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 RESPONSE BRIEF

Filed under Seal

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INTRODUCTION

As the Tribunal has held, "once the elements of Section 8(a) or 8(b) have been established, there is a presumption that RESPA has been violated." May 22 Order at 4. Respondents have not put forward any evidence to refute Enforcement's proof of Section 8(a) and 8(b) violations in this case. Instead, they wave the Countrywide Letter around as if it were a permission slip to violate RESPA Section 8 with impunity. And they persist in re-litigating the clear rulings of this Tribunal on issues like jurisdiction and estoppel. We provide the Tribunal ample reasons in Section I of this brief to quickly dismiss this assortment of arguments, which either misconstrue regulatory guidance or ignore controlling law.

Contrary to Respondents' presentation, this is not a case about the intricacies of reinsurance, or the accuracy of PHH's financial statements. It does not require an actuary or an accountant or any other kind of expert to understand the essential facts. This is a case about kickbacks. The one issue under Section 8(a) that remains undecided by this Tribunal is whether there was an agreement to refer mortgage insurance business (MI business). Enforcement should prevail on this issue because Respondents admit that their allocation of MI business was influenced by captive arrangements. Indeed, it is impossible to deny that PHH's primary mechanism for referring MI business – the "*captive* dialer" – was, in fact, driven by the captive arrangements. Once this element of Section 8(a) is met, and since liability under Section 8(b) has already been established, Respondents' only refuge is the Section 8(c)(2) affirmative defense. Section II discusses the evidence establishing liability under RESPA 8(a) and thwarting Respondents' reliance on the Section 8(c)(2) affirmative defense.

Respondents' entire affirmative defense hangs on the thin reed of a single set of documents – actuarial opinions prepared by Michael Schmitz of Milliman. Those actuarial opinions are abjectly insufficient to establish Respondents' entitlement to an affirmative defense under Section 8(c)(2). To prevail, Respondents must show that the "reinsurance" premiums, dividends, and commutation payments they received were "bona fide" payments made solely for "services actually performed." 12 U.S.C. § 2607(c)(2). But Respondents presented no testimony from a single PHH employee that could possibly suggest Atrium[1] did anything to earn the fees it collected. None of the "reinsurance" payments they received can be deemed "bona fide" because they were, in their entirety, kickbacks, and there never was any reinsurance "services actually performed" by Atrium. Under the Countrywide Letter's guidance, there never was any "real transfer of risk" to Atrium and the premiums paid bore no discernible relationship even to the risk Atrium purported to assume. The essential evidence is clear:

- Respondents initiated the use of captive reinsurance arrangements in the MI industry, years before the Countrywide Letter was issued.
- PHH created and controlled Atrium as a shell company with a bank account, and PHH employees carefully designed Atrium's captive arrangements and managed PHH's relationships with the MIs to avoid any risk of significant economic loss to Respondents.
- For approximately 13 years, Respondents did virtually no business with any MI that lacked a captive arrangement with Atrium.
- Ten years into this scheme, Respondents hired Schmitz to prepare opinions that purported to bless the deals in which Respondents had already long been engaged.

[1] The term "Atrium" as used herein refers to each of the following Respondents: (i) Atrium Insurance Corporation, and (ii) Atrium Reinsurance Corporation. The term "PHH" as used herein refers to each of the following Respondents: (i) PHH Corporation, (ii) PHH Mortgage Corporation, and (iii) PHH Home Loans LLC.

- Even those opinions determined only that "risk transfer" was satisfied if the arrangements were analyzed in pieces artificially removed from the entire arrangement. As such, the "losses" to Atrium that Schmitz projected were nothing more than a return to the MI of some of the kickback payments (ceded premiums) Respondents previously accepted in violation of RESPA.

- Beginning in 2006, Respondents embarked on a RFP campaign designed to extract additional kickbacks through captive reinsurance arrangements, and Milliman served as their partner in this endeavor.

- In 2008, Freddie Mac announced that it would no longer purchase loans with a ceding rate above 25%. To comply with Freddie Mac's 25% cede limit, Respondents were effectively forced to revise only the final book year under their arrangements by reducing the ceding rate on that book year to 25%, but they also narrowed the risk band by an even greater degree. The net result of these cosmetic changes was a massive increase in Respondents' expected profitability.

- From July 21, 2008 through the termination of Respondents' last arrangement in 2013, the vast majority of premiums ceded by those MIs were at the 45% rate.

- At the first signs of claims, Respondents withdrew as much as they could from the captive trust accounts – including the entirety of their purported capital contributions and more.

