to the premiums ceded on those early book years. That is exactly what happened with the Radian and CMG arrangements. Essentially, Atrium had the option to "reinsure" later book years on the condition that it would make a profit on earlier book years.

Yet Milliman did not account for the condition precedent (overall net gain) on which the existence of these book years was premised. The later book years, when analyzed individually, were each separately capable of sustaining a "loss" of more than 10% of premiums only because earlier book years had performed well up to that point, meaning that the MI had already ceded large sums of money to the trust account. Those funds could then be used by Atrium to "pay" claims in excess of premiums on the new book year. This is the only way that Milliman's simulations were able to produce "loss" scenarios, which were the basis for the conclusion that Atrium could sustain a greater than 110% loss ratio with respect to that book year. Such an analysis amounts to concluding that *if Atrium made a sufficiently large profit on earlier book years* (at the MI's expense), then there was a chance that Atrium could be required to pay back some of that profit (but not more) in connection with a subsequent book year. The conditioning of losses on a particular book year on the existence of profits on other book years inextricably ties the performance of the individual book years to one another. It is therefore misleading to state that an individual book year is capable of sustaining losses, because it ignores the fact that such losses necessarily imply net gains (*i.e.*, absence of loss) on the other book years.

Another way to understand these deficiencies in Milliman's methodology is to compare the captive arrangements to a savings account. An MI could choose to "cede" some of its premiums into a savings account, and withdraw funds from the account whenever losses on a particular book year are higher than some threshold (for example, when losses are above 4% of aggregate risk on that book year). There may be book years of insurance for which the MI withdraws more from the savings account than it deposits, even though at all times the MI's total deposits across all book years are greater than its total withdrawals. To describe the bank providing the savings account as having suffered a "loss" would be nonsense. Yet analyzing the account on a single book year basis leads to just that conclusion. Furthermore, an a priori projection of the account's future performance would indicate that, for each individual book year, there exists a possibility that the account will experience a "loss" with respect to that book year.[53] According to this approach, the MI using the savings account in this manner has transferred risk to the bank.[54] Milliman's methodology can easily be used to sanction all manner of mischief through the use of captive "reinsurance" arrangements to facilitate referral payments.

3) The Milliman reports are flawed because they failed to consider the possibility of commutation in any scenario

None of the Milliman reports account for a potential commutation of the arrangement, a limitation that Milliman recognized could be material to its risk transfer analysis. For example, Milliman's report for the Genworth 2008.B book year states: "Our analysis ... does not take into account any possible commutation of insured books.

[53] In order to ensure the possibility of such a "loss" in the first book year, the bank may need to contribute some capital to the savings account for a short period of time at the beginning. That capital could be removed as soon as another book year of insurance is added to this savings account arrangement, because the "premiums" from the new book year would enable a "loss" on the first book year.

[54] Milliman's approach could result in the conclusion that an individual's normal use of her savings account results in a transfer of risk to the bank. For any given year of the saving account's existence, there is a chance that the account holder will withdraw more from her account than she deposits to it, resulting in a "loss" for that year.

It is possible that a commutation could materially impact Milliman's opinions with regard to the transfer of risk and the compensation commensurate with the risk." **ECX 0194** (Milliman report for Genworth 2008.B book year) at 20; *see also, e.g.*, **RCX 0022** (Milliman report for UGI 2005 book year) at 21; **RCX 0025** (Milliman report for UGI 2008 book year) at 18. This limitation was material because, as UGI explained in its response to the RFP, a commutation could reduce risk transfer. **ECX 0032** (10/2006 UGI RFP response) at 13 ("Commutation of books of business before they reach peak claim years can *reduce risk transfer below required levels*.") (emphasis added).

No accounting principle states that a commutation must be 100% certain to occur in order for the *possibility* of commutation to be considered in a risk transfer analysis. As explained above, under SSAP No. 62, a risk transfer analysis should not be limited to a single projected scenario, but rather should evaluate multiple scenarios reflecting all "reasonably possible outcomes," which is defined as an outcome whose "probability is more than remote." **ECX 0790** at 6, ¶ 14. **Hrg. Tr. 730:20-735:19** (3/28 Crawshaw) (explaining how a risk transfer analysis should account for the possibility of a commutation). Milliman's failure to assume a commutation in any of the scenarios it modeled is a glaring flaw, because commutation was at all times a "more than remote" possibility.

For example, as discussed above, during the RFP process, Respondents and UGI focused much of their discussion on the possibility of commuting their arrangement. In its RFP response, dated October 18, 2006, UGI stated that the commutation provisions of its contract with Atrium "allow[] Atrium adequate flexibility to request commutations as business conditions dictate." **ECX 0032** (UGI RFP response) at 13. On November 6, 2006, Rosenthal wrote to Bjurstrom that Atrium would "begin to work the current capital return / book commutation angle" with UGI. **ECX 0745**. Despite these explicit discussions, Milliman's report for the UGI 2005 book year, dated March 2007, assumed that a commutation would not occur under any reasonably possible scenario.

In early 2009, it became even harder to ignore the significant possibility of a commutation, as Respondents engaged in serious discussions with UGI and Genworth about commuting their arrangements, and reached out to Milliman for assistance in valuing the trust accounts in connection with determining the commutation terms. For example:

- In February 2009, Bradfield wrote to Rosenthal: "Could we come to an agreement of value with UGI *to commute the UGI/Atrium trust*? ... Both parties agreed that we should be able to agree on the value of these book years .... *We are going to ask Milliman to forecast the future cash flows* (losses & premiums) on these books to assist us in assessing the value .... I have also placed a call into Genworth to discuss the same." **ECX 0435** (2/26/2009 email) (emphases added).

- In March 2009, Rosenthal wrote to Bjurstrom: "We would like to have you value our UGI Trusts & Genworth Trusts for us. *We are considering a commutation*." **ECX 0366** (3/17/2009 email) (emphasis added).

- In April 2009, Steve Hitchings of Genworth wrote to Rosenthal: "I hope to pin down a firm captive commutation price that I can present to you." **ECX 0365** (4/23/2009 email).

Even though Milliman was aware that a commutation of the UGI and Genworth arrangements was a serious possibility in early 2009, it did not account for a potential commutation in any of the scenarios it modeled in the following seven reports: book years 2006, 2007, 2008.A, and 2008.B under the Genworth arrangement, and book years 2006, 2007 and 2008 under the UGI arrangement.[55] Each of these is dated

[55] *See* **RX 0017** (Genworth 2006 book year) at 18; **RX 0018** (Genworth 2007 book year) at 18; **RX 0019** (Genworth 2008.A book year) at 18; **ECX 0194** (Genworth 2008.B book year) at 20; **RX 0023** (UGI 2006 book year) at 18; **RX 0024** (UGI 2007 book year) at 18; **RCX 0025** (UGI 2008 book year) at 18.

February 2009 or April 2009, contemporaneous with the time period in which the commutation was being discussed, with Milliman's direct participation.

4) There are no Milliman reports for many of the book years covered by Respondents' arrangements, and the Milliman reports in the record are untimely for accounting purposes

Even if the value of Respondents' arrangements could be established by showing risk transfer for each individual book year under those arrangements (it cannot), Respondents would still not be entitled to a defense under Section 8(c)(2) because Milliman apparently performed no risk transfer analysis for many of the book years covered by Respondents' arrangements. There are no Milliman analyses for the following:

- Book years 1994 through 2003 and 2009 under the UGI arrangement;
- Book years 2000 through 2003 under the Genworth arrangement;
- Book years 2006 through 2008 under the Radian arrangement; and
- All book years under the CMG arrangement.[56]

SSAP No. 62 provides: "The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare." **ECX 0790** at 23;[57] **Burke Rebuttal Rep.** at 11. If each book year were indeed a separate and independent contract (as Respondents incorrectly contend), Respondents'

[56] The following exhibits are the Milliman reports for Respondents' arrangements in the record: **RCX 0015** (Genworth 2004 book year); **RX 0016** (Genworth 2005 book year); **RX 0017** (Genworth 2006 book year; **RX 0018** (Genworth 2007 book year); **RX 0019** (Genworth 2008.A book year); **ECX 0194** (Genworth 2008.B book year); **RX 0021** (UGI 2004 book year); **RX 0022** (UGI 2005 book year); **RX 0023** (UGI 2006 book year); **RX 0024** (UGI 2007 book year); **RX 0025** (UGI 2008 book year); **RX 0026** (Radian 2004 book year); **RX 0027** (Radian 2005 book year). There are other exhibits that are duplicates of these documents. These are also the only Milliman reports that Burke reviewed. **Burke Rebuttal Rep.** at 13.

[57] SSAP No. 62 also states: "The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time." **ECX 0790** at 22.

accounting-based argument for the applicability of Section 8(c)(2) would require a separate Milliman opinion to establish the risk transfer "status" of *each* such purported "contract ... at inception." But such an argument would necessarily fail because there is no Milliman report for 11 of the 16 book years under the UGI arrangement, four of the ten book years under the Genworth arrangement, three of the five book years under the Radian arrangement, and all four book years under the CMG arrangement (in total, 22 out of 35 book years).[58]

It is also significant that the first Milliman reports, which covered the 2004 book year under the UGI and Genworth arrangements, were completed in September 2005, almost a decade after Respondents' illegal scheme commenced. **RCX 0021** (Genworth 2004 book year); **RCX 0025 (**UGI 2004 book year). The Milliman reports were commissioned to provide a *post hoc* justification for a scheme that was already long established.

As for the Milliman reports in the record, none were completed "at [the] inception" of the book year analyzed, as required by SSAP No. 62. For example, the Milliman reports for the 2005 book years under the UGI, Genworth and Radian arrangements are all dated March 2007 – more than two years after the inception of those book years. **RCX 0016; RCX 0022; RCX 0027**. The Milliman report for the 2006 book year under the Genworth arrangement is dated February 2009 – more than three years after the inception of that book year. **RCX 0017.** In fact, every Milliman

[58] Respondents cannot contend that a risk transfer analysis performed for one book year establishes risk transfer for other book years merely because the basic structure of the arrangement (such as the attachment and detachment points and ceding percentage) was the same for all of those book years. As shown in Tables 1 and 2, below, the risk profiles varied dramatically for various individual book years under the 4/10/40 structure. *See* § III.B.3, *infra*.

report in the record is dated not just after the inception of the book year,[59] but also after the close of the book year.[60] Accordingly, even if a Section 8(c)(2) defense could be established on the basis of a purportedly "prospective" actuarial opinions performed for individual book years (it cannot), the date of the Milliman reports renders them unreliable. KPMG recognized that Respondents could not rely on the Milliman reports to establish risk transfer due to their untimeliness. In its 2009 email listing reasons "why [the Milliman reports] can't be taken to constitute management's documentation of risk transfer," KMPG noted: "First, SSAP62 requires risk transfer to be a prospective determination. But the Milliman reports for years 2007 and 2006 are both dated in 2009, so *they aren't prospective*." **ECX 0459** (3/23/2009 email, Morris to Prime and Brittingham) at CFPB-PHH-00046736 (emphasis added).

The fact that each of the Milliman reports was completed after the book year being analyzed had already closed raises another troubling implication. At the time Milliman completed its analysis and assumed in every scenario that the *only* additional book year the parties would agree to cover was the book year being analyzed, Atrium and the MIs had *already* agreed to cover the *next* book year as well, and in some cases,

[59] As discussed above, book years were *automatically* added to the Genworth and Radian arrangements absent a termination, so even if each book year were a separate contract, each such purported contract clearly would have "incepted" on the first day of the book year. *See* § III.B.3.a.i.5, *supra*. The written UGI contract provided that coverage of additional book years beyond the first two years required the mutual agreement of the parties by the September 1 before the renewal year. **ECX 0584** at 6, § 5.1. But no evidence was presented at the hearing showing that UGI and Atrium followed this procedure in practice by affirmatively agreeing to cover each additional book year. Rather, it appears that each book year was automatically covered as long as the arrangement remained in place. In any event, all of the Milliman reports for the UGI arrangement in the record are dated after the inception of the book year under analysis (and thus, after September 1 of the preceding year). *See* **ECX 0021; ECX 0022; ECX 0023; ECX 0024; ECX 0025**.

[60] *See* Milliman reports cited in footnote 56, *supra*.

the next two or three book years. For example, when Milliman completed its report for the Genworth 2005 book year in March 2007, it inexplicably assumed in every scenario that the last book year covered under the arrangement would be the 2005 book year, even though the 2006 and 2007 book years were already covered by that time. Milliman stated: "[O]ur analysis has conservatively focused on the performance of the 2005 book year and prior book years since the contract may be put into run-off after the 2005 book year (*i.e.*, the 2005 book year would continue to be reinsured for its 10-year term, *but no subsequent book years would be reinsured*)." **RCX 0016** at 13 (emphasis added). At that point, coverage of book years 2006 and 2007 was not a "reasonably possible outcome" to be assumed in some scenarios. It was a historical fact.

iii. Actual loss ratios on individual book years do not establish that Respondents' arrangements provided value to the MIs

Respondents make much of the fact that several book years in Atrium's captive arrangements had actual loss ratios of more than 100%. That is, the claims on those book years were greater than 100% of the premiums received on those book years. In particular four out the 16 book years under the UGI arrangement and five out of the ten book years in the Genworth arrangement had a loss ratio greater than 100%. **Crawshaw Rebuttal Rep.** at 60; **ECX 0839** at 5, column F; **RCX 2004** at 26 ("Projected Ultimate Loss Ratios as of 03/31/12 Evaluation"). By definition, actual loss ratios – including the numerous comparisons of actual loss ratios in Cascio's reports – are retrospective, and thus cannot establish risk transfer. **Cascio Rebuttal Rep.** at 3 ("For risk transfer analysis, the uncertainty is focused on the economic loss on a net present value basis of all cash flows assessed on a prospective basis."); **Hrg. Tr. 1361:16-17** (5/29 Cascio) ("[t]he fact that there is full limit losses does not prove risk transfer"), *id.* **1400:17:21** ("when I'm looking at actual loss experience, I'm really not proving anything with risk transfer or adequacy"), *id.* **1403:13** ("this doesn't prove anything"), *id.* **1406:19-20** ("I don't believe showing real underwriting results proves anything of risk transfer").

In addition to being irrelevant to whether the arrangements transferred risk, the loss ratios for these book years do not indicate whether the actual experience of the arrangements as a whole resulted in a loss to Respondents. In fact, despite the four book years under the UGI arrangement in which Respondents supposedly sustained "losses," the premiums UGI ceded to Respondents exceeded the claim and commutation payments returned to UGI by at least $128 million. **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C. Similarly, despite five book years under the Genworth arrangement in which Atrium supposedly sustained "losses," the premiums Genworth ceded to Respondents exceeded the claim and commutation payments returned to Genworth by at least $70 million. *Id.* These gains correspond to loss ratios for Atrium well under 60% for both arrangements. *See* **Cascio Rebuttal Rep.** at 10 ("Atrium's average, aggregate loss ratio [was] 51.5% for UGI and 53.6% for Genworth").

Respondents received these lavish returns despite having experienced one of the most severe housing crises in a century, which affected a significant percentage of the book years for which Atrium had provided "reinsurance" coverage. These results are the product of the structure of the arrangements which, as discussed above, enabled Respondents to: place very little of their own capital at risk, remove that capital at the first sign of significant losses, and minimize the "risk band" on each book year, which ensured large profits from most book years and minimized the claims even in the event of genuinely catastrophic losses on the underlying insurance. Focusing on just the book years with relatively high loss ratios conceals the features of the arrangement that ensured that such book years would be outweighed by the other book years, such that Respondents would likely receive large profits and in any event would not sustain any significant loss.[61]

iv. Respondents' argument that there were no trust caps is incorrect but would not in any event establish that the arrangements had value to the MIs

Respondents failed to counter the substantial evidence that Atrium's liability under each of the captive arrangements was limited to the amounts in the associated trust account. In addition to contractual provisions reflecting such a limitation, the course of dealing between Atrium and the MIs shows that they did consider Atrium's liability to be limited to the assets in the trust accounts. *See* § III.B.1.a.i.4, *supra*. Respondents presented no contemporaneous documents suggesting that Respondents or any MI believed that Atrium's assets outside of the trust accounts could be reached.

Nonetheless, Respondents contend that all of Atrium's assets outside of the trust accounts were exposed to risk under each of Respondents' arrangements, except the CMG arrangement.[62] Their apparent argument is that Atrium's assets outside of the trust accounts should thus be accounted for in assessing the value of the arrangements to the MIs. In his rebuttal report, Crawshaw performed an alternative risk transfer

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[61] In his rebuttal report, Cascio attempted to defend Atrium's low actual loss ratios by pointing to loss ratios for Renaissance Reinsurance. **Cascio Rebuttal Rep.** at 9-10. Although most of the Renaissance Reinsurance loss ratios listed in his report are less than 60%, Cascio admitted at the hearing that all of those loss ratios "are average loss ratios aggregated across numerous reinsurance contracts," and that individual Renaissance Reinsurance contracts could have had loss ratios over 500% or even over 1000%. **Hrg. Tr. 1589:22-1591:20** (5/30).

[62] Cascio concedes that the CMG written agreement contains a trust cap. **Cascio Rebuttal Rep.** at 5 n.4**.** Rosenthal concedes that the Radian and CMG written agreements contain trust caps. **Hrg. Tr. 269:8-19** (3/25).

analysis for the UGI and Genworth arrangements that assumed Atrium's liability was not limited to the trust accounts, and he concluded that there was no significant risk transfer even under that hypothetical assumption. **Crawshaw Rebuttal Rep.** at 125-39. As Crawshaw explains, the rate of premium accumulation was so high that Atrium's capital (whether inside or outside the trust account) was extremely unlikely to be called upon, but in any event, the amounts outside of the trust accounts were not sufficient to support a significant loss on the arrangement as a whole. *Id.*

Cascio says he does not believe the written agreements limited Atrium's liability to the trust accounts. **Cascio Rep.** at 8-9 (Genworth and UGI agreements); **Cascio Rebuttal Rep.** at 4-5 (Genworth, UGI, and Radian agreements). At the hearing, Cascio testified that he was "way out on a limb" in that he "do[es]n't believe that only the trust fund should be available to pay claims." **Hrg. Tr. 1396:9-12** (5/29).[63] Cascio did not explain the basis for his view. **Hrg. Tr. 1396:12-15** ("And I'm not going to get into an argument with anybody unless I'm forced to on the stand. You already said you know how to read contracts.").

Cascio's own statements contradict his unsupported belief. He asserted that the trust accounts were necessary to provide security to the MIs because Atrium's "paper isn't good enough" and Atrium does not have "adequate standing to qualify as a regulated reinsurer." **Hrg. Tr. 1358:1-11** (5/29). In addition to supporting

[63] Cascio went on to refer to his earlier testimony that "the trust is to provide security for the MI." **Hrg. Tr. 1396:16-17** ("as I said earlier, the trust is there to provide security for the MI"). Earlier, Cascio had testified that, although he was "a complete outsider on this one" and that "being the only one who holds this opinion is scary," *id.* **1357:21-23**, "in my mind, the trust is only there to provide security for the MI. Full stop," *id.***1358:16-17**, and the trust is "not there to pass risk transfer," *id.* **1359:13-14**. But when he later referred back to this testimony, he contradicted it by asserting that the trust "helps with the risk transfer." *Id.* **1396:18-19**.

Enforcement's argument that Atrium's assets outside of the trust accounts provided no such security to the MIs, these statements show more generally that Respondents' arrangements provided no genuine reinsurance service sought by the MIs. If the MIs truly wanted reinsurance, it would not have made sense to obtain reinsurance from an entity with insufficient "paper" and inadequate "standing to qualify as a regulated reinsurer."

Cascio's claim that Atrium's liability was not limited to the trust accounts is also contradicted by his assertion that the trust accounts associated with each of Atrium's arrangements provided "cross-collateralization." **Cascio Rep.** at 7-8 (referencing "the cross-collateralization structure of *the trust accounts* for the Atrium Agreements") (emphasis added); **Cascio Rebuttal Rep.** at 12. "Cross-collateralization" refers to the possibility of paying claims in connection with one book year out of premiums received in connection with other book years.[64] If Atrium's liability for claims in a particular captive arrangement were not connected in any way to the assets in the relevant trust account, then "cross-collateralization" would be irrelevant because there would be assets available to pay claims under a particular book year regardless of whether premiums from other book years were present in the trust account. In essence, "cross-collateralization" merely refers to the fact that the loss ratio for one book year can

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[64] **Cascio Rep.** at 7-8 ("to the extent Atrium did not pay losses for book years 1997 to 2003, the premiums earned on those policy years, i.e., Atrium's funds, were at risk for losses incurred in book years 2004 through 2008 because of the cross-collateralization structure of the trust accounts for the Atrium Agreements"); **Hrg. Tr. 1677:19-24** (5/30 Cascio) ("What would be left in the trust would be the available funds over and above what premium you would receive for the 2008B book year. You know, due to cross-collateralization, sometimes you have leftover profits from the earlier book years.").

exceed 100% only to the extent that other book years have been profitable (or that Atrium has contributed its own capital to the trust).