- Atrium's reinsurance was a sham because it was virtually impossible for the MI for obtain more value than a free savings account, and the most likely result to the MI was far worse than a savings account.

- The proper ceding rate for a "service" whose sole purpose was to take a share of the MI's profits was not 45%, and not 25%, but "less than zero."

These facts squarely refute Respondents' defenses, and demonstrate that Respondents' use of the specific captive arrangements at issue in this proceeding violated Section 8 of RESPA.[2] For all of the reasons presented in Enforcement's initial

[2] In contrast, many of the central "facts" that Respondents rely on are simply assertions with no citation to any evidence. Appendix A to this brief identifies some of these assertions, along with assertions that are not actually supported by the cited source, and assertions that lack any documentary support.

brief and this response brief, Respondents must be held liable for their violations of RESPA.

Once liability is established, the Tribunal should award Enforcement all the relief it has requested: injunctive relief, disgorgement of Respondent's ill-gotten gains, and civil money penalties. Enforcement's responses to Respondents' arguments relating to remedies, along with a summary of relief requested,[3] is discussed at Section III.[4]

ARGUMENT

I. RESPONDENTS MISCONSTRUE OR IGNORE REGULATORY GUIDANCE AND CONTROLLING PRECEDENT

A. The Countrywide Letter's Informal Guidance Offers No Sanctuary for Respondents

Peppered throughout Respondents' brief is the false claim that "HUD already declared that such [captive reinsurance] arrangements were permissible under RESPA when it issued the HUD Letter." Resp. Br. at 27.[5] Such statements cannot be further from the truth. HUD's Countrywide Letter offers no refuge for Respondents' illegal conduct.

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[3] Enforcement is submitting a revised calculation of its proposed disgorgement award for Respondents' violations of RESPA Section 8(b). *See* pp. 124-27 *infra*.

[4] Enforcement has not filed a separate document with a point-by-point response to Respondents' Proposed Findings of Fact because no such document is required. 12 C.F.R. § 1081.305. Enforcement disputes almost all of the alleged "facts" and characterizations in Respondents' Proposed Findings of Fact, but sets forth its responses in the text of its initial post-hearing brief and this response brief. *See* **Hrg. Tr. 2372:24-2373:5** (6/4) (noting that "briefs are always more useful" than proposed findings").

[5] The following short form citations are used in this brief: (i) "Resp. Br." for Respondents' initial post-hearing brief, filed on August 8, 2014 (Dkt. # 178); (ii) "EC Br." for Enforcement's initial post-hearing brief, filed on August 8, 2014 (Dkt. # 177); (iii) "EC Opp. to 1st MTD" for Enforcement's Opposition to Respondents' Motion to Dismiss or, in the Alternative, for Summary Disposition, filed on February 20, 2014 (Dkt. # 41); and (iv) "EC Opp. to 2nd MTD" for Enforcement's Opposition to Respondents' Renewed Motion to Dismiss or, in the Alternative, for Summary Disposition, filed on May 2, 2014 (Dkt. # 123).

1. The Countrywide Letter did not bless referral agreements

From their inception, captive reinsurance arrangements provoked obvious RESPA concerns. In 1996, the Department of Housing and Urban Development (HUD), then responsible for enforcement of RESPA, sought information regarding one early arrangement, between Countrywide Finance Corporation and Amerin Guaranty Corporation. Countrywide Letter (Attachment A to **ECX 0194**) at 1. Pursuant to that inquiry, Countrywide sought clarification concerning RESPA compliance in connection with its captive mortgage reinsurance arrangements. *Id.* at 1. HUD responded with a letter to Countrywide setting forth "the facts concerning captive reinsurance programs as we understand them, relevant law, and how the Department will scrutinize these arrangements to determine whether any specific captive reinsurance program is permissible under RESPA." *Id.* At the time this letter was issued to Countrywide, Respondents had already been engaged in a captive reinsurance arrangement with UGI for almost two years. The letter did not reflect any awareness of or application to Respondents' arrangement.