This is consistent with Milliman's analyses, which were based on the understanding that Atrium's liability was limited to the assets in the trust account, *see* § III.B.2.a, *supra*, and which cited the "cross-collateralization" effect of placing premiums from all book years into a single trust account, *see, e.g.*, **ECX 0194** at 11 ("we have also projected the performance of the previous book years due to the trust fund providing cross-collateralized security for the previous and prospective 2008B book years"). It would not have made sense for Milliman to describe premiums from prior book years as providing "cross-collateralized security" for the prospective book year had Atrium's general assets provided such security already. There would have been no more security from the presence of old premiums in the trust than from their presence (or that of other assets) in Atrium's other accounts.[65]

Schmitz testified that Milliman assumed Atrium's liability was limited to the funds in the trust accounts only "[f]or the sake of conservativeness." **Hrg. Tr. 1859:18-1860:17** (6/3). Setting aside the fact that there is no documentation showing that Milliman's analyses were intended to be "conservative" and that Walker testified that he believed Milliman's risk transfer opinions "were accurate," *Id.* **2195:16-23** (6/4), Schmitz's explanation makes no sense. As Crawshaw explains, understating risk transfer could have serious consequences. First, if Milliman represented that Atrium's liability was limited to the trust accounts even though no such limit actually existed, that

[65] To the extent this is not the case, because such assets could have been paid out to PHH and thus made unavailable to pay claims to the MIs, this is merely a concession that the arrangements contained *effective* trust caps. Either way, the payment of claims to the MIs was limited to little (if anything) more than the funds in the trusts.

representation, and the resulting conclusion of its risk transfer analysis, could have misled state insurance regulators about the extent of Atrium's potential liability and materially impacted their assessment of Atrium's solvency. **Hrg. Tr. 2280:18-2281:22** (6/4 Crawshaw), **2199:9-13** (6/4 Walker) (agreeing that "if a regulator ... asked to see the Milliman opinion, [UGI] would have provided it"). Given this possibility, it is highly unlikely that anyone would have instructed Milliman to intentionally understate risk transfer.

Second, it would not have made sense for UGI or Genworth to instruct Milliman to assume a trust cap if it did not believe one actually existed because, as Crawshaw explains, if a dispute arose between the MI and Atrium over whether Atrium's assets outside of the trust account were reachable, any claim by the MI that such assets were reachable would be undermined by the contrary statements in the Milliman reports that the MI repeatedly approved before the dispute arose. *Id.* **2280:18-2281:22** (6/4 Crawshaw). Walker acknowledged that if there was such a dispute between UGI and Atrium, the Milliman opinions could be relied upon. *Id.* **2198:9-2199:8** (6/4).

4. The compensation the MIs paid to Atrium was grossly excessive

The Tribunal has held that Section 8(c)(2) of RESPA provides a "complete defense" to Respondents only if they can prove that "the premiums in their entirety were bona fide payments for services actually performed." May 22 Order at 7. But if Respondents cannot make such a showing, yet "can prove that any reinsurance provided had some market value, then the difference between the ceded premiums and the market value is the amount of the referral fee under Section 8(a), or the unearned fee under Section 8(b)," and the "market value would not be considered a referral fee or unearned fee, and would place a limit on damages, disgorgement, restitution, and any other monetary sanction." *Id.* Respondents failed to make any such showing.

Because there was no transfer of significant risk to Atrium under its captive arrangements, there were no "services actually performed," and therefore no price would have been reasonable.[66] Nonetheless, even if the Tribunal were to assume for the sake of argument that some actual service was performed, Respondents presented no evidence that could possibly establish that the premiums they received, in their entirety, were bona fide payments for that service. To make such a showing, Respondents would have to prove that no dollar of premiums received was, even in part, a payment for referrals of business. This is an exceedingly difficult burden to meet in the face of the plethora of evidence discussed above, showing that the very purpose of the Atrium arrangements was to provide Respondents a share of the MIs' profits in exchange for referrals.

But Respondents did not even attempt to show the market value of any service they purportedly performed. Under the Tribunal's May 22 Order, Respondents are entitled to a complete defense only if they can prove that the market value of the purported service was equal to the premiums they received. Such a technical analysis would clearly be within the province of expert testimony, but neither of Respondents' experts opined on that matter.[67] They did not, for example, point to evidence of the range of prices charged by non-captive reinsurance companies to MIs in a market with multiple competing providers. And because Respondents failed to present any evidence

[66] This is indisputably true for each arrangement as a whole, because Respondents have not even contended (or provided any evidence) that an actual service was performed if the risk transfer analysis covered any more than a single book year at a time.
[67] Milliman also did not purport to have reached any conclusions on that matter. **Hrg. Tr. 1941:20-24** (6/3 Schmitz).

of market value – even a value that was less than the premiums received – there is no basis to limit damages.[68]

Respondents cannot prove that any service was priced at a fair market value without showing the existence of a fair market. But there was no market at all for the service Atrium purportedly provided. This is because the captive arrangements did not provide real reinsurance; rather, they were schemes set up to allow Atrium to receive kickback payments in exchange for referrals of PHH loans. Those referrals were the actual "product" Respondents offered. To qualify to compete in this illegal "market" for referrals of PHH loans, the provider of the purported reinsurance had to be able to control those referrals. Respondents, of course, were the only entity that met this qualification. As a result, Atrium was the sole provider, and there were no actual, or even potential, competitors. Rosenthal testified: "I'm not sure if I classify as Atrium having a competitor" because "a competitor is bidding for business and Atrium is only acquiring business from PHH." **Hrg. Tr. 147:13-25** (3/24). As a result, Atrium did not bid for business against any competitors. **Hrg. Tr. 148:2-5** (3/24).

Had the MIs actually wanted reinsurance, there surely would have been legitimate third-party commercial reinsurance companies willing to provide it at a competitive price. **Hrg. Tr. 345:3-22** (3/25 Culver) (In the 1980s, MGIC had one commercial reinsurance agreement, a quota share arrangement, which it needed because "it was going through financial problems at the time"). The lack of competitors indicates not only that Atrium's "reinsurance" was excessively priced, but that it did not

[68] To prove the reasonableness of the price of Atrium's purported service, Respondents rely *solely* on the conclusion in the Milliman reports that the price was commensurate with risk purportedly assumed by Atrium for individual book years. But as discussed below, Milliman's methodology for analyzing the reasonableness of the price Atrium charged was fundamentally flawed. *See* § III.B.2.b.ii, *infra*.

fill a genuine need in the first place. *Id.* **344:11-18** ("[W]e weren't buying commercial reinsurance, we didn't feel the loss side of the business justified it."), **346:8-12** (agreeing that "MGIC felt when it learned of captive reinsurance in the mid '90s that the company did not need the captive reinsurance.").

Thus, Respondents did not show at the hearing that there was a competitive process that could have resulted in a price that was, in fact, competitive. In a truly fair market, multiple providers of a service (the sellers) compete for business by offering the buyer a superior service, a lower price, or some combination. **Hrg. Tr. 1556:6-15** (5/30 Cascio) ("I would say normally reinsurance in the commercial market, you know, is a competitive, and it's shopped around"). Respondents presented no evidence that Atrium was selected over third-party reinsurance companies on the basis of either factor. Indeed, as discussed above, there is no contemporaneous evidence (such as a document created in the ordinary course of business) showing that any of the MIs even sought out reinsurance coverage from Atrium. *See* §§ III.A.2.a, III.B.3, *supra*.

The evidence also shows that competitive pressures ran in the opposite direction from what one would expect in a fair market. Rather than multiple sellers bidding to provide competitively-priced reinsurance to each MI, there was only one provider and multiple MIs bidding to provide ever-more favorable captive arrangements to Atrium, a dynamic that was particularly obvious during the RFP process begun in 2006.

Not surprisingly, the percentage of premiums the MIs were required to cede to Atrium only increased until a 25% percent limit was imposed by Freddie Mac. This was consistent with the trend in the industry. According to Culver, when captive arrangements were initially introduced, the ceding percentage was in the range of 12 percent, but it soon grew to 40%. **Hrg. Tr. 336:18-337:14** (3/25).

Even within the constrained and anti-competitive structure within which Atrium and the MIs operated, Respondents presented no evidence that anyone attempted to determine the price of Atrium's purported reinsurance based on the characteristics of the reinsured mortgage insurance policies. There is no evidence, for example, that any party conducted any type of pricing analysis to ensure that premium ceding percentage was tailored to any risks assumed by Atrium under each specific captive arrangement. No one who worked on behalf of Atrium ever performed underwriting to price the reinsurance coverage that Atrium purported to provide. **Hrg. Tr. 126:24-127:8** (3/24 Rosenthal). Respondents cannot meet their burden of establishing the reasonableness of the price without such evidence.

The premium ceding percentage charged by Respondents demonstrated no sensitivity to significant changes in the risk profiles for individual book years reflected in Milliman's projections. As shown in Table 1 below, the net premium ceding percentage under the UGI arrangement remained fixed at 40% even though Milliman's projected single book year loss ratio for Atrium at the 10% probability level (the "stress scenario," in which 90% of the scenarios had a lower loss ratio for Atrium) decreased from 226% for the 2004 book year to 143% for the 2008 book year.

Table 1: UGI Arrangement

Book Year	**Net Ceding Percentage**	**Projected Loss Ratio for Book Year at 10% Probability Level**	**Source for Milliman Loss Ratio**
2004	40%	226%	**RCX 0021** at 12
2005	40%	213%	**RCX 0022** at 12
2006	40%	148%	**RCX 0023** at 10
2007	40%	143%	**RCX 0024** at 10
2008	40%	143%	**RCX 0025** at 10

Likewise, Table 2 below shows that the net ceding rate under the UGI arrangement remained fixed at 40% even though Milliman's projected single book year loss ratio for Atrium at the 10% probability level (the "stress scenario") decreased from 195% for the 2004 book year to 126% for the 2008A book year.

Table 2: Genworth Arrangement

Book Year	**Net Ceding Percentage**	**Projected Loss Ratio for Book Year at 10% Probability Level**	**Source for Milliman Loss Ratio**
2004	40%	195%	**RCX 0015** at 23
2005	40%	192%	**RCX 0016** at 12
2006	40%	160%	**RCX 0017** at 10
2007	40%	156%	**RCX 0018** at 10
2008.A	40%	126%	**RCX 0019** at 10

Crawshaw explains that it is "unusual" for pricing of reinsurance to remain the same for multiple parties and across many years. **Hrg. Tr. 760:19-761:1** (3/28). Pricing is usually reviewed "annually or biannually." *Id.*

When asked what analysis UGI did to ensure that the price charged by Respondents was appropriate, Walker could point only to the Milliman opinions. **Hrg. Tr. 2138:25-2139:19** (6/4). While the Milliman opinions provided *post hoc* justifications for the ceding percentage under the structures presented to it for analysis, there is no evidence that Milliman performed any analysis that Respondents or any MI relied on to arrive at that percentage in the first place, *before* the parties agreed to that price in the written agreements and amendments.

The only other testimony Walker provided with regard to the price charged by Respondents shows that it was excessive. He testified that "ceded premium in some instances was 40 percent, very high ceded premium." *Id.* **2198:1-2** (6/4). He acknowledged that [redacted]

Respondents left entirely uncontested the evidence Enforcement presented showing that: (1) it was not reasonable to charge the MIs any price at all given that the MIs – not Atrium – assumed a significant risk of sustaining a substantial economic loss; (2) the price Atrium charged would be exorbitant even for a reinsurance or insurance company that assumed significant risk; and (3) the price Atrium charged resulted in an extremely high expected underwriting profit margin to Atrium which, in a competitive market characterized by arm's-length negotiations, would be appropriate only for providers of true catastrophe coverage who face a real possibility of incurring a severe economic loss. **Crawshaw Rep.** at 59-61, 72-76; **Crawshaw Rebuttal Rep.** at 21-26.

As Crawshaw explained in his rebuttal report, an appropriate price charged to the MIs is "*less than zero*" because a savings account "costs little to nothing to open" and "the best case scenario" under Respondents' arrangements "was comparable to the returns that could be expected from a savings account," while "the expected result of the arrangements to the MIs was a loss of a significant portion of their premiums." **Crawshaw Rebuttal Rep.** at 25. The Atrium arrangements were thus "a worse bet for the MIs than a free savings account because they required the MIs (particularly UGI and

Genworth) to incur a substantial opportunity cost by devoting immense amounts of *their* capital to an investment with tremendous downside risk and a minimal upside." *Id.* (emphasis in original). As a result, "it would have made much more sense had Atrium compensated the MIs, rather than vice versa." *Id.* A price of "less than zero" makes sense in light of the evidence that Atrium in fact did compensate the MIs for the negative value of the captive arrangements, by referring business to them.

Respondents did not rebut this analysis. Neither Respondents' experts nor any of their fact witnesses attempted to explain how any of the Atrium arrangements could have resulted in a loss of enough of Atrium's own capital to result in an outcome to the MI that was significantly better than a savings account. In fact, no witness even claimed that such an outcome was possible.[69]

Respondents likewise offered no response to Crawshaw's opinion that the price Atrium charged resulted in an expected underwriting profit margin that would be extraordinarily high even if Atrium had assumed significant risk. The expected profit margin that Milliman projected for each book year it analyzed was consistently in the range of 40% or higher. **Crawshaw Rep.** at 29, 59-61; **Crawshaw Rebuttal Rep.** at 26-27. According to Crawshaw, expected underwriting "profit margins typical of most types of property and casualty insurance agreements are usually 10% or less," *id.* at 25, whereas expected underwriting profit margins in the range of 40% are appropriate only for providers of true catastrophe coverage., *id.* at 24. When price is determined in a competitive market through arm's length negotiations, providers of catastrophe

[69] While it was possible for claims to exceed premiums for a single book year by a margin greater than the return on a savings account, none of the Milliman reports show that the excess would ever be paid using Atrium's own capital, as opposed to premiums ceded by the MI from other book years.

coverage are able to justify demanding such a high profit margin to compensate for assuming the risk of a severe downside loss, reflected in potential loss ratios that approach or exceed 1000%. **Crawshaw Rep.** at 61; **Crawshaw Rebuttal Rep.** at 8-11, 23-25.

Despite charging such a high price, Atrium's maximum theoretically possible loss ratios over the entirety of the UGI and Genworth arrangements (on a present value basis) were approximately 270% and 263%, respectively. **Crawshaw Rebuttal Rep.** at 19-20. But Crawshaw explains that these maximum loss ratios "would only occur if the real estate market suffered multiple successive crises over the entire decade-and-a-half period (uninterrupted by even temporary upswings)," Atrium had sufficient capital to fund those levels of losses, and Atrium would not have terminated the arrangement earlier to avoid the full extent of potential losses. **Crawshaw Rebuttal Rep.** at 19, 21. Thus, he believes "it is almost inconceivable that those lower maximum loss ratios would even be reached" and "there was no chance that the maximum loss ratios would ever translate into an actual significant economic loss to Atrium." *Id.* at 20-21.

No witness offered any basis to dispute Crawshaw's opinions. Instead, Cascio agreed that Atrium's pricing resulted in "higher expected profit margins" which are "normally indicative of catastrophic, excess-of-loss ('XOL') agreements." **Cascio Rebuttal Rep.** at 7. But Cascio also believes that claims that are "catastrophic in nature" are those "*from 14%-25%*." **Cascio Report** at 6 (emphasis added). Atrium never covered a layer that included claims above 14% of aggregate risk. [redacted] It is undisputed that none of Respondents' arrangements ever provided coverage of the catastrophe layer.

Similarly, neither Cascio, nor any other witness, dispute Crawshaw's assertions that expected underwriting profit margins of 40% are, in a fair and competitive market, accompanied by potential loss ratios to the coverage provider approaching or exceeding 1000%. Like Crawshaw, Cascio has experience with insurance or reinsurance contracts in which the actual loss ratios for individual book years was over 1000%. **Hrg. Tr. 1630:17-1631:14** (5/30 Cascio). These contracts have included, but were not limited to, catastrophe contracts. *Id.* **1631:15-19** (5/30 Cascio). No witness testified that Atrium's maximum theoretically possible loss ratio, over any arrangement as a whole or even for a single book year, ever approached 1000%. Even for the four book years that Cascio contends are most "emblematic" of catastrophe protection under the UGI arrangement –2005 through 2008 – Atrium's maximum possible loss ratio was under 170%. **Cascio Rep.** at 2; **Crawshaw Rebuttal Rep.** at 43. Cascio understands that "a 200% loss ratio is the likely maximum for a single contract for Atrium." **Cascio Rebuttal Rep.** at 10.

According to the American Academy of Actuaries, catastrophe protection poses "significant financial hazards to the insurer, including the risk of insolvency, an immediate reduction in earnings and statutory surplus, the possibility of forced asset liquidation to meet cash needs, and the risk of a ratings downgrade." **Crawshaw Rebuttal Rep.** at 7 (citing "Catastrophe Exposures and Insurance Industry Catastrophe Management Practices," American Academy of Actuaries Catastrophe Management Work Group, June 10, 2001 (**Crawshaw Rebuttal Rep.** Ex. 3 at 1)).

Respondents' arrangements never posed any "significant financial hazards" to Atrium, including the risk of insolvency.

Even if it were appropriate to limit the analysis of pricing to the single book years that included loans which closed after July 21, 2008, the available evidence shows that the pricing for those book years was even more excessive and unreasonable than for earlier book years. For the 2008.B book year under the Genworth arrangement, Milliman projected an expected underwriting profit margin to Atrium of approximately 68%, far greater than the 40% expected underwriting profit margin typical of catastrophe arrangements. **ECX 0194** at 16**; Hrg. Tr. 2256:16-2257:17** (6/4 Crawshaw). But because Atrium's risk layer was so small compared to the premiums for that book year, Atrium's maximum possible loss ratio was just 189.6% (on a nominal basis) and the projected stress scenario loss ratio (at the 10% probability level) was a mere 111% (on a present value basis). **ECX 0194** at 11; **Hrg. Tr. 2355:4-9** (6/4 Crawshaw).

Milliman also projected that there was a more than 60% chance that Atrium's loss ratio would be 0% – *i.e.*, that Atrium would not pay a single claim in connection with the 2008.B book year. **ECX 0194** at 11, 17; **EC Demonstrative Ex. 3**; **Hrg. Tr. 2344:24-2351:10** (6/4 Crawshaw). In other words, Milliman found that there was a more than 60% chance that Respondents would gain $1 on every $1 paid by Genworth (and a more than 70% chance that Respondents would make a gain of 94 cents on every $1 paid by Genworth). **ECX 0194** at 11, 17; **Hrg. Tr. 2008:8-2009:2** (6/3 Schmitz); **EC Demonstrative Ex. 3**; **Hrg. Tr. 2344:24-2351:10** (6/4 Crawshaw). By contrast, Genworth had only a slightly more than 10% chance of achieving a gain from the 2008.B book year, and that gain was projected to be only approximately 11 cents on every $1 that it paid to Atrium. **ECX 0194** at 11, 17; **EC Demonstrative Ex. 3**; **Hrg. Tr. 2344:24-2351:10** (6/4 Crawshaw); **Hrg. Tr. 2009:3-12** (6/3 Schmitz). In short, even Milliman predicted that Respondents were highly likely to reap massive gains (and Genworth to suffer massive losses), and had only a small chance of sustaining a small "loss" (and Genworth a small "gain"),[70] from the 2008.B book year.

For the Genworth 2008.B book year, Milliman also purported to project and analyze Atrium's expected internal rate of return (IRR) and cumulative return on capital (CROC). **ECX 0194** at 14-16. Milliman conjured the figures underlying these metrics out of thin air. Crucially, both the IRR and the CROC are based on a purported "initial capital contribution" made by Atrium in connection with the 2008.B book year. But Atrium simply designated $2,060,488 of the funds already present in the Genworth trust account as "capital contributions" made by Atrium. **ECX 0194** at Ex. 1; **Hrg. Tr. 2009:13-2010:10** (6/3 Schmitz).[71] Milliman then used that fictitious "capital contribution" as the basis of its IRR computation. **ECX 0194** at Ex. 2 (the only "equity flows" factoring into the IRR calculation are the two "capital contributions" of $1.3 million and the dividend back to Atrium at the end of the 10-year term). The CROC is an even more arbitrary calculation. It assumes not only that Respondents "contributed" $2.06 million in capital, but also treats all of the premiums paid by Genworth over the ten-year term of the arrangement as Atrium's capital. **Hrg. Tr. 2023:6-2025:5** (6/3

[70] The "loss" only exists when assessed from a single book year perspective. Any such loss, small and unlikely as it was, was due to be paid out of Genworth's own premiums ceded in connection with other book years. But even assuming, as is done here for the sake of argument, that the single book year approach is appropriate, it still barely manages to produce a projection of a "loss" of any magnitude or likelihood.

[71] Milliman manipulated the "capital" associated with the book year it analyzed in its other reports in identical fashion. *See, e.g.*, **ECX 0193** at Ex. 7; **Hrg. Tr. 2022:3-2023:5**.

Schmitz) (discussing identical CROC calculation with respect to the UGI 2005 book year analysis, and conceding that "capital" for a particular book year is made up of premiums paid by the MI). The CROC is simply the "cumulative net income" associated with the book year under review divided by the "cumulative average capital" – *i.e.*, the sum of the "capital," including premiums paid by the MI, that are in the trust each year and that Milliman has designated as relating to the book year in question. **ECX 0194** at 15, Ex. 2. Milliman makes no effort to explain the relevance of this calculation, and it is far from apparent that the ratio of the sum of Atrium's annual net income to the sum of the average annual capital in the Genworth trust account that Milliman deemed to be associated with the 2008.B book year has any bearing on the reasonableness of the compensation that Genworth paid to Atrium.

5. Milliman's analyses were not independent and objective

According to Milliman's report for the Genworth 2008.B book year, Milliman was "retained by PHH to *independently* assess the likelihood" that that book year met Milliman's formulation of the risk transfer and compensation tests of the HUD Letter. **ECX 0194** at 1 (emphasis added). All of Milliman's risk transfer reports contain an identical characterization of its position vis-à-vis PHH (or the MI, as the case may be). *See*, *e.g.*, **ECX 0124** at 1; **ECX 0192** at 1; **ECX 0193** at 1; **ECX 0466** at 1; **ECX 0467** at 1; **ECX 0593** at 1; **ECX 0594** at 1.

But Milliman was far from independent. Milliman created a niche market for actuarial opinions purporting to assess whether captive arrangements complied with HUD letter requirements. Milliman aggressively marketed this service to lenders, hosting an annual conference in Las Vegas for more than a decade. **Hrg. Tr. 2068:11-2069:21** (6/3 Schmitz); **ECX 0678** ("Milliman, Inc. (Milliman) proudly presents its 8th

Annual Mortgage Reinsurance Conference"); **ECX 0679** ("7th Annual Mortgage Reinsurance Conference"); **ECX 0680** ("Third Annual Mortgage Reinsurance Conference"); **ECX 0699** ("Milliman Eleventh Annual Mortgage (Re)Insurance Conference"). Milliman received more than $38 million from lenders and mortgage insurers over that period, solely for work relating to captive mortgage reinsurance arrangements. **RCX 0880** (Dec. 2013 Milliman corrected response to CFPB interrogatory); **Hrg. Tr. 2053:9-2054:12** (6/3 Schmitz). Milliman received nearly $1.9 million from PHH alone. **RCX 0880**; **Hrg. Tr. 2055:8-10** (6/3 Schmitz). Walker of UGI agreed that Milliman "touted" captive arrangements. *Id*. **2193:11-13** (6/4 Walker)

Milliman's executives' aggressive marketing of its service and the substantial profits it received show that it had a strong financial incentive to opine that captive arrangements reflected adequate risk transfer and were reasonably priced. Lenders and MIs were motivated by RESPA, and the HUD Letter, to procure sophisticated-seeming analyses purporting to demonstrate that their captive arrangements had genuine value. Several key personnel at Milliman therefore had a strong incentive to provide such analyses to these eager purchasers. Because issuing such approvals was a significant part of Milliman's captive reinsurance strategy, Milliman stood to gain directly by the proliferation of captive arrangements throughout the industry, which was facilitated by its approvals.

Thus, in an article entitled "Using a Bank Captive Subsidiary to Reinsure Mortgage Insurance" written by Milliman actuary Timothy Cremin in the late 1990s and published on its website, Milliman noted that "[m]ortgage insurance has been profitable" and that "[l]enders, who essentially produce the business for the mortgage insurers, have been seeking ways to share in these profits." **ECX 0682** (printed on 2/28/2014); **Hrg. Tr. 2072:8-15** (6/3 Schmitz) (testifying that the article was written early in the existence of captive arrangements). The article notes that "the captive's total exposure across all origination years also is capped by an aggregate limit (e.g., based on funds available in the trust account)" – *i.e.*, a trust cap. **ECX 0682**. The article also characterizes a captive arrangement in which "losses develop to the expected level" as being "financially equivalent to receiving a commission or profit sharing equal to percentage of premium." *Id*. Even if these were not accurate descriptions of Respondents' captive arrangements (they are), they show that Milliman sought to entice lenders into creating captive arrangements, which Milliman could then bless as bona fide transactions through its risk transfer opinions.

Milliman's captive reinsurance risk transfer opinions permitted lenders like PHH to claim, when their captive arrangements' legality under RESPA was challenged, that those arrangements had been scrutinized and found compliant. This gave Milliman a vital interest in the outcome of its clients' risk transfer analyses that belies any suggestion that Milliman acted independently in furnishing its reports. Schmitz acknowledged that a finding by this Tribunal that Milliman's analyses do not shield Respondents from liability would be harmful to Milliman's business. **Hrg. Tr. 2082:9-17** (6/3).

Milliman's allegiance to its client, PHH, is substantial and well documented. As noted, Milliman provided off-the-shelf certificates of compliance in the form of risk transfer opinions, but it also gave PHH guidance as to how to craft its captive arrangements in order to squeeze the greatest possible payments out of MIs while still satisfying the test for demonstrating bona fide value that Milliman had itself concocted

– the same test behind which Respondents now seek to hide. When PHH sought to extract the maximum possible referral payments from MIs through its RFP beginning in 2006, it directed the MIs to submit their offers to both PHH and Milliman. *See, e.g.*, **ECX 0539** (10/9/2006 letter, Rosenthal to Nicholes (UGI)) at CFPB-PHH-00141180. PHH viewed the RFP as an opportunity to "significantly reduce[] our risk in our Captive Re-Insurance transaction." **ECX 0324**. PHH planned to "use Milliman throughout the process to give us advice and perform relative value / risk / reward analytics" on the MIs' responses. **ECX 0537** (10/9/2006 email, Rosenthal to Bradfield *et al.*). At the outset, PHH directed Milliman to evaluate the value of the MIs' proposals *from PHH's perspective*, asking that Milliman "compare all [proposals] to 4/10/40 cede" and to perform an "analysis, showing that what [a particular MI] offered to us is a bad deal." **ECX 0315** (10/31/2006 email, Rosenthal to Bjurstrom) at CFPB-PHH-00033592.

As the offers in response to the RFP came in from the MIs, Rosenthal repeatedly discussed strategies for negotiating better terms from the MIs – most of which were themselves Milliman's clients, *see* **RCX 0880** – with Milliman. In early November, Rosenthal suggested a "strategy session" with Milliman principal Ken Bjurstrom to share his "thoughts" about the MIs' offers. **ECX 0316** (11/6/2006 emails). None of Rosenthal's comments to Bjurstrom involved risk transfer, but they did include "prov[ing] that what [Radian] ha[s] offered is inferior to our current transactions," prodding UGI to make a better offer to PHH "as opposed to us telling them where they have to get to," noting that PMI's offer "is not as compelling of a transaction vs. what we have received from MGIC" and that as a consequence "they are going to be out of the running," expressing a desire to "determine if there is value" in RMIC's offer and to "talk this through with you to gain your perspective," and soliciting Bjurstrom's "thoughts on what [Genworth] ha[s] shown to us." *Id.*

Two days later, Rosenthal again contacted Bjurstrom, this time to relate that although he wanted to respect the confidentiality of his negotiations with the various MIs, Rosenthal wanted the MIs to "scramble to give us the best bid possible." **ECX 0328** (11/8/2006 emails). To that end, Rosenthal had told PMI that there was "another provider whose attachment / detachment points are more appealing." *Id.* PMI responded that a "more aggressive" offer would not "pass risk transference / price commensurate with risk." *Id.* Rosenthal alerted Bjurstrom that PMI "might be calling you directly." *Id.* Rosenthal also asked PMI to "get creative on allowing me to extract capital on burnt out books" but PMI "didn't have any original thoughts on this either (yet!)." *Id.* In early December, Rosenthal forwarded Radian's latest offer (which Rosenthal had negotiated up from an earlier proposal over the preceding days) to Bjurstrom, characterizing it as "unimpressive." **ECX 0314** (12/7/2006 email). Rosenthal again asked Bjurstrom to "strategize." *Id.* Later in the month, Rosenthal forwarded a captive reinsurance offer from PMI to Bjurstrom and Hunley. **ECX 0320** (12/22/2006 email). Rosenthal noted that he hoped that PMI would conclude that a more favorable arrangement (with a lower detachment point) "would pass the [risk transfer] test," and proposed comparing PMI's offer to those from MGIC and Triad while observing that "Radian and Genworth are both coming back and upping their ante." *Id.*

In early January 2007, Rosenthal scheduled a meeting with Milliman and several PHH executives so that Milliman could "present their analysis on the relative value of the MI company's [sic] proposals to our RFP." **ECX 0313** (1/2/2007 scheduler from

Rosenthal). Milliman did perform such an analysis, ranking the MIs' various proposals, **ECX 0014** at 3, noting the projected loss ratio in the "stress loss scenario" for each proposal, which ranged from 92% to 120%, *id.* at 9, and noting the expected loss ratio to Atrium for each proposal, which ranged from 22% to 39%, *id*. Still in early January, Rosenthal forwarded UGI's latest offer to Bjurstrom and Hunley and asked them for their "thoughts" on the offer, while noting that he (Rosenthal) wanted UGI to increase its proposed attachment points by 50 basis points. **ECX 0346** (1/3/2007 email). Two weeks later, Rosenthal again forwarded an MI offer (Radian) to Milliman, characterizing it as "inferior than current deal." **ECX 0120** (1/17/2007 email).

Thus, far from seeking an arms'-length, independent professional judgment of the value of Respondents' captive arrangements, Rosenthal endeavored to involve Milliman in the intimate details of PHH's negotiations, business strategizing, and execution of the arrangements. And PHH continued to integrate Milliman in its operations well into 2008. *See, e.g.*, **ECX 0298** (9/26/2008 email, Rosenthal to Bjurstrom) (asking Bjurstrom whether it would "benefit or hurt us" to agree to certain captive terms).

PHH employed Milliman as an advisor for the purpose of devising the most profitable captive arrangements possible and assessing the value of the offers from the various MIs. **ECX 0014** (1/29/2007 presentation by Milliman to PHH) at 3 (ranking the MIs' RFP responses). Having participated in the design of PHH's captive schemes, Milliman was in no position to "independently assess" their compliance with the law.

Given Milliman's financial stake in perpetuating the use of captive mortgage reinsurance arrangements, it is unremarkable that it was Milliman that devised the methodology used to analyze Respondents' (and other lenders') compliance with the requirements of the HUD Letter. **Hrg. Tr. 1853:1-5** (6/3 Schmitz) (Milliman, and Schmitz in particular, created the models used to assess risk transfer), **1977:6-17** (Milliman determined the methodology for assessing compliance with HUD Letter on its own). It is equally unexceptional that the methodology Milliman devised systematically obscured the many risk-limiting features of the captive arrangements.

C. The Tribunal Should Enter an Order Requiring Disgorgement, Injunctive Relief, and Civil Money Penalties Against Respondents

1. For violating Section 8(a), Respondents should disgorge all gains causally connected to illegally-referred loans that closed within the limitations period

"Disgorgement wrests ill-gotten gains from the hands of a wrongdoer. It is an equitable remedy meant to prevent the wrongdoer from enriching himself by his wrongs." *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1085 (D.N.J. 1996) (quotations / citation omitted). Courts have "broad discretion in fashioning the equitable remedy of a disgorgement order." *Id*. at 1085 (D.N.J. 1996) *aff'd*, 124 F.3d 449 (3d Cir. 1997) (citations omitted). Once liability has been established, a plaintiff is "entitled to disgorgement upon producing a reasonable approximation of a defendant's ill-gotten gains." *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).

The plaintiff "has the initial burden of establishing that its disgorgement figure reasonably approximates the amount of unjust enrichment." *Hughes Capital*, 917 F. Supp. at 1085 (quotation /citations omitted).[72] The plaintiff's burden "is light: a reasonable approximation of a defendant's ill-gotten gains." *SEC v. Huff*, 455 Fed. App'x 882, 883 (11th Cir. Jan. 3, 2012) (quotation omitted). The plaintiff "is required to prove

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[72] *See also SEC v. Secure Capital Funding*, Civ. No. 11–916, 2014 WL 1716226, at *1 (D.N.J. Apr. 29, 2014) (same).

only an amount of disgorgement reasonably approximate of the *benefits or profits causally connected to the violation*." *SEC v. Great Lakes Equities Co.*, 775 F. Supp. 211, 214 n.21 (E.D. Mich. 1991) (first emphasis in original; second emphasis added) (quotation omitted), *aff'd*, 12 F.3d 214 (6th Cir.1993). *See also SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) (holding that "property *causally related* to the wrongdoing" at issue is subject to disgorgement) (emphasis added); *SEC v. Save The World Air Inc.*, No. 01 Civ. 11586(GBD)FM, 2005 WL 3077514, at *17 (S.D.N.Y. Nov. 15, 2005) (requiring only a "reasonable approximation of the profits amassed through the fraudulent conduct").

Once the plaintiff has met its initial burden, the "burden then shifts to the defendant to demonstrate that the [plaintiff's] estimate is not a reasonable approximation." *Calvo*, 378 F.3d at 1217 (citation omitted); *accord Secure Capital Funding*, Civ. No. 11–916, 2014 WL 1716226, at *2 (D.N.J. Apr. 29, 2014). But "all doubts concerning the determination of disgorgements are to be resolved against" the defendant. *Great Lakes*, 775 F. Supp. at 214 (quotations omitted). Indeed, courts have recognized that precisely measuring disgorgement can be a near-impossible task, particularly when illegal profits are commingled with legal profits. As a result, the risk of any uncertainty falls on the wrongdoer. For example, in *SEC v. First City Financial Corp., Ltd.*, the D.C. Circuit explained that "[r]ules for calculating disgorgement must recognize that separating legal from illegal profits exactly may at times be a near-impossible task," and affirmed a disgorgement award that included some portion of legal profits that could not be separated out. 890 F.2d at 1231. The court concluded that "the risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *Id.* at 1232 (citations omitted).[73]

The Bureau has "jurisdiction to grant any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law," including "disgorgement or compensation for unjust enrichment." 12 U.S.C. § 5565(a)(2). As set forth below, the Tribunal should enter an order requiring Respondents to disgorge all kickback payments causally connected to loans that closed on or after July 21, 2008.

a. Snow *permits disgorgement of all kickback payments causally connected to loans that closed on or after July 21, 2008*

Under the holding in *Snow v. First American Title Insurance Company*, which the Tribunal has ruled applies to this proceeding, an illegal payment is actionable under Section 8 of RESPA only if it relates to the referral of a loan closed on or after July 21, 2008. 332 F.3d 356 (5th Cir. 2003). As long as a loan closed within the limitations period that applied to HUD, any payment accepted by Respondents that caused or influenced the selection of the MI for that loan is an actionable illegal referral payment, and is therefore reachable through disgorgement, *regardless of when the payment was made*. A payment that is "causally connected" to a violation, which *Snow* deems to occur at the time of the loan closing, is recoverable. *See, e.g.*, *Great Lakes*, 775 F. Supp. at 214 n.21 (the plaintiff "is required to prove *only* an amount of disgorgement reasonably approximate of the benefits or profits causally connected to the violation") (emphasis in original). Respondents must disgorge any illegal referral payment causally connected to

[73] *See also Bigelow v. RKO Radio Pictures*, 327 U.S. 251 , 265 (1946) ("The most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.") (citation omitted).

a loan that closed on or after the cutoff date of July 21, 2008 established by the Tribunal's May 22 Order.

Thus, for example, if an illegally referred loan closed on July 22, 2008 (the day after the limitations period began), but a kickback payment to obtain that referral was given and accepted on July 20, 2008 (the day before the limitations period commenced), *Snow* would permit disgorgement of that kickback payment. Disgorgement of the payment is necessary because it is an illegal benefit to PHH that is "causally connected" to the closing of the referred loan.[74] For the same reason, kickback payments accepted by PHH five years before July 21, 2008 or one year after July 21, 2008 – or at any time whatsoever – would also be recoverable if they are causally connected to the selection of the MI for any loan that closed within the limitations period.[75]

Indeed, even in cases that have applied the holding in *Snow*, courts have recognized that a kickback payment for an illegally referred loan can be given and

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[74] In its May 22 Order, the Tribunal reasoned that under RESPA, "the cause of action can accrue at one time for limitations purposes, and at another time for purposes of bringing suit." Order at 12. Even if the giving or acceptance of a kickback payment in exchange for a referral of a loan that closed on or after July 21, 2008, rather than the closing transaction itself, is regarded as the violation, those kickback payments should be disgorged because they are benefits obtained by Respondents that are clearly "causally connected" to the giving and acceptance of those payments.

[75] Interpreting *Snow* to bar recovery of kickback payments tendered before the limitations period but which are causally connected to loans that closed within the limitations period is not only unsupported by the opinion, it would render the holding even more illogical and unfair to consumers than it already is. The Tribunal has recognized that, under *Snow*, a "defendant in private litigation could avoid all liability by the simple (though admittedly impractical) expedient of simply tendering any unlawful payment more than one year after loan closing." May 22 Order at 11. Barring recovery of payments made before the limitations period would allow a defendant to avoid all liability by tendering unlawful payments sufficiently in advance of loan closing (depending on when the plaintiff asserts his claim). Also, *Snow* has nothing to do with disgorgement, a form of relief unavailable to private plaintiffs.

accepted at a time other than the closing date. *See, e.g.*, *Henson v. Fidelity Nat'l Fin., Inc.*, No. 1:13–CV–01452–AWI–JLT, 2014 WL 641978, at *6, n.2 (E.D. Cal. Feb. 18, 2014) ("It is possible for the actual acceptance of the payment to occur at a time other than at closing, but this will not change the timing of the violation in this case."). In *Edwards v. First American Corp.*, the district court held that the plaintiff's RESPA Section 8 claim was timely under *Snow* because she filed it in 2007 – "within one year of paying for the allegedly tainted service" – even though the alleged $2 million kickback was paid in 1998, many years before closing. 517 F. Supp. 2d 1199, 1205 (C.D. Cal. 2007); *see also Edwards v. First Am. Corp.*, 610 F.3d 514, 516 (9th Cir. 2010) (indicating that loan closed in 2006), *cert. granted*, 131 S. Ct. 3022 (2011), *cert. dismissed as improvidently granted*, 132 S. Ct. 2536 (2012).

b. Payments accepted by Atrium in and after October 2006 are causally connected to illegally-referred loans that closed after July 21, 2008

Enforcement sets forth below two alternative measures of disgorgement. The first seeks disgorgement of all ceded premiums accepted by Respondents in or after October 2006, when the RFP was issued. The second seeks disgorgement of all payments taken by Respondents from the trust accounts during the same time period, including dividend payments and commutation payments. Enforcement offers the second measure as an alternative to the first, because some payments taken from the trust accounts removed (at least in part) funds whose original source are ceded premiums.

i. Disgorgement based on ceded premiums

Enforcement presented abundant and uncontested evidence at the hearing that ceding of premiums was a significant factor in the allocation of future business to MIs. Moreover, Respondents used modifications to the dialer to punish MI behavior that it deemed potentially harmful to its future captive relationships. *See* § III.A.2, *supra*. There is no evidence that Respondents' referral program operated solely on a loan-by-loan basis. Rather, the evidence shows that Respondents were enriched through a repeated cycle of kickback payments and referrals, in which entering into a captive arrangement with Atrium, and ceding premiums on multiple already-referred loans, enabled MIs to obtain many additional referrals of other loans from PHH going forward. Because of the pervasive nature of Respondents' referral scheme, calculating disgorgement relief limited to ceding payments on individual loans would not reasonably approximate Respondents' ill-gotten gains. *See SEC v. Huff*, 455 Fed. App'x 882, 883 (11th Cir. 2012) ("where the record shows that fraud to have been 'pervasive,' we cannot say it was an abuse of the district court's broad discretion to order that the profits associated with the fraudulent scheme be disgorged.") (citing *CFTC v. British Am. Commod. Options Corp.*, 788 F.2d 92, 93–94 (2d Cir.1986) (holding that where fraud is "pervasive," disgorgement of "all" profits is warranted)).

In addition to the facts discussed in Section III.A, *supra*, two additional facts make clear that a loan-by-loan remedy would be inappropriate here. First, the loans referred to the MIs were not limited to loans covered by captive arrangements; PHH referred many loans that were not covered by any captive arrangement. Respondents' data shows both the "# of originations involving PMI loans" and "# of originations involving PMI *Captive* loans" for each year from 2006 through 2011. **ECX 0159** (emphasis added). The latter figure, which reflects referred loans that were placed into a captive, is a subset of the former figure, which reflects referred loans regardless of whether they were placed into a captive.[76] This difference exists because some loans originated by PHH were eligible for mortgage insurance but were not eligible for reinsurance for one of several reasons (*e.g.*, investor restrictions, different underwriting guidelines). There are no ceded premiums specifically associated with these loans not covered by a captive arrangement because the obligation to cede only arises if a loan is covered by a captive arrangement. Nevertheless, the mortgage insurance for these loans was allocated through the dialer or the "preferred provider" list as part of the captive reinsurance scheme. **ECX 0773** (6/4/2008 email, Kennedy to Rosenthal). Thus, for example, the ceded premiums that enabled UGI and Genworth to obtain the referral of such loans must have been premiums they ceded from other loans, which collectively led to the MI's business-share setting on the dialer.

Second, as discussed above, the dialer was periodically reprogrammed to allocate business to MIs at fixed business-share percentages; and once the dialer was set to a particular allocation, referrals of retail MI business *thereafter* were controlled by that setting, until the setting was changed. Because the dialer setting allocated business prospectively, any factor that influenced the setting is causally connected to subsequent referrals.

There is no dispute that PHH referred a substantial number of loans to UGI, Genworth, Radian and CMG that closed on or after July 21, 2008 – at least 12,401 loans through December 2011[77] – and that those referred loans were mostly or entirely

[76] For example, in 2009, PHH referred 566 loans to Genworth, of which 508 were placed into the captive. **ECX 0159** at tab "2009," cells B18 & D18. In 2010, PHH referred 901 loans to Genworth, but *none* of those loans was placed into the captive. **ECX 0159** at tab "2010," cells B18 & D18.

[77] This 12,401 figure is based on data in a spreadsheet provided by Respondents in response to Enforcement's request during its investigation. **ECX 0159**. It is the sum of

federally-related loans.[78] But the allocation of business to those MIs on and after July 21, 2008 was a direct result of many transactions that preceded July 21, 2008 – namely, the payment of premiums the MIs were required to make to break into PHH's account in the first place, and then to receive continued referrals thereafter.

For example, the configuration of the dialer on and after July 21, 2008 was the product of UGI's and Genworth's agreement to cede immense amounts of premium to Atrium in the years prior. From its inception in 2001 to November 20, 2008, the dialer included only UGI and Genworth, each of whom had a captive arrangement. **ECX 0654** at Ex. M. When they were each added to the dialer, they were the only MIs who had captive arrangements with Atrium. Prior to July 21, 2008, the last two changes to the

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the figures listed for UGI, Genworth, Radian and CMG in the column labeled "# of originations involving PMI loans" for August 2008 through December 2011. The 12,401 figure includes both referred loans that were placed in a captive and referred loans that were not placed in a captive. The portion of this figure representing just loans that were placed in a captive from August 2008 through December is 5,165. Both figures would be higher if data after December 2011 were included, but such data was not provided by Respondents.