The Countrywide Letter did not grant permission for lenders to steer referrals of business to mortgage insurers (MIs) in exchange for their participation in captive reinsurance arrangements. To the contrary, it warned that "[i]f the lender or its reinsurance affiliate is merely given a thing of value by the primary insurer in return for this referral, in monies or the opportunity to participate in a money-making program, *then section 8 would be violated*; the payment would be regarded as payment for the referral of business or the split of fees for settlement services." *Id.* at 3 (emphasis added). As the letter explained, captive reinsurance arrangements on their face risked violating both Section 8(a) and 8(b) of RESPA. *Id.* at 2-3. The arrangements would be

permitted, however, pursuant to the Section 8(c)(2) defense "*so long as* payments for reinsurance under captive reinsurance arrangements are *solely* 'payment for goods or facilities actually furnished or for services actually performed.'" *Id.* at 1 (emphases added) (citing Section 8(c)(2)). The purpose of the letter was to transparently identify certain ways by which HUD intended to "scrutinize these arrangements" for RESPA compliance. *Id.*

As the Tribunal has observed, and Respondents have long conceded, the Countrywide Letter constitutes informal, non-binding guidance and lacks the force of law. *See* May 22 Order at 6; **ECX 0653** (PHH NORA Resp.) at 18-19. Nonetheless, it indicated the manner by which captive reinsurance arrangements might be "scrutinize[d]" under claimed reliance on Section 8(c)(2). The Countrywide Letter unambiguously states the critical point: captive reinsurance arrangements cannot be used to cloak kickbacks and unearned fees, and if they are, they will plainly violate RESPA. *Id.* at 2-3 ("[A]ny captive reinsurance arrangement in which reinsurance services are not actually performed or in which the payments to the reinsurer are not bona fide and exceed the value of the reinsurance would violate section 8 as an impermissible referral fee.") (emphasis in original). This guidance is entirely consistent with the position advanced by Enforcement, and plainly reflects how Respondents' conduct failed to comply with RESPA. Respondents' attempts to misconstrue and manipulate the Countrywide Letter only serve to demonstrate their own recklessness in violating RESPA.

Nothing in the Countrywide Letter issues a blank check to lenders to use captive reinsurance to steer business referrals to certain MIs over others in exchange for payments to the lender that maximized their benefits under the captive arrangement

because those payments are kickbacks and not "bona fide" payments "solely" for reinsurance services performed. Such conduct would be proof of a kickback scheme, in violation of Section 8(a). Respondents repeatedly seize on a sentence in the Countrywide Letter describing the "Background" facts, which notes that "[t]he lender, therefore, has a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance." This basic observation simply sets out *why* captive arrangements are potentially problematic under RESPA Section 8(a). The lender's "financial interest" in referring business to a captive partner MI is circumstantial evidence of a kickback *on its face* unless an alternative, neutral explanation is proven. This sentence is not a statement by HUD that this kind of referral arrangement is lawful; Section 8(a)'s plain terms make clear that it is not, and the Countrywide Letter states clearly that a captive arrangement that gives the lender a "financial interest" in referring business to the captive MI partner *would* violate RESPA Section 8(a) *unless* the terms and use of the arrangement fall completely within the parameters of Section 8(c)(2). *Id.* at 3. The main point of the letter is to then discuss when Section 8(c)(2) would apply.

Respondents' claim that the Countrywide Letter allowed them to extract captive reinsurance payments in exchange for referrals is incorrect, and demonstrates that they know referral agreements have been proven in this case.[6]

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[6] The Tribunal should also reject any attempt by Respondents to rely on a 1996 letter from the Office of the Comptroller of the Currency, cited in their Proposed Findings of Fact. *See* Resp. Proposed Findings of Fact ¶ 30 (citing RCX 0821 as well as November 2, 1998 letter from the Office of Thrift Supervision). First, Respondents do not argue that the OCC's letter has any bearing in this proceeding. Second, the OCC interpretive letter involves an interpretation of the National Bank Act and related regulations. **RCX 0821** at 4-9 ("Analysis" section discussing National Bank Act and related case law and regulations). It does not address or even mention RESPA. The permissibility of any

2. Respondents' conduct triggered the Countrywide Letter's non-exhaustive "red flag" factors

The Countrywide Letter set forth a multi-faceted analysis applying Section 8(c)(2) to captive reinsurance arrangements. The purpose of the analysis, as described by HUD, was to elicit whether payments made by an MI to a lender-affiliated captive reinsurer are bona fide payments solely for reinsurance services actually performed, or merely a smokescreen for illegal kickbacks and unearned fees. As noted above, actual evidence that a payment was in fact a kickback would constitute automatic proof of a RESPA Section 8(a) violation with respect to that payment, for which there is no defense. May 22 Order at 4 ("A kickback by its very nature is not a bona fide payment, and proof of a kickback is therefore sufficient to establish liability under Section 8(a), without any reference to a Section 8(c) exception."). Absent such overt evidence, HUD explained that it would still "scrutinize" captive reinsurance arrangements to attempt to