[78] Because Enforcement's request sought data relating to federally-related loans subject to RESPA Section 8, Enforcement believes the loans referenced in **ECX 0159** are federally-related loans. **ECX 0126** (1/3/2012 letter, Horwitz to Brown) ("It is our understanding that the company has: (a) originated fixed and adjustable rate first- or second-lien *federally related mortgage loans* to home buyers ('borrowers'); (b) referred some of these borrowers to specific MI carriers in connection with such loans ....") (emphasis added). Additionally, two of the captive agreements are expressly limited to federally-related loans. Among other characteristics, a federally-related loan is a loan "secured by a first or subordinate lien on residential real property ... designed principally for the occupancy of from one to four families ...." 12 U.S.C. § 2602(1)(a). The definition of "Mortgage Guaranty Insurance" in the UGI agreement requires that the agreement to pay be "*secured by a mortgage*, deed of trust, or other instrument constituting or equivalent to a *first lien* or charge on ... real estate provided the improvement on such real estate is a *residential building* or a condominium or manufactured or mobile housing deemed to be real estate or buildings designed for *occupancy by not more than four (4) families*." **ECX 0584** at 3 (emphases added). *See also* **RCX 0044** (Genworth/Atrium agreement) at CFPB-PHH-00091584 ("This Agreement shall be applicable to one-to-four family mortgage loans ..."). PHH is also a "lender which is regulated by any agency of the Federal Government." 12 U.S.C. § 2602(1)(b)(i).

dialer setting were made on September 19, 2007 and November 18, 2007. *Id*. In both cases, the dialer was set to allocate retail business exclusively to UGI and Genworth – as it had always been. The allocation percentages set on November 18, 2007 were 75% to UGI and 25% to Genworth. *Id***.** The dialer was not reprogrammed again until November 21, 2008, *id*., so the setting on November 18, 2007 affected referrals of PHH loans through that date – well past July 21, 2008.[79] **ECX 0654** at Ex. M.

The dialer was reprogrammed for the first time after July 21, 2008 on November 21, 2008. *Id.* The setting allocated 90% of PHH's retail business to either UGI or Genworth (50% to Genworth, 40% to UGI). The remaining 10% was allocated to newly-added MGIC, but MGIC was added because Respondents thought they were "going to get an attractive captive from [MGIC]." **ECX 0747** (11/28/2007 email). This dialer setting also indisputably resulted in UGI and Genworth receiving referrals of loans that closed after July 21, 2008.

PHH presented no testimony or documentary evidence providing any other explanation for why, from its inception in 2001 through all of 2008, the dialer allocated business exclusively to UGI and Genworth, with the lone exception of MGIC receiving 10% at the very end of that period. The only reasonable conclusion is that UGI and Genworth's participation in PHH's captive program, including their ceding of massive

[79] The dialer allocation percentages were provided by PHH, and Enforcement assumes they are correct. It appears that PHH may have at times directed allocations that differed from the dialer percentages, but those allocations were also driven by captive participation. For example, as discussed above, due to PHH's dissatisfaction with UGI's captive proposal at the time (after their agreement lapsed), UGI received negligible business between June and November 2008, even though its dialer allocation was 75% during that time. But this only provides additional support for the strong link between captive participation and referrals. Moreover, the dialer setting on November 18, 2007 resulted in a massive number of loans referred to Genworth in the second half of 2008, all of which closed after July 21, 2008. *See* **ECX 0159** at tab "2008"; **ECX 0654** at Ex. M. Moreover, referrals to UGI were substantial in 2009. *See* **ECX 0159** at tab "2009."

amounts of premiums to Atrium over many years, was the reason they – and no other MI – were included on the dialer from its inception through November 21, 2008. This long practice of paying referral fees to PHH, and the disposition to continue to pay-to-play that this history demonstrates, enabled UGI and Genworth to continue to receive referrals from PHH long after July 21, 2008.

While the evidence above shows that all of the premiums illegally ceded by the MIs before July 21, 2008 are causally connected to the referral of loans which closed on or after July 21, 2008, Enforcement seeks disgorgement of premiums ceded only from October 2006 to the present. This is because substantial additional evidence from October 2006 forward shows with particular clarity and detail the nexus between the MIs' participation in PHH's captive program and their ability to maintain a significant share of PHH's business during the limitations period. *See* § III.A.2, *supra*. The dominant role of Atrium's captive arrangements in determining PHH's allocation of future business to the MIs is reflected in numerous emails and other documents exchanged between Respondents and the MIs after the RFP was issued.

During the RFP process, the MIs complied with Respondents' requests that they propose captive arrangements that were, solely from an insurance perspective, increasingly beneficial to Respondents and harmful to the MIs. In a normal market, it is irrational for buyers of a purported service to "compete" with one another to propose terms that are progressively worse for them. No witness offered any reasonable explanation for the MIs' behavior other than the obvious: the MIs were competing for referrals. They were simply responding to PHH's leverage arising from its ability to refer future MI business to them, or away from them. *E.g.*, **ECX 0737** (PHH planned to "[u]se [its] leverage to re-negotiate Captives with [the] MIs"); *see also* **Hrg. Tr. 181:4-**

15 (3/24 Rosenthal) (discussing ECX 0737), **272:6-273:1** (3/25 Rosenthal) (same) (prior testimony describes PHH's "leverage" as: "we'll send you mortgage insurance and you give us as good of a deal as possible.").

As UGI's Dan Walker testified, PHH "always" had this leverage over the MIs resulting from their ability to steer MI business to them, **Hrg. Tr. 2202:23-2203:13** (6/4), and that leverage is also the only reasonable explanation for why Atrium's *existing* MI partners (UGI, Genworth and Radian) would cede premiums to Atrium under their existing arrangements, which were also otherwise economically irrational.

UGI, Genworth and Radian were active participants in the RFP process, as they also responded to PHH's request by proposing new captive arrangements that were increasingly favorable to Respondents. *See* § III.A.2.c., *supra*. Their responses show that they were not willing to risk the consequences otherwise. Simply refusing PHH's request and standing on their existing arrangement, as they had a right to do, likely would have resulted in PHH punishing the MI – by refusing to "send [the MI] mortgage insurance" business in the future.

Of course, it would not have been acceptable to PHH had UGI, Genworth or Radian responded to its request by insisting on deviating from their existing arrangements in a way that was *worse* for Atrium, and better for the MI. For example, they could not have proposed to reduce the premium ceding percentage *below* the exorbitant rate in their contracts without facing the significant risk that PHH would use its leverage to penalize the MI by reducing future referrals, particularly given that other MIs were aggressively competing for those referrals by offering captive arrangements that were more favorable to Atrium. And surely they could not have proposed to cease ceding altogether without being penalized. When Radian responded to PHH's request, PHH chastised Radian for proposing terms that it considered to be "worse than our current deal of 4/10/40 in all respects" and "going the wrong way." **ECX 0322** (12/1-6/2006 email thread) at 1, 2. Due to PHH's leverage, rather than insist on the terms it originally proposed, Radian hastily returned with adjustments that got their offer "up to even with the current deal." **ECX 0332** (12/7/2006 PHH internal email). There was every reason for UGI and Genworth to believe that proposing to reduce or cease ceding to Respondents would have provoked the same type of reaction from PHH. Indeed, PHH responded similarly in 2003 when Genworth sought to limit ceding to 30%: PHH immediately reduced Genworth's allocation on the dialer from 75% to 10%. *See* § III.A.2.b.i, *supra*.[80]

Thus, the evidence from October 2006 and later leaves no doubt that the *minimum* expectation for UGI, Genworth, and Radian was that they would continue to cede on an ongoing basis. Continued ceding to the full extent under the existing arrangements from October 2006 and later was also necessary for any new arrangements offered by those MIs in response to the RPF, proposing better terms for Respondents, to have any credibility to Respondents. Had those MIs ceased or reduced

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[80] These MIs were also doubtless aware of the reaction that MGIC received after it announced in 2002 that it would not participate in excess-of-loss captive arrangements with premium ceding greater than 25%. **ECX 0816** (10/24/2002 MGIC Board minutes), at CFPB-PHH-00609851; **Hrg. Tr. 363:18-366:20** (3/25 Culver). In response, lenders [redacted] **ECX 0822** (5/13/2004 MGIC Board minutes) at CFPB-PHH-00609665; **Hrg. Tr. 372:20-373:5** (3/25 Culver) [redacted]. MGIC was forced to revert to ceding 40% of its premiums, after which [redacted]. It was rational to expect that PHH would react the same way.

ceding under their existing arrangements during that time, any such offers would almost certainly have been dismissed out of hand.

Accordingly, while the causal nexus between the MIs' agreement to cede and subsequent referrals was already well-established from the very beginning of their captive arrangements in 1995, the responses of PHH's existing MI partners to the RFP show even more clearly that the ceding of premiums under their existing arrangements from October 2006 and later was an important – and likely necessary – factor in their ability to receive subsequent referrals. Discussions tying captive participation to the dialer were ongoing in November 18, 2007 (the last time the dialer was reprogrammed before July 21, 2008) and continued well beyond November 21, 2008 (the first time the dialer was reprogrammed after July 21, 2008). In light of all of this evidence, the Tribunal should conclude that the premiums ceded by UGI and Genworth from at least October 2006 significantly influenced the November 18, 2007 and November 21, 2008 dialer settings, which resulted in UGI and Genworth receiving referrals of loans that closed on or after July 21, 2008.[81]

Denying such a link would require Respondents to establish that, had UGI and Genworth not ceded *any* premiums from at least October 2006 and later, they would have somehow maintained their exclusive position on the dialer from November 18, 2007 through November 21, 2008, and a 90% total share from November 21, 2008 through January 28, 2009 (when the dialer was next reprogrammed). **ECX 0654** at Ex.

[81] It is no defense that ceding of premiums was contractually required, because that ceding was impermissible under RESPA. Respondents could have, at any time, voluntarily ceased their illegal conduct by, at a minimum, declining further receipt of ceded premiums. Respondents also showed a constant willingness to revise the terms of their arrangements (in their favor) by seeking and executing numerous amendments over the years.

M. Such a contention is unsupported by any evidence, and would be untenable in light of the evidence presented by Enforcement, which strongly supports the conclusion that UGI and Genworth would have been treated no differently from the many other MIs during that period who in fact did not cede premiums to Atrium – they would have been blocked from the dialer, or at most, Respondents would have been forced to set the dialer using criteria that did not violate RESPA Section 8(a), and UGI and Genworth would have received significantly smaller allocations on the dialer than they did because other MIs would have been included.

The evidence also supports a conclusion that premiums ceded by Radian and CMG from October 2006 forward enabled those MIs to receive referrals of loans that closed on or after July 21, 2008. In his December 12, 2007 email to Rosenthal, Chris Kennedy of RMIC stated explicitly: “I know the captive relationship has driven your MI allocation ....” **ECX 0768**. This statement was not limited to allocations through the dialer. Thus, while Radian was added to the dialer in 2009 and CMG received referrals outside of the dialer, Mr. Kennedy’s statement dispels any conceivable doubt that their participation in captive arrangements drove referrals of business to them.

Respondents provided no basis to conclude that the causal connection between the ongoing ceding of premiums and the ability of the MI the continue to receive referrals suddenly ceased on July 21, 2008. Rather, the evidence discussed above shows that each of the arrangements remained in place and continued to achieve its objective until it was terminated. *See* § III.A.3, *supra*. Just as before July 21, 2008, in order to continue to receive significant referrals on an ongoing basis after that date, the MIs had not only to cede premiums on new loans, but also to continue to cede premiums on prior loans. Indeed, even as late as 2009 (well after July 21, 2008), Rosenthal referred to the dialer as the "captive dialer," explicitly reaffirming the long-standing connection between captive participation and referrals. **ECX 0743** (2/10-11/2009 internal email); *see also, e.g.*, **ECX 0744** (5/19/2009 email, Bradfield to Rosenthal *et al.*) (directing that PHH steer referrals to "max ugi b/c of captive"); **ECX 0275** (2/3/2009 email, Bradfield to Dodds *et al.*) (reporting that "final decisions regarding the captive" were pending and that PHH "will be able to scope out the plan for directing MI" only after decisions on captives were made). Thus, all of the premiums ceded by the MIs after July 21, 2008 are also causally connected to illegally referred loans that closed after July 21, 2008.

PHH cannot avoid disgorgement simply because it is not possible to trace every dollar of ceded premium to a specific illegally referred loan that closed on or after July 21, 2008. To show a causal connection between the disgorgement figure and the violations, a plaintiff is "not required to trace every dollar of proceeds misappropriated by the defendants ... nor is [a] plaintiff required to identify monies which have been commingled by them" and need only show that the amount of disgorgement is a "reasonabl[e] approximation of profits causally connected to the violation." *Great Lakes*, 775 F. Supp. at 214, n.21 (quotation omitted; alteration in original). *See also* 69A Am. Jur. 2d *Securities Regulation* § 1616 (2014) ("In calculating disgorgement of ill-gotten gains ... a district court need only make a reasonable approximation of profits causally connected to the violation and is not required to trace every dollar of the offering proceeds fraudulently retained by the defendants.").

This is particularly the case where, as here, the illegal benefits were obtained through a pervasive pattern of conduct, rather than isolated instances of wrongdoing. As the court explained in *SEC v. Hasho*, "When a defendant engages in a pervasive pattern of fraudulent conduct as opposed to isolated instances, it is unnecessary to prove a direct nexus between each instance of unlawful conduct and the disgorgement amount due." 784 F. Supp. 1059, 1111-12 (S.D.N.Y. 1992). Likewise, in *CFTC v. British American Trading Corporation*, the Second Circuit rejected the appellant's argument that, to properly measure disgorgement, the CFTC was required to "establish, dollar for dollar, the proceeds that were derived from fraudulent conduct." 788 F.2d 92, 93 (2d Cir. 1986). The Second Circuit held that no such requirement applies when the wrongdoer "was involved not in isolated instances of fraud, but in systematic and pervasive fraud." *Id.*[82]

Based on the above, Enforcement believes that all ceded premiums accepted by Respondents in and after June 2001 – the first month after the dialer was instituted, **ECX 0654** at Ex. M – are causally connected to referrals of loans that closed on or after July 21, 2008, and therefore should be disgorged. But Enforcement requests that, at a minimum, the Tribunal require Respondents to disgorge the ceded premiums they accepted in and after October 2006. That amount, as shown in column B of Table 3 below, is $187,385,428.85.

[82] *See also U.S. v. Philip Morris USA, Inc.*, 396 F.3d 1190, 1228 (D.C. Cir. 2005) (rejecting argument that the government was required to show how each dollar of its proposed disgorgement amount was attributable to RICO violations in part because the defendants' ill-gotten gains were obtained through a "comprehensive, decades-long pattern of deliberate behavior").

Table 3

	[A]	[B]	[C] = [A] + [B]
MI Company	**Gross Ceded Premiums from June 2001 to September 2006 (inclusive)**	**Gross Ceded Premiums in and after October 2006**	**Total Gross Ceded Premiums in and after June 2001**
UGI	$149,749,541.27[83]	$122,671,294.59[84]	$272,420,835.86
Genworth	$77,495,864[85]	$58,935,580.89[86]	$136,431,444.89

83 Because gross ceding data for UGI was not available on a monthly basis, this amount is an estimate calculated as follows. According to the September 30, 2012 UGI cession statement, the total net ceded premiums (*i.e.*, deducting ceding commissions) from June 2001 through September 2006 was $130,216,992.41. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," sum of cells D51-D114. The total gross premium amount ceded by UGI from the inception of its arrangement through September 2012 was $349,606,523. **RCX 0126** (9/30/2012 Atrium Financial Statements) at CFPB-PHH-00098499. The total net premium amount ceded by UGI from inception through September 2012 was $297,056,562. **ECX 0198**. Thus, on average over that time period, gross premiums exceeded net premiums by 17.7% ($349,606,523 divided by $297,056,562 minus 1). To estimate the total gross ceded premiums from June 2001 through September 2006, the $130,216,992.41 net figure was multiplied by a conservative factor of 115% (rather than 117.7%).

84 Because gross ceding data for UGI was not available on a monthly basis, this amount is an estimate calculated as follows. According to the September 30, 2012 UGI cession statement and UGI's compliance report to the CFPB, the total net ceded premiums (*i.e.*, deducting ceding commissions) from October 2006 through June 2013 was $106,670,690.95. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," sum of cells D115-D186**; RCX 1058** (10/4/2013 UGI compliance report) at UGCFPB00001884 ("Premium Deposits" total). To estimate the total gross ceded premiums from October 2006 through June 2013, the $106,670,690.95 net figure was multiplied by the 115% factor described in footnote 83 above.

85 This figure is the sum of the following cells in the 'Settlement" tab of the March 31, 2012 Genworth cession statement (**ECX 0257**): H11, M11, S11, X11, AC11, AD11, AE11, AF11, M12, S12, X12, AC12. Some of these cells are "hidden" in the format of the Excel file as produced.

86 This figure is the sum of the following cells in the 'Settlement" tab of the March 31, 2012 Genworth cession statement (**ECX 0257**): AG11, AM11, AR11, AW11, BB11, BG11, BH11, AG12, AM12 AR12, AW12, BB12, BG12, BH12, BC18, BH18. Some of these cells are "hidden" in the format of the Excel file as produced.

Radian	$1,098,071.13[87]	$3,012,456.37[88]	$4,110,527.50
CMG	N/A	$2,766,097.00[89]	$2,766,097.00
TOTAL	$228,343,476.40	**$187,385,428.85**	$415,728,905.25

The figures for UGI and Genworth in Table 3 are gross ceding amounts – they do not reflect any deduction for ceding commissions.[90] Consistent with "the overwhelming weight of authority hold[ing] that ... violators may not offset their disgorgement liability with business expenses," *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1087 (D.N.J. 1996) (citing cases), the ceding commission should not be deducted as an offset because it is a business expense. *See, e.g.,* **RCX 0097** (8/31/2010 Atrium Financial Statements) at CFPB-PHH-00098186 (listing various categories of Atrium's expenses, including "Ceding Commissions"); *see generally* **Hrg. Tr. 128:22-129:4** (3/24 Rosenthal), **1042:11-16** (5/28 Crawshaw).

87 This figure is the sum of the following cells in the "Cendant ETD" tab of the July 20, 2009 Radian cession statement (**ECX 0650**): J14 through J39, J82 through J102, and J145 through J153.
88 This figure is the sum of the following cells in the "Cendant ETD" tab of the July 20, 2009 Radian cession statement (**ECX 0650**): J40 through J72, J103 through J135, J154 through J186, J196 through J225, and J235 through J252.
89 **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C.
90 On a net basis (deducting ceding commissions), the total premiums ceded in and after October 2006 was $106,670,690.95 for UGI and $52,989,640.97 for Genworth. **ECX 0198** at tab "Trust Deposits," sum of cells D115-D186**; RCX 1058** (10/4/2013 UGI compliance report) at UGCFPB00001884 ("Premium Deposits" total); **ECX 0257** (sum of cells AG11 through AG14, AM11 through AM14, AR11 through AR14, AW11 through AW14, BB11 through BB14, BG11 through BG14, BH11 through BH14, BG18, and BH18). The Radian and CMG agreements did not provide for any ceding commissions. **ECX 0200**; **ECX 0202**.

In evaluating whether Enforcement has met its burden to show that the requested disgorgement amount reasonably approximates Respondents' ill-gotten gains "causally connected" to their violations of RESPA, it is worth noting that "[i]n making such an approximation, courts *broadly construe* the phrase 'causally connected' to accomplish the goals of equity and disgorgement." *SEC v. Huff*, 758 F. Supp. 2d 1288, 1359 (S.D. Fla. 2010) (emphasis added). But Enforcement need not rely on a broad construction of the phrase "causally connected" because the evidence of the nexus between ceded premiums and the MIs' ability to remain on the dialer and preferred provider list (which generated referrals of loans that closed on or after July 21, 2008) could meet an even more stringent standard. In any event, it is Respondents burden to clearly negate the causal connection shown by Enforcement. In *SEC v. First City Financial Corp., Ltd.*, the D.C. Circuit explained that once the government has "presumptively satisfied" its burden, the defendant is "obliged *clearly* to demonstrate that the disgorgement figure was not a reasonable approximation," including showing any intervening factors that "demonstrated a clear break in or considerable attenuation of the causal connection between the illegality and the ultimate profits." 890 F.2d 1215, 1232 (D.C. Cir. 1989) (emphasis added). Respondents presented no evidence at the hearing to show what, if any, other specific factors they actually used to set the dialer on November 18, 2007, November 21, 2008,or at any time after that, or to select which MIs would be included on the preferred provider list, which could conceivably be deemed to negate the causal connection Enforcement has shown. For example, if there were factors other than ceding of premiums that Respondents used to allocate business exclusively to UGI and Genworth through the November 18, 2007 and November 21, 2008 dialer settings, those factors would presumably be detailed in emails or other documents in Respondents' possession, and it would be their burden to present them.

Under both RESPA and relevant authority on disgorgement, Enforcement need not demonstrate that the kickback payment was the *exclusive* cause of the referrals. 12 C.F.R. § 1024.14(f) (A "referral" occurs whenever an action "has the effect of affirmatively influencing the selection by any person of a provider of a settlement service."); *Pure Power Boot Camp, Inc. v. Warrior Fitness Boot Camp, LLC*, 813 F.Supp.2d 489, 523 (S.D.N.Y. 2011) (holding that a plaintiff seeking disgorgement need only prove that the defendant's wrongdoing "was a 'substantial factor' contributing to the defendant's profits"). Thus, for example, if it were the case that a lender referred business only to MIs not in bankruptcy proceedings, clearly RESPA Section 8(a) would not allow the lender to then use captive participation to refer business to particular MIs who met the first condition. A lender could impose any number of other legitimate qualifications to limit the universe of MIs to which it refers business – for example, only to MIs in a particular geographic area or only MIs who have particular capabilities. These other factors would not defeat Enforcement's claim if captive participation was nonetheless a significant factor in the allocation. As the Second Circuit held in *SEC v. Razmilovic*: "Once the [plaintiff] has met the burden of establishing a reasonable approximation of the profits causally related to the fraud, the burden shifts to the defendant to show that his gains 'were *unaffected by his offenses*.'" 738 F.3d 14, 31 (2d Cir. 2013) (emphasis added) (quoting *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996)).

To be sure, many of the premiums ceded by the MIs in and after October 2006, were "causally connected" to referrals of loans that closed both before and after July 21, 2008. This is because, as discussed above, PHH's "pay to play" program did not operate strictly on a loan-by-loan basis. Rather, an MI had to continue to cede on multiple existing loans to obtain referrals of multiple other loans. As a result, a dollar of ceded premium could be a kickback payment for multiple illegally referred loans, some of which closed before the limitations period and some of which closed after the limitations period. But in that case, the entire dollar should be disgorged because it was a benefit illegally obtained by Respondents. The fact that some referrals "causally connected" to the same illegal payment are no longer actionable because of the statute of limitations does not mean Respondents can retain their ill-gotten gains that are also "causally connected" to actionable referrals.

Indeed, as discussed above, even where legal profits and illegal profits are commingled and impossible to separate, the disgorgement award may include legal profits because the risk of uncertainty must fall on the defendant. Thus, even if each dollar of ceded premium reflected some amount of legal profit and some amount of illegal profit, the entire dollar is subject to disgorgement because it is impossible to separate out the legal from the illegal portion. Here, however, no portion of the premiums ceded by UGI and Genworth represents a legal profit because all such payments were illegal kickbacks, even if a subset of the referrals that the kickbacks purchased involved loans that are no longer actionable due to the statute of limitations. Because "[t]he wrongdoer, who has created the uncertainty by his violation, bears the risk of uncertainty," *SEC v. Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587 , 612 (S.D.N.Y. 1993), where payments that are causally connected to some illegally referred loans that closed within the limitations period and some illegally referred loans that closed outside of the limitations period, the law requires Respondents to disgorge the payments in their entirety, rather than keep them in their entirety.

The $187,385,428.85 disgorgement figure includes the ceded premiums from loans covered under the UGI 2009 book year and the Genworth 2008.B. book year which closed on or after July 21, 2008. Those amounts are estimated to be $2,454,633.40 for the UGI 2009 book year and $4,419,062.38 for the Genworth 2008.B book year.[91] **ECX 0257**. (3/31/2012 Genworth cession statement). Although the disgorgement award certainly must include those ceded premiums, limiting such an award to just the premiums ceded under those book years (as Respondents appear to argue) would allow Respondents to retain massive gains that are causally connected to violations within the limitations period. If the Tribunal believes that the premiums ceded under those book years are referral payments for loans that closed within the limitations period, then it must conclude that UGI's and Genworth's participation in PHH's captive program was a factor in obtaining referrals of those loans. But if so, there would be no basis to conclude that the referral of those loans to UGI and Genworth was *solely* attributable to UGI's and Genworth's agreement to cede premiums under just those two book years, rather than their broader participation in PHH's captive program, including ceding payments on other loans from prior book years. Such a conclusion would also run counter to all of the evidence regarding how the referral scheme operated in practice.

ii. Disgorgement based on payments Respondents took from the trust accounts

As noted above, there is an alternative theory under which disgorgement may be calculated – the amount by which Respondents were unjustly enriched through

[91] The calculation of these estimates is described in Section III.C.2, *infra,* in which Enforcement discusses disgorgement for Respondents' violation of Section 8(b) of RESPA).

payments they took from the trust accounts. In determining whether a payment to Respondents was illegally obtained under RESPA Section 8(a) and thus subject to disgorgement, the payment cannot be fairly assessed without considering the purpose of the arrangement within which it was made. All of Atrium's captive arrangements were, in their entirety and at all points in time, illegal arrangements designed and implemented to funnel kickback payments from the MIs to Respondents. [redacted] That is not a legitimate objective. The [redacted] to the lender are simply kickback payments. The various other purported objectives advanced by Respondents' witnesses and litigation experts at the hearing, which are lacking in documentary support, cannot be credited in light of [redacted] this document created in the ordinary course of business.

[redacted] description did not, of course, apply solely to its own arrangement with Atrium (which did not exist at the time), given that [redacted] was competing in a market against other MIs and their captive arrangements – including Atrium's already-existing arrangements with UGI and Genworth, which had the same 4/10/40 structure described in this presentation. [redacted] statement is also consistent with Crawshaw's conclusion that all of Respondents' arrangement were mechanisms "designed to yield large profits to Atrium," not genuine reinsurance arrangements. **Crawshaw Rep.** at 4.

Because the very purpose of Respondents' arrangements was to transfer payments to Respondents in exchange for referrals, in violation of RESPA Section 8(a), any movement of funds to Atrium within each arrangement from its inception to its termination was in furtherance of that purpose and thus likewise violated RESPA

Section 8(a). Accordingly, any step taken to transfer funds to Atrium was simply the implementation of the overarching illegal purpose, and was itself illegal.

For the UGI and Genworth arrangements, the ceding of premiums to the trust accounts was just the first step in the transfer of funds to Respondents. Atrium took a series of dividends and other payments from the UGI and Genworth trust accounts which, after the recovery of its capital contribution, removed funds whose original source was exclusively the premiums ceded by those MIs. And ultimately, Atrium received substantial commutation payments from those trust accounts, also funded by the premiums previously ceded by the MIs. All of these dividend payments were an integral part of Respondents' kickback scheme, and the MIs allowed them for the same reason that they ceded premiums to Atrium – they were heavily dependent on PHH for ongoing and future referrals of business, and the various kinds of payments were the price of these referrals. These payments had no purpose other than to pay Respondents in exchange for referrals, and they clearly fall within RESPA's definition of a "thing of value" – which includes, "without limitation, monies, things, ... dividends, ... [and] retained or increased earnings…." 12 C.F.R. § 1024.14(d).

As an alternative to awarding disgorgement based on the premiums ceded in and after October 2006, Atrium should be required to disgorge all payments it took from the trust accounts during that same time period. The totality of evidence, including evidence of the entire purpose of Atrium's captive arrangements and of the course of dealing throughout each arrangement, shows that *all* such payments under those arrangements were "things of value" given by the MIs and accepted by Respondents as consideration for referrals not only of past business, but also ongoing and future business, including loans that closed on or after July 21, 2008. But as with ceded premiums, the causal connection is particularly strong with regard to such payments after October 2006 due to the plethora of evidence specifically relating to those payments.

For example, as described above, in March 2007, Respondents took a $52 million dividend from the UGI trust account, which required an amendment to the agreement because it was not permitted under the terms of the existing agreement. *See* § III.A.2.c, *supra*. This dividend resulted in the removal of all of Atrium's remaining capital contributions in the trust account (and much more), ensuring that Atrium could not suffer a loss of its capital under its arrangement with UGI. **Crawshaw Rep.** at 41. Even if the Tribunal were to conclude (contrary to the evidence) that UGI and Atrium did not agree to limit Atrium's liability to the trust account, the $52 million dividend would still have been unquestionably favorable to Atrium because it allowed Respondents to move funds further away from UGI, and thereafter permanently insulate those funds from exposure by taking dividends from Atrium to PHH, the parent.

With regard to why UGI would have agreed to an amendment to its agreement to allow the $52 million dividend, Crawshaw "can think of no rational explanation for this behavior within the realm of insurance." *Id*. He states in his report: "If the arrangement reflected a real reinsurance service, I would have expected UGI to insist that Atrium add more capital, or at least resist any attempt to remove the small amount remaining." *Id*. It would make no sense for UGI to agree to an amendment that only benefited Atrium and harmed UGI. Indeed, Cascio believes that "AIG, the parent company of UGI, is a sophisticated entity with a reputation for not being taken advantage of in the market." **Cascio Rebuttal Rep.** at 14. But no witness called by Respondents attempted to explain what conceivable reinsurance benefits UGI obtained by allowing the dividend.

This is because the benefit to UGI was not reinsurance-related, but rather the ability to maintain or increase UGI's share of PHH's MI business on a prospective basis. The amendment and ensuing dividend were the direct result of the RFP, and they were a response to PHH's leverage arising from its ability to refer business to the MIs. In its cover letter to its response to the RFP, UGI informed PHH that "the intent of our response" is "to maintain market share." **ECX 0733** at CFPB-PHH-1368934. In that response, UGI explicitly committed to "work together with PHH to address any developing capital issues." *Id*. Shortly after receiving UGI's RFP response, Rosenthal suggested to Milliman that they "begin to work the current capital return / book commutation angle" with UGI. **ECX 0745** (11/6/2006 email) at 1. The amendment was executed and the dividend removed a few months later. The next year, UGI reminded PHH that "you got a very nice dividend check last year." **ECX 0378** (2/14/2008 email, Walker to Rosenthal).

In light of all of this evidence, it would require an extraordinary inference, supported by no evidence, to conclude that the $52 million dividend (as well as dividends of $11 million and $14 million taken in November 2006 and January 2007, respectively) had no effect whatsoever on PHH's allocation of business to UGI through any of the dialer settings in 2007, 2008 and 2009, which referred loans to UMI at business share percentages ranging between 30% and 100%. *See* **ECX 0654** at Ex. M. Those settings indisputably resulted in referrals of loans to UGI that closed after July 21, 2008. **ECX 0159**.

There is no basis to conclude that the causal connection between dividend payments and ongoing referrals to the MIs ceased on July 21, 2008. To the contrary, the evidence shows that payments from the trust accounts continued to influence referrals after July 21, 2008.

As discussed above, according to an internal PHH report, after a slowdown of referrals in early 2009 attributable in part to Genworth's poor financial condition, including a risk-to-capital ratio that was "Worst among active MIs," **ECX 0495** at 2, PHH substantially *increased* its referrals to Genworth in the second half of 2010 and through 2011, **ECX 0654** at Ex. M; **ECX 0159** at tabs "2010" and "2011," rows 18-30. This increase occurred very soon after Respondents were allowed to take a $5 million dividend payment from the Genworth trust account on June 9, 2010. **ECX 0258** at tab "Contributions and Withdrawals," cell D14.

The internal PHH report states that Genworth's "*premium pricing is not as competitive as other providers*" but that "*PHH allocates volume based on factors other than rate competitiveness today*." **ECX 0495** at 2 (emphasis added). The other factors that drove those referrals to Genworth (which closed on or after July 21, 2008) included, in significant part, the transfer of additional funds from Genworth to Respondents through dividend and commutation payments. The report identifies "Recent Key Successes / Milestones" in the relationship, the first of which is that "Genworth streamlines process for dividends from Captive Reinsurance Trust." *Id.* It also identifies "Current Initiatives / Opportunities" including Genworth's "active bid to commute active Atrium captive re-insurance underway with PHH." *Id*. Genworth streamlined the dividend process by agreeing to allow an $8.9 million payment from the trust account in the fourth quarter of 2011, even though, as discussed above, Genworth did not believe the dividend was permitted by its agreement with Atrium.

These payments to Genworth rendered any "reinsurance" service that Atrium purported to provide a farce. For example, the $5 million dividend that Atrium removed from the Genworth trust account in 2010 reversed almost all of Atrium's previous $5.5 million capital contribution, rendering it impossible for Atrium to suffer a significant loss of capital on the arrangement. **Crawshaw Rep.** at 45, Table 2, column E; *id.* at 49. The $8.9 million dividend that Atrium removed in 2011 was, according to Genworth, not allowed by their written agreement because it caused the trust account balance to fall below the minimum level required by the agreement. **ECX 0396** (discussed at Section III.A.3.a.ii, *supra*).[92] In fact, Milliman told PHH that its conclusion regarding risk transfer on the 2008.B book year was conditioned on Atrium not taking any dividend from the Genworth trust. **ECX 0194** (Milliman report for Genworth 2008.B. book year) at CFPB-PHH-00113122 ("However, we have not allowed future trust disbursements in our modeling of the trust (with the exception of the trust liquidation dividend), since allowing releases from the trust results in insufficient capital available to satisfy losses at the 10% probability level needed to pass the transfer of risk threshold."); **Hrg. Tr. 1990:25-1992:2** (6/3 Schmitz) (testifying that "no dividends would be permitted in our forecast" and that he "made clear to Atrium" that the book year would not transfer risk if dividends were taken).

The commutation of the arrangements also invalidated the claim of risk transfer that Atrium and the MIs used the justify accounting for their captive arrangements as reinsurance on their financial statements. Milliman determined that Atrium faced a 10% chance of incurring a 111% loss ratio for the 2008.B book year under the Genworth

[92] Even if this or other payments were not prohibited by the written agreement, they were impermissible under RESPA.

arrangement – in other words, that book year just barely passed the 10/10 test according to Milliman. **ECX 0194** at 11. But Milliman stated that its analysis of the 2008.B book year did "not take into account any possible commutation of insured books" and that it "is possible that a commutation could materially impact Milliman's opinions with regard to the transfer of risk and the compensation commensurate with the risk." *Id*. at 20. A commutation would reduce risk transfer. As UGI noted in its RFP submission to PHH: "Commutation of books of business before they reach peak claim years can reduce risk transfer below required levels." **ECX 0032** at 13. If the Genworth 2008.B book year barely passed the 10/10 test of risk transfer without accounting for a potential commutation, then it would certainly have failed that test had such a commutation been accounted for.[93]

Having accounted for Respondents' arrangements as reinsurance on their financial statements, UGI and Genworth should not have allowed Respondents to take payments from the trust accounts which eliminated any possibility of significant risk transfer even under the artificial single-book year approach they used to justify that accounting. That they did so without objection shows they never believed that justification. With any pretense of risk transfer stripped away, their real motivation is laid bare: refusing to allow dividend and commutation payments would jeopardize their ability to obtain referrals of business from PHH.

Based on the totality of evidence reflecting the course of dealing throughout the UGI and Genworth arrangements and the specific evidence discussed above, all of the

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[93] Dr. Crawshaw explains in his initial and rebuttal reports precisely how a commutation reduces risk transfer. **Crawshaw Rep.** at 21-26, 53-55, 57-59; **Crawshaw Rebuttal Rep.** at 73-81. The upshot is that Atrium eliminated any possibility of risk transfer, and through the commutation payments it obtained, locked in as profits premiums previously ceded.

payments taken by Respondents from the UGI and Genworth trust accounts after June 2001 (when the dialer was instituted) are “causally connected” to PHH’s referral of loans that closed after July 21, 2008, but Enforcement requests, at a minimum, that the Tribunal require Respondents to disgorge at least those payments taken in and after October 2006. This amount, shown in Table 4 below (rows shaded in gray), is $205,183,304.

Table 4

Date of Payment	**Type of Payment**	**Amount**
Dec. 2002	Payment from UGI Trust for taxes and expenses	$32,800,000[94]
Dec. 2003	Payment from UGI Trust for taxes and expenses	$10,500,000[95]
Dec. 2003	Payment from Genworth Trust for taxes and expenses	$3,503,182[96]
Feb. 2005	Payment from UGI Trust for taxes and expenses	$6,972,000[97]
Feb. 2005	Payment from Genworth Trust for taxes and expenses	$12,272,000[98]
Sept. 2005	Dividend from UGI Trust	$7,000,000[99]
Nov. 2005	Dividend from UGI Trust	$4,000,000[100]
Mar. 2006	Dividend from UGI Trust	$5,800,000[101]
Mar. 2006	Payment from Genworth Trust for taxes and expenses	$6,500,000[102]

94 **ECX 0198** at tab “Trust Deposits,” cell K69. As discussed below, a defendant subject to disgorgement of illegally obtains funds cannot obtain an offset for expenses associated with the illegal scheme or taxes. *See* Section III.C.3.c, *infra*.
95 **ECX 0198** at tab “Trust Deposits,” cell K81.
96 **ECX 0258** at tab “trust,” row 23.
97 **ECX 0198** at tab “Trust Deposits,” cell K95.
98 **ECX 0258** at tab “trust,” row 29.
99 **ECX 0198** at tab “Trust Deposits,” cell L102.
100 **ECX 0198** at tab “Trust Deposits,” cell L104.
101 **ECX 0198** at tab “Trust Deposits,” cell L108.
102 **ECX 0258** at tab “trust,” row 34.

Nov. 2006	Dividend from UGI Trust	$11,000,000[103]
Jan. 2007	Dividend from UGI Trust	$14,000,000[104]
Jan. 2007	Payment from Genworth Trust for taxes and expenses	$5,900,000[105]
Mar. 2007	Dividend from UGI Trust	$52,563,805[106]
Mar. 2009	Payment from Genworth Trust for taxes and expenses	$6,250,000[107]
June 2010	Dividend from Genworth Trust	$5,000,000[108]
Q4 2011	Dividend from Genworth Trust	$8,900,000[109]
May 2012	Dividend from UGI Trust	$6,800,000[110]
May 2012	Commutation Payment from Genworth Trust	$24,100,000[111]
Mar. 2013	Dividend from UGI Trust	$1,500,000[112]
June 2013	Commutation Payment from UGI Trust	$69,169,499[113]
	Total – Oct. 2006 to June 2013	**$205,183,304**
	Total – Dec. 2002 to June 2013	$294,530,486

[103] **ECX 0198** at tab "Trust Deposits," cell L116.
[104] **ECX 0198** at tab "Trust Deposits," cell L118.
[105] **ECX 0258** at tab "trust," row 39.
[106] **ECX 0198** at tab "Trust Deposits," cell L120.
[107] **ECX 0258** at tab "trust," row 48.
[108] **ECX 0258** at tab "trust," row 54.
[109] **ECX 0258** at tab "trust," row 62; **ECX 0653** (PHH NORA submission) at Ex. A to Ex. 1.
[110] **ECX 0198** at tab "Trust Deposits," cell L182.
[111] **ECX 0653** at Ex. A to Ex. C.
[112] **RCX 1058** (10/4/2013 UGI compliance report) at UGCFPB00001884, column "Excess Funds."
[113] **ECX 0653** at Ex. A to Ex. C.

As shown above, there is substantial evidence that the illegal purpose of Respondents' arrangements, as described in the Radian pitch, was, in fact, the purpose that motivated many of the specific payments listed in Table 4. And the evidence with respect to each of those specific payments, in turn, reinforces the conclusion that the arrangements as a whole had only one purpose – to transfer illegal kickback payments to Respondents. *See, e.g., Hill v. Evans*, No. CV 05-03861-JVS (CT), 2009 WL 2869922, at *12 (C. D. Cal. July 27, 2009) (holding that proof of a "common plan or scheme" can be proven by multiple specific acts that "demonstrate 'not merely a similarity in the results, but such a concurrence of common features that the various acts are naturally to be explained as caused by a general plan of which they are the individual manifestations'" (quoting 2 Wigmore, EVIDENCE, § 304, p. 249 (Chadbourn rev. ed.1979)); *People v. Fiore*, 312 N.E.2d 174, 178 (N.Y. 1974) (explaining that the existence of a "single scheme to take bribes" can be established by "evidence of a considerable number of bribes over an extended period of time from the same persons, involving the same gambling places").

Thus, although some of the other payments listed in Table 4 are not accompanied by similarly specific or explicit evidence, the Tribunal can consider evidence of the purpose of the arrangements as a whole as well as evidence of the purpose of similar payments to conclude that all payments Respondents took from the trust accounts were motivated by the same illegitimate purpose.[114] For example, in *U.S. v. Hendershot*, the court held that evidence relating to particular payments provided "strong circumstantial

[114] Requiring specific proof of that *each* payment listed in Table 4 was motivated by an illegal purpose is no more necessary than requiring such specific proof for each of the numerous premium payments underlying Enforcement first alternative measure of disgorgement damages.

evidence of the kickback scheme," and that the total amount of kickback payments collected by one of the defendants in an illegal scheme could be established even though the government did not present specific evidence "for every ... check." 150 F. Supp. 2d 965, 969, 972 (N.D. Ill. 2001). *See also, e.g.*, *Kurins v. Silverman*, No. 08 Civ. 6886(LTS)(GWG), 2009 WL 321011, at *4 (S.D.N.Y. Feb. 10, 2009) (finding that multiple payments obtained by the defendants were related because they were taken from "single escrow account in furtherance of Defendants' alleged scheme to funnel money out of Silverseal" and were "neither isolated nor sporadic"); *Sachs v. U.S.*, 281 F.2d 189, 191 (9th Cir. 1960) ("evidence of other transactions was material as tending to show that the relationship between Berson and Sachs involved a regular course of dealing and not an isolated transaction or two"); *U.S. v. Ojomo*, 332 F.3d 485, 489 (7th Cir. 2003) (evidence of "related conduct" that is "part of the same course of conduct, common scheme, or plan" is admissible in criminal sentencing); *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996) ("It was well within the discretion of the district court in the present case to reason that because the *purpose and effect of the scheme* was to manipulate and stabilize the prices of the Haas stocks, appellants *likely profited from the scheme in all of their trades* in those securities.") (emphasis added); *Michelson v. U.S.*, 335 U.S. 469, 475, n.8 (1948) (noting that "evidence as to other transactions or a course of fraudulent conduct" is admissible to establish intent).[115]

Indeed, the Tribunal may consider evidence relating to payments Respondents took from the trust account for one MI in evaluating the purpose of payments

[115] Rule 303(b)(4) provides: "Evidence that would be admissible under the Federal Rules of Evidence is admissible in a proceeding conducted pursuant to this part." 12 C.F.R. § 1081.303(b)(4). Under Federal Rule of Evidence 404(b)(2), evidence of "other acts" is admissible to prove "motive" or "intent."

Respondents took from the trust account of another MI, given the similarity among all of Respondents' arrangements. *See*, *e.g.*, *Karsun v. Kelley*, 482 P.2d 533, 539-540 (Or. 1971) (holding that evidence of conduct by the defendant vis-à-vis persons other than the plaintiff is admissible to establish that the defendant's conduct vis-à-vis the plaintiff violated the law, due to similarities in that conduct).

The evidence discussed throughout this brief establishes a clear course of conduct demonstrating that all payments Respondents took from the trust accounts were motivated by a common, illegal purpose, and Respondents failed to present any evidence to rebut that conclusion with respect to any of the payments listed in Table 4. Accordingly, if the Tribunal does not award disgorgement based on the first measure set forth above, it should award disgorgement of those payments from the trust accounts after October 2006 totaling $205,183,304.