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captive reinsurance arrangement under the National Bank Act is irrelevant to its permissibility under other federal laws, including RESPA. Third, none of the Respondents is a bank, is subject to the National Bank Act, or has ever been subject to the OCC's authority. Any statement by the OCC regarding the application of the National Bank Act to a bank's involvement in captive reinsurance is immaterial to the proceeding against Respondents. Fourth, RCX 0821 is an interpretive letter from the OCC's chief counsel dated October 17, 1996, approximately a year after Respondents entered into their captive arrangement with UGI. Fifth, under the heading "Safety and Soundness Considerations," the OCC noted that the bank "Subsidiary's risk exposure also will be limited" and that under many scenarios "the Subsidiary will not be required to make any payment under the reinsurance agreement with United Guaranty." **RCX 0821** at 3-4. The OCC also characterized the arrangement as an exchange of "limited credit risk" for "reinsurance premiums, as well as investment income . . . , providing a potentially important source of revenue for the bank and its subsidiary." *Id.* at 4. These characterizations, based on representations made by UGI, suggest little if any transfer of risk. They also indicate that the motivating concern for the OCC's guidance was protecting the safety and soundness of the bank, and that this differed from ensuring that the bank's captive assumed significant risk. Sixth, nothing in the OCC letter indicates that the hypothetical captive arrangement in question involved all of the risk-limiting features present in Respondents' arrangements. Therefore, any statement about that arrangement's compliance with RESPA (of which there are none) is immaterial to the issues in this proceeding.

determine whether they were genuine reinsurance arrangements or not. As HUD stated to Countrywide, "[t]he Department will first determine whether the reinsurance arrangement meets three requirements that establish that reinsurance is actually being provided in return for the compensation," including proof of a "legally binding contract for reinsurance" and a "real transfer of risk." Countrywide Letter at 5-6. HUD made clear that "[i]f *one* or more of the requirements is not met, the inquiry will end, *and the arrangement will be regarded as an impermissible captive reinsurance arrangement under RESPA*." *Id.* at 5 (emphases added). If the arrangement passed this initial inquiry, then analysis would be conducted to assess "whether the compensation exceeds the value of the reinsurance." *Id.*

In addition to this test, HUD identified eight non-exhaustive factors (noted by Respondents as "red flags") which may trigger "particular scrutiny" and could also be considered generally in testing whether a given arrangement violated RESPA. *Id.* at 4-5. These "red flags" identify particularly egregious warning signs that a captive reinsurance arrangement is not bona fide. Contrary to Respondents' claims, their conduct raised plenty of "red flags" on this list. For example:

(1) The amount charged to consumers: There is evidence that Respondents prevented consumers from accessing reduced MI rates or other benefits because it would cost them captive reinsurance premiums. EC Br. at 224 (citing **ECX 0296**, **0300**, **0440**). In an internal memo, PHH admitted 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. Respondents therefore caused "[t]he amount charged directly or indirectly to the consumer for mortgage insurance in a captive program [to be] greater" than the amount which would be charged absent any captive program. There is also evidence that Respondents charged additional fees on correspondent loans as a penalty for not using their captive MI partners, which were likely passed on to consumers. EC Br. at 25.

(2) The cost of captive reinsurance versus comparable non-captive reinsurance available in the market: Though Respondents claim that arms'-length

reinsurance was not available in the market, PHH has admitted that third-party reinsurance was available when needed, and that fact was confirmed by Culver, as discussed herein. *See* pp. 61, 72 *infra*. A direct cost-comparison was not advanced in this case because during the time captive reinsurance was used, third-party reinsurance was infrequently used. The reason for this, as Culver testified, was that the MIs were generally not seeking to reinsure their business during this time because it was a period of high profits and strong capitalization. **Hrg. Tr. 337:25-340:12** (3/25).

(3) Restriction of referrals: For over a decade, Respondents overtly restricted their business "in whole or to a large extent to a primary mortgage insurer that has a reinsurance arrangement with the lender's captive reinsurer." Countrywide Letter at 4; EC Br. at 8-71. It is astonishing that Respondents even attempt to deny this fact. As described in Enforcement's initial brief, this conduct persisted well after July 21, 2008, though severe market disruptions eventually forced Respondents to allow some limited business to flow to non-captive MIs (who had themselves promised future captive arrangements). *Id.*

(4) Rejection by the secondary market: In February 2008, Freddie Mac effectively declared that starting June 1, 2008 it would "refuse[] to purchase mortgages insured under a particular captive reinsurance agreement" – namely, arrangements with a greater than 25% ceding rate such as those that had long been used by Respondents – and "place[d] special conditions" on purchases of loans with captive reinsurance, that is, by setting a maximum 25% ceding rate. Countrywide Letter at 4; **ECX 0031** (UGI letter attaching press release). Respondents "sold the bulk of their loans to the GSEs, Fannie Mae and Freddie Mac." Resp. Br. at 31.