2. For violating Section 8(b), Respondents should disgorge all premiums ceded to Atrium on loans that closed on or after July 21, 2008

For violating Section 8(b) of RESPA, Respondents should be required to disgorge all premiums split with Atrium on loans that closed on or after July 21, 2008. Because these premiums were ceded in violation of RESPA Section 8(b), Atrium was unjustly enriched by accepting those premiums.

The UGI 2009 book year covered loans that closed between March 1, 2009 and December 21, 2009. **RCX 0057** (UGI/Atrium agreement, Amendment # 9) at 1, ¶ 1**.** According to the most recent UGI cession statement dated September 2012, UGI ceded at least $2,029,793 of premiums under the 2009 book year through September 2012. **ECX 0198** at tab "Earned Premium," cell E58. UGI continued to cede premiums to Atrium from October 1, 2012 through at least June 2013, **RCX 1058** at CFPB-PHH-

01372470, but Respondents' records do not break out ceded premiums during those additional ninth months by book year, so Enforcement is unable to determine precisely the premiums ceded during the ninth-month period specifically for the 2009 book year. Because the $2,029,793 figure reflects ceded premiums over a 43-month period (March 1, 2009 through September 30, 2012), a reasonable estimate of the premiums ceded under the 2009 book year during the nine months from October 1, 2012 through June 2013 is $424,840.40 (=$2,029,793 times 9/43). Thus, a reasonable estimate of the total ceded premiums under the UGI 2009 book year is $2,454,633.40 (=$2,029,793 + $424,840.40).

The Genworth 2008.B. book year covered loans that closed from June 1, 2008 through March 31, 2009. **RCX 0051** at 2. The total ceded premiums for loans under the Genworth 2008.B book year was at least $5,523,827.97. **ECX 0257** at tab "Inception to Date," cell H109. Because the Genworth 2008.B book year includes loans that closed between June 1, 2008 and July 20, 2008 (outside the limitation period), the premiums ceded on loans that closed from July 21, 2008 through March 31, 2009 can be estimated by multiplying the $5,523,827.97 total by 80.0%,[116] which results in $4,419,062.38 of ceded premiums.

The Radian 2008 book year covered loans that closed from January 1, 2008 through December 31, 2008. **RCX 0040.** The total ceded premiums for loans under the Radian 2008 book year was at least $134,403.60. **ECX 0650** at tab "Cendant ETD," cell

[116] The 80.0% factor is the result of dividing 8 months by 10 months to account for the period from June through July 2008 (2 out of the 10 months covered by book year). *See F.T.C. v. Direct Marketing Concepts, Inc.*, 624 F.3d 1, 15 (1st Cir. 2010) ("Any fuzzy figures due to a defendant's uncertain bookkeeping cannot carry a defendant's burden to show inaccuracy."); *Calvo*, 378 F.3d at 1217-18 (allowing reasonable estimate "where a defendant's record-keeping or lack thereof has so obscured matters that calculating the exact amount of illicit gains cannot be accomplished").

J254. Because the 2008 book year includes loans that closed between January 1, 2008 and July 20, 2008 (outside the limitation period), the premiums ceded on loans that closed from July 21, 2008 through December 31, 2008 can be estimated by multiplying the $134,403.60 total by 41.7%,[117] which results in $56,001.50 of ceded premiums.

The CMG 2008 book year covered loans that closed from January 1, 2008 through December 31, 2008. **ECX 0618** at CFPB-PHH-00651631. The total ceded premiums for loans under the CMG 2008 book year was at least $226,672.26. *Id.* Because the 2008 book year includes loans that closed between January 1, 2008 and July 20, 2008 (outside the limitation period), the premiums ceded on loans that closed from July 21, 2008 through December 31, 2008 can be estimated by multiplying the $226,672.26 total by 41.7%,[118] which results in $94,446.78 of ceded premiums.

The total of the amounts indicated above is $7,024,144.06. This amount is subsumed within the disgorgement amount Enforcement requests as a remedy for Respondents' violation of Section 8(a). Therefore, if the Tribunal awards disgorgement of that amount for Respondents' violation of Section 8(a), it need not also award disgorgement of the $7,024,144.06 figure identified above. But if the Tribunal does not award the requested disgorgement amount for Respondents' violation of Section 8(a), it should award disgorgement of $7,024,144.06, which stands independently of the arguments supporting the Section 8(a) disgorgement figure.

[117] The 41.7% factor is the result of dividing 5 months by 12 months to account for the period from January through July 2008.
[118] The 41.7% factor is the result of dividing 5 months by 12 months to account for the period from January through July 2008.

3. Respondents are not entitled to any offsets to the disgorgement award

‘[T]he overwhelming weight of authority holds that ... violators may not offset their disgorgement liability with business expenses.” *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1087 (D.N.J. 1996) (citing cases). *See also SEC v. Amerindo Inv. Advisors Inc.*, No. 05 Civ. 5231(RJS), 2014 WL 2112032, at *5 (S.D.N.Y. May 6, 2014) (“In making the disgorgement calculation, the proper focus is revenues, not profits.”). In *FTC v. Bronson Partners, LLC*, the Second Circuit rejected the defendant’s argument that disgorgement should be based on profits, and held that “[a]lthough we sometimes refer casually to the power of district courts to require wrongdoers to disgorge fraudulently obtained *profits*, ... where the profits from fraud and the defendant’s ill-gotten gains diverge, the district court may award the larger sum.” 654 F.3d 359, 375 (2d Cir. 2011) (emphasis in original) (quotation omitted). The court explained: “[I]t is well established that defendants in a disgorgement action are not entitled to deduct costs associated with committing their illegal acts.” *Id.* at 374-75 (quotation omitted).

In cases where courts have considered offsets for certain types of expenses – for example, for expenses not associated with the illegal act – the burden was on the defendant to establish the offset, including entitlement to any such offset and quantification of the amount. *See, e.g.*, *SEC v. Zwick*, No. 03 Civ. 2742(JGK). 2007 WL 831812, at *23 (S.D.N.Y. Mar. 16, 2007) (“The defendant bears the burden of demonstrating that he is entitled to any offsets.”); *In re Outsidewall Tire Litig.*, 748 F. Supp. 2d 543, 551 (E.D. Va. 2010) (“[I]n proving the proper amount for disgorgement, plaintiffs were only required to establish defendants’ gross revenues from the infringing tires. Once this was done, the burden then shifted to defendants to show deductible expenses and profits attributable to factors other than infringement.").

Respondents are not entitled any offsets to the disgorgement award. The disgorgement award should be based on the proceeds Respondents obtained through their illegal scheme , which represent their ill-gotten gains. But even if the Tribunal were to measure disgorgement based on "profits," the expenses discussed below are not legitimate expenses properly deductible from the award.

a. Respondents are not entitled to an offset for claim payments or commutation payments

If the Tribunal awards disgorgement based on premiums ceded by the MIs – per the first alternative measure of disgorgement offered by Enforcement for Respondents' violation of Section 8(a) as well as the disgorgement calculation Enforcement offers for Respondents ' violation of Section 8(b) – it should not deduct claim payments or commutation payments made to the MIs for the following reasons.[119]

First, the Tribunal has held that Respondents may be entitled to an offset only in an amount equal to the market value of any services provided, which they have the burden to prove. May 22 Order at 7. The market value of a reinsurance arrangement is the price that would be paid in a fair and competitive market for the level of risk transferred under that arrangement. Because risk transfer is measured prospectively, the market value must also be measured prospectively. The market value cannot be measured by claim payments, because claim payments are retrospective amounts which

[119] Nor should payments to the MIs be deducted from a disgorgement award based on payments that Respondents took from the trust accounts (the second alternative disgorgement measure) because payments from the trust accounts were pocketed by Respondents and, by definition, not returned to the MIs. To avoid any doubt, however, all of the reasons stated in this subsection for why payments to the MIs should not be deducted apply to the second alternative measure.

could not have been known at the time a price would have been set in a fair and competitive market. Nor should commutation payments be deducted, because commutation payments were negotiated at the end of the arrangements and thus, necessarily reflected some historical information not available at the inception of the arrangement. As discussed above, because Respondents failed to prove the market value of any reinsurance services, the Tribunal should find that the premiums ceded to Respondents in their entirety were illegal kickback payments and, thus, they must be disgorged without any offset.

Second, the amount of disgorgement is properly measured by the illegal payments received by the wrongdoer. *See, e.g.*, *SEC v. Blavin*, 760 F.2d 706, 713 (6th Cir. 1985) (requiring defendant to "disgorge a sum of money equal to all the *illegal payments he received*") (emphasis added); *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir.1987) (same); *SEC v. Washington Cnty. Util. Dist*., 676 F.2d 218, 227 (6th Cir. 1982) ("[W]e conclude that the district court should order Patrick to disgorge a sum of money equal to the total value of all of the [kickback] *payments he received* from Alcock.") (emphasis added). Claim payments, like Respondents' other expenses, are "costs associated with committing their illegal acts," and thus they should not be deducted from the illegal payments received in determining the proper disgorgement amount. *Bronson Partners*, 654 F.3d at 375. *See, e.g.*, **RCX 0097** (8/31/2010 Atrium Unaudited Financial Statements) at CFPB-PHH-00098186 (listing various categories of Atrium's expenses, including "Paid Losses").

Third, although there should be no offset for claim payments regardless of whether they were funded by Atrium's capital contributions or ceded premiums, the vast majority of claim payments did nothing more than return ceded premiums, and courts have held that defendants are not entitled to an offset merely because they later returned some illegally-obtained funds. For example, in setting the disgorgement award in *SEC v. Levine*, the district court explain that it was "irrelevant that defendants purportedly paid back funds they received" and held that it would "not offset funds unjustly obtained merely because those funds were allegedly given back." 517 F. Supp. 2d 121, 139 (D.D.C. 2007). *See also SEC v. Whittemore*, 744 F. Supp. 2d 1, 8-9 (D.D.C 2010) (rejecting defendant's argument that he was entitled to an offset because "he retained none of the proceeds from the sale" on the grounds that an "order to disgorge establishes a personal liability, which the defendant must satisfy regardless [of] whether he retains the selfsame proceeds of his wrongdoing") (quotation omitted). Because commutation payments also returned ceded premiums back to the MI, they should not be deducted for the same reason.

The argument against applying an offset is particularly compelling where, as here, the illegally obtained funds were returned in order to sustain the illegal scheme itself. In *SEC v. Milan Capital Group, Inc.*, an action brought by the SEC against the perpetrators of a Ponzi scheme, the court awarded disgorgement of the full $8.3 million that the defendants "took in ... from investors over the course of the fraud," and refused to deduct $2.4 million of funds returned to investors. No. 00 Civ. 108(DLC), 2014 WL 2815590, at*6 (S.D.N.Y. June 23, 2014). Citing the rule propounded in *Bronson Partners* that "defendants in a disgorgement action are not entitled to deduct costs associated with committing their illegal acts," the court reasoned: "One of the costs associated with running a Ponzi scheme or similar frauds may be the return of some revenue to investors." *Id*. Likewise, one of the costs associated with running Respondents' illegal kickback scheme was the potential return of some illegally-obtained funds to the MIs in the form of claim payments. Accordingly, those costs should not be deducted.

Fourth, courts have held that when illegally-obtained funds are subsequently paid to co-conspirators in an illegal scheme, those payments cannot be offset against the disgorgement award. *See, e.g., SEC v. Benson*, 657 F. Supp. 1122, 1134 (S.D.N.Y. 1987) (funds illegally obtained by the defendant but subsequently spent "to keep his co-conspirators happy" should not be deducted from the disgorgement award); *SEC v. Rosenfeld*, No. 97CIV.1467WHPRLE, 2001 WL 118612, at *2 (S.D.N.Y. Jan. 9, 2001) ("payment to co-conspirators are not deductible" from ill-gotten gains subject to disgorgement). Because the MIs were co-participants in the illegal scheme, there can be no offset for any payments Atrium made to them.[120]

Fifth, in contrast to ceded premiums, which flowed automatically to Respondents pursuant to the terms of their illegal arrangements, which they controlled, the occurrence and magnitude of any claim payments (and commutation payments which

[120] Some courts have allowed offsets for amounts illegally obtained in violation of securities laws but subsequently returned to defrauded investors. In most of these cases, however, the offset was applied because the disgorgement award funded a distribution to victims, so failing to account for funds already returned to those investors would result in double-counting. *See, e.g., SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1475 (2d Cir.1996) (approving a district court's decision to credit defendants for money they had already paid to victims as part of a private settlement); *Amerindo Inv. Advisors*, 2014 WL 2112032, at *3, 5 (allowing deduction for "any money that a defendant returns or has returned to her or his victims" in case where receiver was appointed to distribute funds to investors); *SEC v. Evolution Capital Advisors, LLC*, 2013 WL 5670835 (S.D. Tex. Oct. 16, 2013) (allowing offset for "amounts collected by the receiver and returned to investors" where the receiver was appointed to make "final distribution to investors"); *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1111, n. 4, 1113 (9th Cir. 2006) (affirming disgorgement award equal to "entire proceeds from the scheme less amounts paid to investors" where receiver had been appointed to perform comprehensive accounting of investor funds). These cases do not support an offset here. Respondents returned funds to co-participants in the illegal scheme – the MIs – rather than to victims of the illegal kickback scheme – PHH borrowers.

reflected expected claim payments) were dependent on external market events. **RCX 0127** (Atrium's "Vermont Captive Business Plan") at CFPB-PHH-00123863 ("[T]he ultimate liability of claims is subject to the outcome of events yet to occur, e.g., interest rates, housing appreciation rates, and the general health of the economy."). Courts have recognized that, once a defendant has received ill-gotten gains in a transaction, the defendant bears the risk that subsequent market events might reduce or eliminate those gains or even result in a net loss to the defendant.

For example, in *SEC v. Shapiro*, an insider trading action in which the defendants purchased stock based on non-public information which was subsequently disclosed to the public on February 18, 1971, the Second Circuit affirmed the district court's award of disgorgement based on "paper profits" resulting from the increase in the stock price on February 18, 1971, even though the defendants held their stock after that date and, when they ultimately sold the stock, incurred a loss as a result of a decline in the stock's price. 494 F.2d 1301, 1304-05, 1309 (1974). The Second Circuit explained that defendants in insider trading cases obtain an illegal profit "[o]nce public disclosure is made" and that thereafter "*the violat[o]r should take the risks of the market himself*." *Id.* at 1309 (emphasis added). The court reasoned that to do otherwise would create bad incentives:

> [A] contrary holding would create a serious anomaly that might encourage insider trading. To require disgorgement only of actual profits in cases where the price of the stock subsequently fell would create a heads-I-win tails-you-lose opportunity for the violator: he could keep subsequent profits but not suffer subsequent losses. Such a rule would emasculate the deterrent effect of Rule 10b-5.
>
> [*Id.*]

See also SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 102 (2d. Cir. 1978) (holding that it is irrelevant to the disgorgement award that "losses after trading was resumed wiped out any profits").

Here, the transactions that resulted in the ill-gotten gains were the ceding of premiums from the MIs to Respondents. Thereafter, Respondents bore the risk that those gains might be diminished by claim payments resulting from subsequent market events. Allowing an offset for claim payments (or commutation payments which reflected expected claim payments) would eliminate the deterrent effect of any disgorgement award. *See, e.g., SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d. Cir. 1997) ("The primary purpose of disgorgement orders is to deter violations ... by depriving violators of their ill-gotten gains."). Because not all violations of Section 8 may be prosecuted, and any damages would be uncertain even after an action is brought, companies (including but not limited to PHH) who engage in such violations would only stand to profit from their wrongdoing, while any downside risk they would otherwise face from their illegal conduct would be eliminated by the offset. Such a result would effectively subsidize the illegal conduct.

b. Respondents are not entitled to an offset for capital contributions to the trust accounts

If the Tribunal awards disgorgement based on funds Respondents removed from the trust account – the second alternative measure of disgorgement under Section 8(a) offered by Enforcement – it should not deduct Respondents' capital contributions to the trust accounts for the following reasons.[121]

[121] Nor should capital contributions be deducted from a disgorgement award based on ceded premiums (the first alternative disgorgement measure) because capital contributions did not reduce the ill-gotten gains to Respondents from the ceding of

First, Respondents' capital contributions must not be deducted, because they are "costs associated with committing their illegal acts," *Bronson Partners*, 654 F.3d at 374-75. Respondents were required to contribute some capital as an investment to set up and maintain their illegal scheme. The law is clear that such expenses cannot be recovered by the perpetrator of the illegal scheme.

Second, the evidence of Respondents' capital contributions is not sufficiently reliable to meet their burden of proving entitlement to an offset. Under the UGI arrangement (and possibly other arrangements), Respondents were apparently allowed to provide "letters of credit" in lieu of cash or other assets. A UGI cession statement dated March 2006 states: "Credit allowed for initial capitalization of Atrium." **RCX 0860** (3/2006 UGI cession statement) at tab "Trust Requirement," line 27. Schmitz explained in a 1998 article on captive mortgage reinsurance arrangements: "Mortgage insurance is a capital-intensive business. However, a portion of the capital required of the reinsurer may be met through sources other than cash, such as a letter of credit." **ECX 0635** (2/1/1998 Schmitz article titled "Investigating captive mortgage reinsurance,") at CFPB-PHH-00611009. In light of the availability of this option, Respondents should have produced direct records, such as bank account statements or proof that funds were wired to the trust accounts, that could prove with reasonable certainty that Respondents actually made payments of cash (or some other asset of real value, such as securities) to the trust accounts, which could conceivably have resulted in a loss to Respondents. Without such direct records, it is cannot be determined with

premiums. Capital contributions are simply an additional source of funds deposited into the trust accounts; they did not alter the amounts ceded in any way. To avoid any doubt, however, all of the reasons stated in this subsection for why capital contributions should not be deducted apply equally to the first alternative measure.

reasonable certainty that no portion of Respondents' purported capital contributions was satisfied using a letter of credit.[122] Having failed to present such documents, which are within their possession, Respondents cannot now seek an offset for those purported contributions.

Third, under both the UGI and Genworth arrangements, by September 2006, Respondents had already recouped all of their purported capital contributions through prior withdrawals from the trust accounts. With respect to the UGI arrangement, by September 2006, Respondents had withdrawn $50.3 million for taxes and operating expenses and $19.1 million for dividends, which exceeded the $46.8 million of capital contributions purportedly made to that date. **ECX 0198** (9/30/2012 UGI cession statement) at tab "Trust Deposits," columns F and K. With respect to the Genworth arrangement, by September 2006, Respondents had withdrawn $22.3 million for taxes and operating expenses, which exceeded the $5.5 million of capital contributions purportedly made to that date.[123] **ECX 0258** (3/31/2012 Genworth cession statement) at tab "trust," column N. Because Respondents had already recouped all of their purported capital contributions before they took any of the payments from the trust accounts indicated in Table 4, they would be unjustly enriched if they were given credit for those contributions through an offset.

[122] For example, in its response to the RFP, RMIC offered to ease the "capital burden" of its proposed captive arrangement on Atrium by accepting "a letter of credit in lieu of cash or securities." **ECX 0030** (10/2006 RMIC Proposal) at CFPB-PHH-00141262. It is possible that UGI, Genworth, Radian or CMG offered the same option to Respondents.

[123] As discussed below, taxes and operating expenses cannot be considered in determining whether a payment from the trust accounts unjustly enriched Respondents. *See* § III.C.3.b, *infra*.

Fourth, once a defendant has received ill-gotten gains in a transaction, courts have refused to apply an offset for subsequent market losses even in cases where the defendant ultimately lost some of his own money invested in the scheme. For example, in *SEC v. Seghers*, the district court denied the SEC's disgorgement request on the basis that the defendant "had lost over $900,000 of his own money along with the investors and was therefore not unjustly enriched by any ill-gotten gains." 298 Fed. App'x 319, 323 (5th Cir. 2008). The Fifth Circuit reversed, holding "that the district court erred in finding that [the defendant] was not unjustly enriched merely because he lost money" in the illegal scheme. *Id.* at 336. *See also SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1192, n.6 (9th Cir. 1998) (affirming district court's refusal to reduce disgorgement award merely because the illegal "scheme ultimately failed and [the defendant] lost [] $1,000,000 of his own funds"). Accordingly, Respondents are not entitled to an offset for any capital contributions it lost, or could have lost, under their captive arrangements.

c. *Respondents are not entitled to an offset for tax payments*

Respondents should not be allowed to deduct tax payments from the disgorgement award. *See, e.g.*, *SEC v. U.S. Pension Trust Corp.*, 444 Fed. Appx. 435, 436 (11th Cir. 2011) ("We know of no authority, and the Individual Defendants cite none, requiring the court to deduct from the disgorgement figure the amount of ill-gotten gains paid to the government in income tax."); *SEC v. Razmilovic*, 822 F.Supp.2d 234, 277 (E.D.N.Y. 2011) (refusing to offset disgorgement amount for paid income taxes and finding "no legal authority to support a deduction for taxes paid upon ill-gotten gains"), *aff'd in relevant part, vacated in part, remanded*, 738 F.3d 14 (2d Cir.2013);

SEC v. Orr, No. 11–2251–SAC, 2012 WL 1327786, at *8 (D. Kan. Apr. 17, 2012) ("That the defendants used some or all of the proceeds to pay business taxes or other business expenses does not make them deductible from their gross ill-gotten gains subject to disgorgement.").

4. Respondents should be required to pay pre-judgment interest on any disgorgement award

The Tribunal should use its discretion to include pre-judgment interest on any disgorgement award. The decision to award pre-judgment interest "rests very much in the discretion of the tribunal which has to pass upon the subject ...." *City of Milwaukee v. Cement Div., Nat. Gypsum Co.*, 515 U.S. 189, 196 (1995) (quotation omitted). *See also Myron v. Chicoine*, 678 F.2d 727, 734 (7th Cir. 1982) ("[T]he decision to award prejudgment interest rests in the sound discretion of the adjudicatory tribunal.").

Requiring Respondents to pay pre-judgment interest is necessary to prevent unjust enrichment. As the court explained in *SEC v. Moran*: "Requiring payment of interest prevents a defendant from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity." 944 F. Supp. 286, 295 (S.D.N.Y. 1996). *See also SEC v. Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587, 612 (S.D.N.Y. 1993) ("The award of prejudgment interest, like an award of disgorgement, deprives the [defendants] of their ill-gotten gains and prevents unjust enrichment."). Allowing Respondents to avoid prejudgment interest will undermine the deterrent effect of any disgorgement award. *See, e.g., SEC v. Shehyn*, No. 04 CV 2003(LAP), 2010 WL 3290977, at *7 (S.D.N.Y. Aug. 9, 2010) ("Prejudgment interest serves the important purpose of deterrence, which is central to securities law."); *Williamson v. Handy Button Mach. Co.*, 817 F.2d 1290, 1297 (7th Cir. 1987) (in action for violation of federal antidiscrimination laws, prejudgment interest was "necessary to carry out the federal policies of compensation and deterrence"). To effectuate the policy of deterrence, courts routinely include prejudgment interest as part of disgorgement awards in SEC enforcement actions. *See, e.g., SEC v. Merchant Capital, LLC*, 486 Fed. Appx. 93, 97 (11th Cir. 2012) (affirming award of prejudgment interest on disgorgement amount because "[w]ithout prejudgment interest, the [defendants] would have benefitted from what in effect amounted to interest-free loans of the ill-gotten funds"); *SEC v. Brown*, 658 F.3d 858, 860 (8th Cir. 2011) (affirming award of prejudgment interest on disgorgement amount as "appropriate to discourage future violations of securities laws and to make the investors whole").

There is no basis for a different result here. In *Kansas v. Colorado*, a Special Master for the Supreme Court surveyed cases on the issue of prejudgment interest and held: "[L]ooking to the law generally ... the cases favor the inclusion of prejudgment interest as a component of damages, unless circumstances justify otherwise." No. 105, 2000 WL 34508307, at *41 (2000). No circumstances justify a departure from the majority of cases allowing pre-judgment interest. Rather, the facts here provide additional support for an award of pre-judgment interest because Respondents could, and did, invest the "interest free loan" – that is, the proceeds of their illegal scheme, including both premiums within the trust accounts and funds removed from the trust accounts – in assets that grew over time.[124] For example, Atrium made over $6 million

[124] For example, the Trust Agreement between UGI and Atrium provided that "[a]ssets deposited in the Trust Account by Grantor and investments and reinvestments thereof shall consist only of currency of the United States, certificates of deposit issued by a United States bank and payable in currency of the United States and government obligations, corporate obligations, preferred or guaranteed stocks, common stock and other assets or investments of the types listed by the .Securities Valuation Office of the

of investment income in 2008. **Crawshaw Rebuttal Rep.** Ex. 61 (Atrium Financial Statement for Years Ended Dec. 31, 2008 and 2007).

Pre-judgment interest may be awarded even though neither RESPA nor the Consumer Financial Protection Act explicitly provides for pre-judgment interest. In *Monessen Southwestern Railway Co. v. Morgan*, the Supreme Court held that pre-judgment interest was appropriate under the Federal Employers' Liability Act even though the statute "does not specifically state that 'damages' includes interest" because "Congress' silence as to the availability of interest on an obligation created by federal law does not, without more, manifest an unequivocal congressional purpose that the obligation shall not bear interest." 486 U.S. 330, 336-37, 344 (1988) (quotation/alteration omitted). *See, e.g., Waterview Mgmt. Co. v. F.D.I.C.*, 257 F. Supp. 2d 31, 35-36 (D.D.C. 2003) (Pre-judgment interest "is routinely awarded" even "when a statute is silent on the matter.") (citation omitted). Courts have awarded compounded pre-judgment interest in RESPA actions. *See, e.g., Fournigault v. Independence One Mortg. Corp.*, 242 F.R.D. 486, 488 (N.D. Ill. 2007).

Enforcement has calculated pre-judgment interest for both measures of disgorgement for Respondents' violations of RESPA Section 8(a), as well as for the proposed disgorgement award for their violations of RESPA Section 8(b). These calculations are contained in a file attached to this brief as Exhibit A. The amounts are shown in Table 5, below.

National Association of Insurance Commissioners and qualified as admitted assets and also permitted under the provisions of North Carolina Insurance Law ...." **ECX 0122** (1/15/1998 Atrium-UGI Trust Agreement) at CFPB-PHH-01142045, § 2.3.

Table 5

	Disgorgement Calculation	**Pre-judgment Interest Calculation**
RESPA Section 8(a): First Measure of Disgorgement	$187,385,428.85	$34,244,282.69
RESPA Section 8(a): First Measure of Disgorgement	$205,183,304.00	$34,441,725.30
RESPA Section 8(b)	$7,024,144.06[125]	$826,734.77

A tribunal has discretion over the calculation of pre-judgment interest, including the rate used in the calculation. *See, e.g.*, *Caldwell v. Life Ins. Co. of North Am.*, 287 F.3d 1276, 1287 (10th Cir. 2002) ("Many circuits have held that ... the calculation rests firmly within the sound discretion of the trial court."); *Taxman v. Board of Educ. of Tp. of Piscataway*, 91 F.3d 1547, 1566 (3d. Cir. 1996) (rate used in calculation of pre-judgment interest is within trial court's discretion). In SEC enforcement actions, the rate typically used to calculate pre-judgment interest is the rate provided under 26 U.S.C. § 6621(a)(2), commonly referred to as "the IRS underpayment rate." *SEC v. Abernathy*, No. 1:11–cv–00580, 2012 WL 7679270, at *5 (W.D. Mich. Nov. 30, 2012) ("Courts have approved the use of the IRS underpayment rate to calculate prejudgment interest in connection with disgorgement in cases brought by the Commission"). This rate "reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from" violating the law. *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1476 (2d Cir. 1996). The rate "is

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[125] As explained above, because the disgorgement amount requested for Respondents' violation of Section 8(b) is subsumed within the disgorgement amount requested for Respondents' violation of Section 8(a), if the Tribunal awards the latter, it need not also award disgorgement the former. The same is true with respect to the pre-judgment interest amounts in Table 5 above.

established quarterly by the Internal Revenue Service." *Drexel Burnham Lambert*, 837 F. Supp. at 612, n.8.

The IRS underpayment rate is also commonly used to calculate pre-judgment interest in many other types of actions, including actions brought by the Commodity Futures Trading Commission (CFTC). *See, e.g.*, *Fraserside IP L.L.C. v. Faragalla*, No. C11–3032–MWB, 2012 WL 453237, at *9 (N.D. Iowa Feb. 13, 2012) (awarding pre-judgment interest for violation of the Lanham Act based on IRS underpayment rate); *Commodity Futures Trading Comm'n v. Angus Jackson, Inc.*, 2013 WL 320185, at *11, 15 (S.D. Fla. Jan. 28, 2013) (awarding pre-judgment interest based on IRS underpayment rate and noting that "[a]wards of prejudgment interest are commonly based on the IRS underpayment rate, as defined in 26 U.S.C. § 6621(a)(2)"); *Commodity Futures Trading Comm'n v. Palmer*, Civ. Action No. CV–09–76–EEJL, 2010 WL 4027792, at *6 (D. Idaho Oct. 4, 2010) (calculating pre-judgment interest based on IRS underpayment rate).

Enforcement uses the IRS underpayment rate in its calculations because the same policy of deterrence underlying disgorgement awards in SEC and CFTC enforcement actions must be given full effect against Respondents.[126] A lower rate, such as the rate for treasury bills, would not be sufficient. *See First Jersey Secs.*, 101 F.3d at 1476 (rejecting use of treasury-bill rate of interest because that "is the rate at which one lends money to the government rather than borrows money from it" and that such an "advantageous rate would seem highly inappropriate in the circumstances here, where defendants have had the use of the money.").

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[126] The IRS underpayment rate under 26 U.S.C. § 6621(a)(2) is available at http://www.dol.gov/ebsa/calculator/interestratetables.html.

The IRS underpayment rate should be applied over "the entire period from the time of defendants' unlawful gains to the entry of judgment." *First Jersey Secs.*, 101 F.3d at 1477. The rate should be compounded quarterly. *See, e.g.*, *SEC v. Wilde*, No. SACV 11–0315 DOC(AJWx), 2012 WL 6621747, at *15 (C.D. Cal. Dec. 17, 2012) ("In determining the amount of prejudgment interest, courts may use the IRS underpayment rate, as calculated in 26 U.S.C. § 6621(a)(2), and interest should be compounded quarterly.").[127] Enforcement's calculations reflect these principles.[128]

Enforcement's pre-judgment interest calculations are conservative in two respects. First, the pre-judgment interest calculations for Respondents' Section 8(a) violations assume that the illegal payments were accepted on the first day of the following quarter, rather than the quarter in which the payment was actually made. Thus, for example, if premiums were ceded by UGI in November 2010, the calculation assumes that those premiums were ceded on January 1, 2011. This reduces the time period over which the rate is applied to each illegally obtained payment.

Second, because the disgorgement amount requested for Respondents' Section 8(b) violations was calculated using *total* ceded premium figures for particular book years, and Respondents' records do not indicate *when* premiums for specific book years were ceded, Enforcement took the total ceded premiums estimated above and divided

[127] In *Price v. Stevedoring Services of America, Inc.*, the Ninth Circuit explained that a "movement in the case law away from the 'American rule' against compounding pre-judgment interest reflects a growing consensus that the attitudes underlying the common law presumption are being displaced by the modern recognition that compound interest fosters fairness and efficiency." 697 F.3d 820, 841, n.15, 842 (9th Cir. 2012) (citing cases). The Ninth Circuit noted that modern commentary recognizes that simple interest "underdeters the defendant." *Id.* at 842 (citing Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 Tex. L. Rev. 293, 308 (1996)).

[128] If the Tribunal awards disgorgement in an amount different from what Enforcement requests or disagrees with any aspect of Enforcement's calculation, Enforcement respectfully requests an opportunity to submit a revised calculation.

them evenly across all quarters over the entire period during which the ceding occurred. For example, the estimated total premiums ceded by UGI on loans closed on or after July 21, 2008 is $2,454,633.40. *See* § III.C.1.b, *supra*. This estimated amount was ceded over a period of 18 quarters, from March 2009 through June 2013, inclusive. Thus, the calculation assumes that $136,368.52 of premiums was ceded in each quarter during that period. This is conservative because ceding under a particular book year declines over time, as loans are pre-paid or go into default.

5. Injunctive relief is warranted to ensure that Respondents allocate MI business in compliance with Section 8 of RESPA

The Bureau has authority to "grant any appropriate legal and equitable relief," including, among other forms of equitable relief, "limits on the activities or functions" of Respondents. 12 U.S.C. § 5565; *see* May 22 Order at 7. Injunctive relief against Respondents is warranted to ensure that Respondents do not violate Section 8 of RESPA with respect to allocating mortgage insurance business in the future.

Respondents' illegal captive scheme continued uninterrupted from November 1995, until May 2013, through up markets and down, through the mortgage crisis beginning in 2007 and the broad financial crisis beginning the next year,[129] and for years afterward. It comprised mortgages originated as early as 1993. **ECX 0709** (UGI/Atrium agreement 3-44) at 4-5. The captive scheme was born of the powerful leverage exercised by PHH as a very large mortgage lender over the MIs, and the payments it was able to demand as a result. *See* § III.A, *supra*. Today, nothing in the market has changed to reduce that leverage or the incentives on PHH to demand payments for referrals. Although some MI companies are under order not to enter into

[129] *See generally* **ECX 0683** (St. Louis Federal Reserve, "The Financial Crisis: A Timeline"); May 22 Order at 23, ¶ 10.

new captive arrangements before 2023, several other recent entrants are not, *see, e.g.*, **Hrg. Tr. 326:22-25** (3/25 Culver) (NMI, Essent, and Arch are among MGIC's competitors), and still other entrants could emerge. Indeed, Essent has already become a major provider for PHH. **ECX 0654** at Ex. M (Essent dialer setting between 15% and 45% in 2012 and 2013). Thus, PHH could enter into multiple new captive schemes at any time. Moreover, PHH's leverage over the MIs can be wielded in many ways, not just through captive schemes.

Therefore, in addition to the order for disgorgement described above, Enforcement respectfully requests that the Bureau issue an injunction with the following non-money provisions:

1) that Respondents, and any entity controlled by Respondents, be barred from engaging in the business of providing captive reinsurance;

2) that Respondents be barred from entering into any business arrangement with any mortgage insurance company for any purpose other than the procuring of mortgage insurance by Respondents on mortgages they have originated or purchased (including arrangements that are necessary and appropriate to support the procurement of mortgage insurance by Respondents, subject to Enforcement's prior approval);

3) that within 30 days of the order, Respondents disclose to Enforcement all services provided to any of them by any mortgage insurance company since January 1, 2004;

4) that Respondents be barred from violating Section 8 of RESPA; and

5) that other appropriate compliance reporting and monitoring requirements be imposed.

Where a violator carried out its illegal scheme uninterruptedly for eighteen years, ended it only one year ago, continues to protest that the scheme was legal, and has both the means and the incentives to pursue similar schemes again, an injunction is justified. It is plainly within the Bureau's authority to issue such an injunction, and on these facts, it must do so to ensure that the law is followed. 12 U.S.C. § 5565(a).

Enforcement has previously detailed the conclusive authority supporting an injunction even where violative behavior has ceased, and reincorporates that argument by reference here.[130] As this Tribunal has noted, "[a]ctual ongoing illegality is not required; an injunction may be justified even where there is only 'some cognizable danger of recurrent violation.'" May 22 Order at 8 (quoting *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953)). Briefly, this is plainly not a case where it is "*absolutely* clear that [Respondents'] ... wrongful behavior could not reasonably be expected to recur," *Adarand Constructors, Inc. v. Slater*, 528 U.S. 216, 222 (2000) (emphasis in original), and Respondents cannot meet the "stringent" standard for showing that injunctive relief would be moot, and is therefore unavailable, *Friends of the Earth, Inc. v. Laidlaw Environmental Servs. (TOC), Inc.*, 528 U.S. 167, 189 (2000).

Respondents should be banned from participating in captive arrangements. They developed their captive referral scheme in 1995 and used it to violate RESPA for nearly two decades. The abundant evidence adduced at hearing shows they have never used Atrium for a legitimate purpose, and there is no reason to expect they will do so in the future.

Moreover, to the extent the relief sought here goes beyond prohibiting strictly captive-related behavior, it is likewise necessary. The Supreme Court held long ago that a federal agency must sometimes impose "fencing-in" relief in order to carry out its statutory law enforcement mission, noting that the agency

> is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past. If the [agency] is to attain the objectives Congress envisioned, it cannot be required to confine its road block to the narrow

[130] Enforcement Counsel's Opposition to Respondents' Renewed Motion to Dismiss, Document # 123, at 22-26. *See also* May 22 Order at 7-8.

> lane the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity.
>
> [*FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952).]

See also FTC v. Nat'l. Lead Co., 352 U.S. 419, 431 (1957) ("...[R]espondents must remember that those caught violating the [FTC] Act must expect some fencing in."); *KPMG, LLP v. S.E.C.*, 289 F.3d 109, 123-24 (D. C. Cir. 2002) (there is no "requirement on the part of the [S.E.C.] to tailor its order more narrowly to specific types of violations of the provision involved") (citing *Ruberoid*, 343 U.S. at 473).

Here, the evidence demonstrates powerfully that PHH and its affiliates can – and are reasonably likely to – enter into business arrangements in the future with MI companies in order, yet again, to leverage their control over the MIs' business for their own gain. If captive arrangements are not available for the purpose, another means will present itself. The proposed order is necessary because it would take away such means for violating RESPA, and so "close all roads" to the prohibited goal. *See Ruberoid*, 343 U.S. at 473.[131]

6. Civil money penalties should be awarded against Respondents

a. Civil money penalties apply to Respondents' acts and omissions occurring on or after July 21, 2011 that continued their violations of RESPA

A central purpose of the CFPA is to strengthen the enforcement of Federal consumer financial law. One way in which Congress effectuated this goal was by adding civil money penalties for violations pursued by the Bureau. Section 1055 provides that "[a]ny person that violates, through *any act or omission*, any provision of Federal

[131] Enforcement intends to submit a proposed order reflecting the relief requested herein.

consumer financial law shall forfeit and pay a civil penalty pursuant to this subsection." 12 U.S.C. § 5565(c)(1) (emphasis added). Penalties apply "for each day during which *such violation … continues*." *Id.* at (c)(2)(A-C) (emphasis added). The CFPA governs remedies for all conduct occurring on or after July 21, 2011, the effective date of the statute. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 245 (1994) (as a general principle, "a court must apply the law in effect at the time it renders its decision") (citations omitted).

On or after July 21, 2011, Respondents engaged in numerous acts and omissions that continued their violations of RESPA with respect to referred loans that closed on or after July 21, 2008. First, it is undisputed that UGI and Genworth continued to cede captive reinsurance payments to Respondents on or after July 21, 2011, including ceding on the approximately 5,497 captive loans referred to UGI, Genworth, Radian and CMG that closed on or after July 21, 2008. **ECX 0159**; **EC Demonstrative Ex. 1**. For example, the evidence of ceding on UGI book year 2009 and Genworth book year 2008.B, both of which consisted entirely or primarily of referred loans that closed on or after July 21, 2008 shows:

- For the UGI 2009 book year, UGI ceded $1,646,000 of premiums as of December 31, 2011 and $2,250,000 of premiums as of March 31, 2013. *Compare* **RCX 0007** at 14, column "Written as of 12/31/11," row "2009") *with* **ECX 0839** at 14 (column "Written as of 3/31/13," row "2009"). The difference – $604,000 – reflects some of the premiums ceded on the UGI 2009 book year after the CFPB's transfer date (July 21, 2011).

- For the Genworth 2008.B book year, Genworth ceded $5,263,000 of premiums as of December 31, 2011 and $5,541,000 of premiums as of March 31, 2012. *Compare* **RCX 0007** at 14 (column "Written as of 12/31/11," row "2008.1") *with* **RCX 2004** at pdf page 408 (column "Written as of 03/31/12," row "2008.1"). The difference – $278,000 – reflects some of the premiums ceded on the Genworth 2008.B book year after the transfer date.

- The UGI agreement expressly provided for a ten-year duration of coverage for loans in the captive. **ECX 0584** at 5, § 2.1. Walker testified that ceding under UGI's captive agreements lasted "for ten years." **Hrg. Tr. 2228:18-29:2** (6/3). This means that UGI continued to cede on the 2009 book year well past the transfer date.

Respondents continued to receive these ceding payments as a "thing of value" and "percentage[s] of . . . charge[s] made" in violation of RESPA on a regular basis on or after July 21, 2011.

In addition, Respondents accepted, on and after July 21, 2011, substantial ceded premiums on loans from book years other than the UGI 2009 book year and Genworth 2008.B book year. As discussed above, the evidence shows that UGI and Genworth had to continue to cede premiums on *all* loans in their captive arrangements in order to continue to qualify for ongoing and future referrals of business from PHH. *See* § III.A, *supra*. Because this requirement persisted until the arrangements were terminated, and UGI and Genworth did continue to cede premiums through the life of their arrangements, Respondents' acceptance of ceded premiums after July 21, 2011 continued their violations of RESPA Section 8(a) with respect to referred loans that closed on or after July 21, 2011 (which by definition also closed on or after July 8, 2011).

Second, Respondents removed dividend payments from the UGI and Genworth trust accounts after July 21, 2011, which were additional things of value accepted by Respondents pursuant to the ongoing *quid pro quo* exchange for referrals of MI business. PHH extracted an $8.9 million dividend from the Genworth trust in the fourth quarter of 2011, and dividends from the UGI trust of $6.8 million and $1.5 million in May 2012 and March 2013, respectively. *See* § III.A.3.a.ii., *supra*. Although the dividend payments were not rational from an insurance perspective, the MIs acquiesced to them to provide additional things of value to Respondents, both in consideration of past referrals but also because doing so was necessary to maintain their referral relationship with PHH, which continued to generate business for the MIs on an ongoing basis through the dialer and or preferred provider list. *See Toldy v. Fifth Third Mortgage Co., et al.*, 721 F.Supp.2d 696, 703-04 (N.D. Ohio 2010) (holding that the payment of dividends is a "thing of value" that may itself violate RESPA).

Third, in 2012, Respondents removed a $24.1 million commutation payment from the Genworth trust account, and in 2013, Respondents removed a $69.2 million commutation payment from the UGI trust account. *See* § II.A, B, *supra*. Even though the commutation payments negated Respondents' purported claim of risk transfer, they were allowed because the actual purpose of the scheme was to transfer funds to Respondents in exchange for referrals. Like the dividend payments, each of the commutation payments was an act that, for purposes of the civil money penalties provision, continued Respondents' violations of RESPA with respect to illegally referred loans that closed on or after July 21, 2008. *See* § III.A.3, *supra*.

The dividend and commutation payments were directly connected to illegally referred loans that closed on or after July 21, 2008 in another important way – they were funded in part by premiums ceded on those loans, including loans in the UGI 2009 book year and the Genworth 2008.B book year, which were previously deposited in the trust accounts. In addition, the commutation payments to Respondents incorporated the present value of premiums expected to be ceded in the future on loans that closed on or after July 21, 2008, including loans in the UGI 2009 book year and the Genworth 2008.B book year. In a 2009 email, Rosenthal described a commutation payment as a payment that would cause PHH to "receive the calculated present value of future losses & *future premiums*." **ECX 0442** (2/26/2009 email, Rosenthal to Danahy et al.)

(emphasis added). Respondents cannot deny that the commutation payments Respondents took from the UGI and Genworth trust accounts included the present value of premiums expected to be ceded under the UGI 2009 book year and the Genworth 2008.B book year. *See* **ECX 0412** (12/6/2011 email, Rosenthal to Erdmann et al.) (attaching Genworth commutation bid spreadsheet); **ECX 0414** (Genworth commutation bid spreadsheet) (cell D42 shows projected ultimate ceded premiums under Genworth 2008.B book year totaling $10,174,000); **ECX 0839** at 14 (projected ultimate premiums ceded under UGI 2009 book year exceeds premiums already ceded under that book year). While the ceding of premiums under those book years violated RESPA, the dividend and commutation payments were additional acts that consummated those violations by inexorably transferring the funds to Respondents.

Though the Tribunal has applied the ruling in *Snow* in this proceeding to determine the date that a violation "accrues" for purposes of the statute of limitations, the *Snow* does not dictate the application of civil money penalties to those violations.

First, as the Tribunal has stated, even if, per *Snow*, the statute of limitations begins to run at the time of a referred loan closed, "RESPA is what the Supreme Court has called an 'odd' statute – one where the cause of action can accrue at one time for limitations purposes, and at another time for purposes of bringing suit." May 22 Order at 12. Regardless of whether *Snow* makes any sense for purposes of determining when a violation accrues for purposes of the statute of limitations, the Tribunal has made clear that for purposes of bringing suit under RESPA Section 8, a violation occurs when the payment is given or accepted:

> In particular, as alleged in this case, no violation could have occurred until an MI paid its first ceded premium to Atrium, which may not have happened until months after loan closing. *Bay Area*

> *Laundry and Dry Cleaning Pension Fund v. Ferbar Corp. of California*, 522 U.S. 192, 201 (1997) (a cause of action does not become complete and present until the plaintiff can file suit and obtain relief). This is because Enforcement's claim could not have accrued until an MI "gave," and Atrium "accepted," a ceded premium; prior to that moment, Respondents would not have committed a violation, even if they had a captive agreement obliging Atrium to accept ceded premiums.
>
> [*Id.* at 11.]

Thus, the "violation" in a RESPA 8(a) claim does not begin and end with the origination of a loan. For illegally referred loans that closed within the limitations period, a violation for purposes of determining liability under Section 8(a) occurs when a "thing of value" is given or accepted in exchange for those referrals, 12 U.S.C. § 2607(a), and a violation for purposes of determining liability under RESPA Section 8(b) occurs every time a borrower's payment on such a loan is "split" with a third party who does not earn that fee by providing a settlement service, *id.* § 2607(b).[132] These violations can occur at any time. As the *Snow* court itself recognized, a "thing of value" may be given or received pursuant to an agreement to refer at various moments in time.[133] Thus, regardless of whether such ceding payments trigger the statute of limitations as a separate claim, they are an indispensable element of the violation and

[132] Both sections of RESPA begin with identical language: "No person shall give and no person shall accept any" payment in violation of the law. *Compare id.* ("no person shall accept any portion, split, or percentage . . .") *with* § 2607(a) ("no person shall accept any fee, kickback, or thing of value . . .").

[133] The *Snow* court itself held that "[t]he phrase 'date of the occurrence of the violation' refers to the closing, i.e., when the plaintiffs paid for the insurance, because that is when the agents earned the allegedly prohibited 'thing of value.'" *Snow v. First Amer. Title Ins. Co.*, 332 F.3d 356, 359 (5th Cir. 2003). It continued, in footnote 3, "We use 'closing' interchangeably with the date of plaintiffs' payment for the title insurance, because they are identical in this case, as they are in most real estate transactions. We recognize, however, the possibility that purchasers could pay for a settlement service subject to § 2607(a)-(b) at a time other than the closing, in which case 'the date of the occurrence of the violation' presumably would be the date of payment, not the unrelated closing." *Id.*, n. 3.

plainly constitute an "act" "that violates" RESPA. 12 U.S.C. § 5565(c)(1); 12 U.S.C. § 2607(a)-(b) (making clear that a violation encompasses "any" "fee, kickback, thing of value," "portion, split, or percentage" accepted by a culpable party).

Second, the plain language of the CFPA's penalty provisions expressly attaches penalties to the continuation of a violation. The penalty provisions of the CFPA apply to "[a]ny person that *violates, through any act or omission*, any provision of Federal consumer financial law . . . . for each day during which *such violation . . . continues*." 12 U.S.C. § 5565(c)(1), (c)(2)(A-C) (emphases added). Section 1055 carefully and purposefully states that, for the purposes of assessing civil money penalties, violations of Federal consumer financial law may occur through "any act or omission" of a party. *Id*. at (c)(1) (emphasis added). This provision applies irrespective of how the underlying Federal consumer financial law (such as RESPA) may dictate the accrual of a claim. To find that a party can only be assessed civil money penalties for "acts" done at the closing of a loan, for example, would be directly inconsistent with the purposefully-broad phrase "any act or omission," and the statute's explicit directive to apply penalties "for each day during which such violation . . . continues." 12 U.S.C. § 5565(c)(1-2). Section 1055 explicitly directs the Bureau to impose penalties "for each day during which such violation . . . continues" across the board, irrespective of whether the continuing violations doctrine may be applied in any given case or under any particular enumerated statute enforced by the Bureau, for purposes of determining whether a claim is timely asserted. *Id*. at (c)(2)(A-C). *See also Interamericas Investments, Ltd. v. Bd. of Governors of the Fed. Reserve Sys.*, 111 F.3d 376, 382 (5th Cir. 1997) (holding that civil penalty provision that "contemplates per diem penalties" serves to recognize "continuing violations").

Further, the language of the CFPA speaks in the active, present tense. For example, second-tier penalties apply when a person "recklessly engages in a violation" – present-tense language which recognizes active and ongoing participation in a violation. 12 U.S.C. § 5565(c)(2)(B); *Interamericas*, 111 F.3d at 382 (citing language that "uses the present tense ['any company which violates'] in describing the offenses [made] reasonable reading [the statute] as contemplating continuing violations"). This language cannot sensibly be confined to the initiation of a violation alone. The CFPA's penalty provisions unambiguously and intentionally overlay additional consequences for acts in continuation of a violation of any and all Federal consumer financial laws. *Snow* speaks to an entirely different question: when a violation accrues for statute of limitations purposes under RESPA. Nothing in *Snow* restricts that application of penalties under the CFPA for ongoing payments that continue a violation of RESPA solely to the date that a given loan is originated.[134]

Accordingly, even if the Tribunal does not deem any of the payments described above to be "violations" which themselves trigger the statute of limitations, they are unquestionably "acts" that give rise to civil money penalties because they show that Respondents "continue[d]" their violations of RESPA Section 8 after July 21, 2011, including continuing to violate RESPA Section 8 by accepting payments in exchange for illegally referred loans that closed on or after July 21, 2008. *See* 12 U.S.C. § 5565(c)(2)(A-C) (penalties apply "for each day during which such violation ...

[134] The central rationale of *Snow* hinged on the singular word "violation" in RESPA itself. The *Snow* panel held that "[f]irst and most importantly, the statutory text and structure better support this reading" because "Congress spoke of a single triggering violation, not multiple violations" in Section 16 of RESPA." *Snow*, 332 F.3d at 359. Even if there is a "single triggering violation" for purposes of applying the statute of limitations, *Snow* did not hold that the violation must conclude at closing.

continues.”). Respondents must therefore “forfeit and pay a civil penalty” “for each day during which such violation continue[d].” *Id*.

Applying the CFPA to conduct in violation of RESPA that persisted after July 21, 2011 does not pose any retroactive effect. Retroactivity doctrine disfavors application of new statutes that “would impair rights a party possessed when he acted, increase a party’s liability for past conduct, or impose new duties with respect to transactions already completed.” *Landgraf*, 511 U. S. at 280 (emphasis added). There is no retroactive effect because it cannot be disputed that Respondents continued to accept payments after July 21, 2011, in exchange for referrals of loans that closed on or after July 21, 2008. As discussed above, these include, but were not limited to, the ceded premiums from loans in the UGI 2009 book year and Genworth 2008.B book year, as well as dividend and commutation payments taken by Respondents after July 21, 2011 that were funded by those premiums.

If a party were engaged in activity violating RESPA on the date of the CFPA’s enactment, June 21, 2010, it would have had a year to cure and stop its violation. *Id*. Thus, Respondents had a year from that date to cease and desist from continued participation in their captive arrangements. During that time, they could have returned all illegally obtained funds in the trust accounts to the MIs, or at the least, declined further receipt of referral payments. PHH failed to do so. Instead, PHH persisted in receiving ceding payments (including adding new book years to the arrangement), amending the agreements to perpetuate the illegal scheme rather than end it, and extracting dividends and commutation payments that violated RESPA. *See* § III.A, B, *supra*. Even Cascio has asserted that during this later period the MIs were effectively making a recurring, daily decision to continue their arrangements and remain in their contracts, which could be cancelled at any time.[135]

b. The statutory factors justify a penalty at the recklessness level

The CFPA provides for three tiers of civil money penalties, calibrated by scienter. See 12 U.S.C. § 5565(c)(2). Each tier establishes a range of discretion, setting a maximum penalty for each day that a violation continues. The first-tier penalties apply on a strict-liability basis "[f]or any violation of a law, rule, or final order or condition imposed in writing by the Bureau." *Id*. at (c)(2)(A). The penalty "may not exceed $5,000 for each day during which such violation or failure to pay continues." *Id*. (emphasis added). Second-tier penalties apply "[n]otwithstanding [the first-tier provision], for any person that recklessly engages in a violation of a Federal consumer financial law . . ." *Id*. at (c)(2)(B) (emphasis added). At the second tier, "a civil penalty may not exceed $25,000 for each day during which such violation continues." *Id*. The third tier applies to "any person that knowingly violates" a Federal consumer financial law and raises the maximum penalty to $1,000,000 "for each day during which such violation continues." *Id*. at (c)(2)(C).

At a minimum, Respondents acted recklessly by continuing to engage in captive reinsurance activity on or after July 21, 2011. Black's Law Dictionary defines recklessness as "[c]onduct whereby the actor does not desire harmful consequence but .

[135] Mr. Cascio testified that because the reinsurance contracts, which transferred the "thing of value," could be cancelled at any time, they should be reviewed on an annual or perhaps even "90-day" basis, because effectively, the parties were renewing the contract by deciding, periodically, *not* to exit the contracts. **Hrg. Tr.** 1490:13-1494:7 (5/29). This undermines Respondents' argument that the "thing of value" is transferred only at the time that a borrower's loan is closed subject to reinsurance ceding on that individual loan. In addition, it makes clear that Respondents' "omissions" in failing to end a RESPA-violative arrangement are actionable.

. . foresees the possibility and consciously takes the risk." Black's Law Dictionary 1053 (Bryan A. Garner ed., 8th ed. abr. 2005). In SEC actions, for example, recklessness may be established where a party engages in "highly unreasonable conduct which is an extreme departure from the standards of ordinary care." *S.E.C. v. George*, 426 F.3d 786, 792 (6th Cir. 2005). Respondents knew or should have known that their conduct of continuing to intentionally extract things of value from captive reinsurance arrangements was likely to violate RESPA. Nothing in the HUD letter, Schmitz's Milliman reports, or any other purported source of guidance obviated RESPA's clear and plain prohibition on kickbacks or unearned splits of fees. *See* § III.B.2.b.ii, *supra*. Respondents were also aware as early as October of 2006 that ceding practices were the subject of multiple government investigations, but took the calculated step of continuing with their captive activities. *See* **ECX 0733** (Oct. 2006 UGI RFP response) at 10 ("Both New York and Minnesota insurance regulators have active investigations into mortgage guaranty reinsurance arrangements"); *see also* **ECX 0018** (12/7/2010 Atrium Annual Board Mtg. Minutes) at CFPB-PHH-00128065 (noting board received "an update on the ongoing investigation" of captive arrangements by Minnesota Dep't . of Commerce and HUD); **ECX 0430** at 1 (7/7/2009 email) (Rosenthal writes during commutation discussions with Radian that he believes Radian will not "just relinquish the Trust Balances" because "they believe that the State of Minnesota will find this to cause lack of risk transference.").

In fact, in presenting their case at hearing and briefing on prior dispositive motions, Respondents put forward no evidence to deny the explicit *quid pro quo* exchange at the root of the arrangements. Instead, they proffered testimony from UGI's Dan Walker, who testified that the desire to obtain referrals was intertwined with the captive arrangements, and influenced UGI's participation. *See* § III.A.4, *supra*. Similarly, Respondents conceded that they obtained splits of fees for purported reinsurance, which they understood was not a "settlement service" as required under Section 8(b). *See* Respondents' Renewed Motion to Dismiss, Dkt. No. 101 at 35 & n.23. Throughout this proceeding, Respondents have relied nearly exclusively upon Section 8(c)(2), and specifically, the Schmitz actuarial opinions which purported to interpret the HUD letter, for an affirmative defense to its conduct. At the hearing, that purported defense crumbled. *See* § III.B.2.b, *supra;* **Hrg. Tr. 2190:3-2192:22** (6/4 Walker) (agreeing that HUD letter criteria were "very vague" and never set forth the test chosen by Milliman). The Schmitz opinions, created for the first time nearly a decade after the scheme began, were not the basis for PHH's conduct; they were a means of attempting to disguise it. To further the scheme, the Milliman opinions devised the thinnest possible test for "risk transfer" and proclaimed that only an artificial segment of the arrangements passed it. Schmitz's opinions are plainly insufficient to overcome the overwhelming evidence showing that to the contrary, Respondents consciously created and operated captive reinsurance arrangements as a means to extract kickbacks for referrals. *See* § III.A.2, 3, *supra*. By engaging in conduct that overtly violated RESPA, Respondents acted recklessly – they "fore[saw] the possibility [of violating the law] and consciously [took] the risk." Black's at 1053.

The CFPA further directs that, within the appropriate tier, "[i]n determining the amount of any penalty assessed . . . the Bureau shall take into account the appropriateness of the penalty with respect to" certain factors, namely:

A) The size of financial resources and good faith of the person charged;

B) The gravity of the violation or failure to pay;

C) The severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided;

D) The history of previous violations; and

E) Such other matters as justice may require.

[12 U.S.C. § 5565(c)(3).]

First, PHH is a large, publicly-traded corporation that ranks as the sixth-largest mortgage originator in the United States. It has substantial financial resources, reporting a net income of $166 million in the first six months of 2013.

Respondents cannot demonstrate any good faith that might mitigate the need to impose CMPs. PHH ceased adding new book years to their captive arrangements in 2009 only because of larger market forces, not any desire to stop their violative conduct. Respondents continued to use captive reinsurance as a factor in steering MI business well into 2011 and beyond, and continued to profit from captive reinsurance until their last arrangement was commuted in 2013. In addition, any purported attempts by Respondents to comply with RESPA were designed not to avoid illegal kickbacks or fee-splits, but to take advantage of perceived loopholes by commissioning self-serving risk-transfer opinions. As discussed, the Milliman reports were a thinly-veiled attempt to further disguise the payments of kickbacks. *See* § III.B.2.b.ii, *supra*. Respondents used captive arrangements as elaborate instruments to demand side payments for themselves in exchange for referrals. Any actions taken to extract or receive such payments violated RESPA. No state insurance regulator, no federal agency, and no outside consultant ever advised PHH that such conduct was permissible under RESPA.

Respondents' lack of good faith is further demonstrated by their attempt to understate the profitability of their captive reinsurance arrangements to the Bureau during the course of the investigation. In its initial NORA response, Respondents emphasized that their profits from Atrium "represent a meager return of approximately 5%." **ECX 0653** (PHH NORA submission) at 28, 140 (representing returns to be 5%). In reality, the true annual rate of return of the Genworth and UGI arrangements was 20%. **ECX 0147**, tabs "UGI-IRR" and "Genworth-IRR."

Upon questioning by Enforcement Counsel, Respondents admitted that they had submitted a rate of return that was calculated quarterly – which had the effect of understating Atrium's profitability four times over. **ECX 0840** (9/12/2013 Letter, Enforcement Counsel to PHH); **Hrg. Tr. 1170:1-1171:15** (5/28 Thomas) (revealing that Respondents submitted internal rate of return figures that were calculated on a quarterly basis, without identifying them as such); **ECX 0654** at 7-8 (discussing IRR calculation in response to CFPB letter). Respondents neglected to come forward with a corrected calculation. Even after Respondents were confronted with this material discrepancy, they continued to rely upon this misleading figure and insisted that "had PHH invested the $52 million in other investment vehicles or other opportunities, it would more than likely have exceeded the 5% return it ultimately received on the capital it invested in Atrium." **ECX 0654** at 8. Given that Atrium's returns from the Genworth deal had doubled market benchmarks like the S&P 500, and in the case of UGI, quadrupled the S&P 500, this statement was plainly inaccurate. **Hrg. Tr. 1284:18-286:17** (5/29 Thomas).

Another example of Respondents' lack of good faith is their false representation to the Bureau that they complied with the minimum capitalization requirements of their written agreements with the MIs. Respondents attached to their NORA submission to the Bureau a declaration from Michael Bogansky, in which he stated that, to the best of his knowledge, "Atrium always met its contractual funding obligations with respect to the four trusts that were created in connection with its reinsurance arrangements." **ECX 0653** (PHH NORA submission) at Ex. C, ¶ 12. That statement was not to the best of his knowledge because he stated clearly in an email dated May 2008 that "[w]e never made the minimum capital requirements for Radian's trust from inception ...." **ECX 0246**; *see also* **ECX 0425 (6/2/2009** email, Bogansky to Rosenthal and Danahy) ("[W]e have a deficiency of approximately $800K in Atrium's Radian Trust Account."). Crawshaw explains that Respondents failed to meet the minimum capital requirements of all its contracts with *all four* of its MI partners. **Crawshaw Rebuttal Rep.** at 96-103. Respondents did not contest those opinions at the hearing, nor did they retract the statements in their NORA submission repeating Bogansky's assertion. *See* **ECX 0653** at 2 ("Simply stated, PHH followed the rules ... Atrium's reinsurance agreements provided for adequate and real transfer of risk- they were not sham agreements. *Atrium's trusts were always adequately capitalized*.") (emphasis added); id. at 23 ("Adequate capital and reserves: There has never been any question that Atrium met all required reserves ....").

Second, the gravity of Respondents' RESPA violation is significant. They extended far beyond technical violations or regulatory compliance lapses. From its highest executive levels, PHH orchestrated a massive scheme to take advantage of opportunities to steer borrowers to one mortgage insurance company over another and to profit illegally off of those referrals by seeking kickbacks. PHH created an extensive system to closely control those referrals for its own gain, collecting hundreds of millions of dollars in kickbacks in exchange.

Third, Respondents' acceptance of substantial kickbacks and unearned fees from MI premiums likely inflated the price of mortgage insurance for affected consumers. RESPA presumes that kickbacks in the MI harm consumers by inflating prices through anticompetitive conduct. There are also indications that these practices encouraged PHH to (1) require more mortgage insurance coverage than was truly necessary for higher premiums (**ECX 0296** (reduced MI coverage could have been available to some borrowers, but PHH did not allow it because it wanted to maximize premiums for its captive and "always thought borrowers did not really grade us on full/reduced MI premiums"); **ECX 0300** (same); **ECX 0440** (describing MI program that would benefit consumers and should be offered "absent a captive"); (2) steer borrowers to higher-cost providers in exchange for kickbacks (**ECX 0495** (Genworth's "premium pricing is not as competitive as other providers" but "PHH allocates volume based on factors other than rate competitiveness today"), and (3) effectively penalize borrowers who received loans from PHH's correspondent channel with mortgage insurance issued by an MI that did not participate in PHH's captive scheme by charging a 75 basis-point price adjustment which would presumptively be passed on to the consumer (*see* § III.A.2.b.ii, *supra*).

Fourth, while conduct subject to penalties is limited to actions taken on or after July 21, 2011, the full scope of Respondents' conduct demonstrates an extensive history of previous violations which must be considered for purposes of assessing the appropriate amount of penalties. Respondents entered into the first captive mortgage reinsurance arrangement in the history of the MI industry, *see* § II.A, *supra*, and for nearly 18 years, they used and manipulated their captive arrangements to extract kickback payments from MIs.

Lastly, PHH has made no effort to act responsibly and ameliorate the damage it has caused consumers. Civil money penalties should be issued in this case to deter similar conduct by other actors. All of these factors counsel that a second-tier penalty at the maximum level is appropriate for PHH's conduct.

In light of these factors, Enforcement respectfully requests that for Respondents' violations of Section 8(a) of RESPA, the Tribunal award the maximum civil money penalty for each day that they continued to engage in each RESPA-violative captive reinsurance arrangement through various acts and omissions, including, but not limited to, collecting ceding payments, dividends, and commuting the trusts with substantial disbursements to Respondents. For Respondents' arrangement with UGI, this conduct persisted daily for approximately 22 months. For Respondents' arrangement with Genworth, this conduct persisted daily for approximately 8 months. Accordingly, $25,000 per day for 30 months equals $22.5 million in civil money penalties.

For Respondents' violations of Section 8(b) of RESPA, Enforcement respectfully requests that the Tribunal award the maximum civil penalty for Respondents' continued receipt of unearned fees on or after July 21, 2011 for each of the 5,497 loans deemed to be originated in violation of RESPA within the limitations period determined by the Tribunal. The evidence above regarding the continuation of regular ceding payments on these loans in 2011, 2012, and for UGI, 2013, demonstrates that at least one unearned fee in violation of Section 8(b) of RESPA was accepted by Respondents on or after July 21, 2011 for each of these loans (and likely, many more). A penalty of $25,000 should be applied to each loan on that basis, resulting in $137,425,000 in civil money penalties.

IV. Conclusion

For all of the reasons set forth above, Enforcement respectfully requests that the Tribunal enter a recommended decision holding Respondents liable for violating Section 8 of RESPA, and imposing disgorgement, injunctive relief, and civil money penalties as described above. Enforcement reserves the right, if it prevails, to seek recovery of its costs to the extent allowable under 12 USC § 5565(a)(1), which confers upon the Tribunal authority to grants "any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law ...." 12 USC § 5565(a)(1).

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Certificate of Service

I hereby certify that on this 8th day of August 2014, I caused a copy of the foregoing "Enforcement Counsel's Post-Hearing Brief" to be filed with the Office of Administrative Adjudication and served by electronic mail on the following persons who have consented to electronic service on behalf of Respondents:

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