(5) Ratings reduction by credit rating agency: From the early days of captive arrangements, there was concern at rating agencies and within the investment community more generally about the negative impact of captive arrangements on the MI industry's financial performance. **ECX 0820** (12/18/2003 letter, Pierzchalski to Culver) at 1 ([redacted]); **ECX 0793** (3/2003 Bear Stearns report); **RX 1048** (Q1 2003 Earnings Call Transcript) at 12 (analyst noting that "a lot of investors I talked to really feel that this deep seeded [sic] premium issue is going to be the downfall of the whole industry"). It is possible that the credit rating agencies did not take greater action because the negative impact on MIs' financial performance due to ceding of premiums was offset by increased revenue projections resulting from illegal referrals.

(6) Questioning of adequacy of reserve by state regulators: The New York Insurance Department repeatedly questioned whether Atrium's reserves were compliant with state law, and found on occasion that it was not. **ECX 0279** (4/29/2009 NYID letter) (notifying Atrium that its reserves violated two state regulations, one prohibiting Atrium from investing more than 10% of its assets in a single institution and another requiring at least 60% of its reserves

to be invested in specified asset classes); **ECX 0464** (11/16/2009 NYID letter) (showing that Atrium requested to release amounts from contingency reserve in excess of the amount required by state law). Atrium also failed to meet the minimum capital levels required by its contracts with the MIs, and there is no evidence that they notified state regulators of those shortfalls. **Crawshaw Rebuttal Rep.** at 96-103.

(7) Referral of all or a predetermined volume of business: For years, UGI had essentially an exclusive referral arrangement with Respondents. EC Br. at 22. Later, the RFP expressly offered to double Respondents' referral volume to the MIs in exchange for benefits from captive reinsurance arrangements. *Id.* at 29-30. Further, there is evidence that discussions occurred with MIs that sought to trade predetermined volumes of referrals for captive reinsurance terms. *Id.* at 54.

(8) Adequate consumer disclosure: As discussed below, *see* pp. 32-34 *infra*, Respondents have not demonstrated that the manner by which they disclosed their captive reinsurance arrangements allowed for "meaningful choice" by consumers. In addition, there is evidence that Respondents exercised a form of "veto" that impaired consumers from actually choosing other MI providers or deterred them from doing so by adding fees to such a choice. May 22 Order at 15-16; **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."); **ECX 0262** (requiring price adjustment to use RMIC even where it was the only MI that would close the loan).

While Enforcement need not prove the presence of any of these factors to establish that Respondents' arrangements violated RESPA, the presence of many, if not all, of these "red flags" exacerbates Respondents' conduct and further undermines their defenses.

Not only did Respondents fail to heed the Countrywide Letter's warnings, there is no evidence that any member of PHH management ever read the letter for himself and considered its terms. Rosenthal, who was charged with managing much of the captive arrangements, was shown the Countrywide Letter during the hearing. In reaction, he testified that "I don't have any recollection of this document" and that because it was addressed to someone at Countrywide, "I'm guessing that I wouldn't have received it." **Hrg. Tr. 509:7-511:13** (3/26 Rosenthal). Respondents cannot now claim any

supposed good-faith reliance upon a document they never read. Further, it was reckless for Respondents to purport to rely upon the Schmitz opinions – which claimed to apply the Countrywide Letter's guidance on risk transfer – without reviewing the terms of the letter themselves.

B. The Rule of Lenity is Irrelevant to the Issues in this Proceeding

Respondents open their post-hearing brief by arguing that the rule of lenity "is a death knell to Enforcement's case" because it entitles them to a favorable interpretation of any ambiguity in RESPA Section 8. Resp. Br. at 5. But Respondents do not contend that Section 8 is ambiguous in any way, much less that a particular allegedly ambiguous provision should be construed in a particular manner. Without any specific assertion of ambiguity in the language of the statute, proposed interpretation of that ambiguity, or any explanation as to why the rule of lenity compels that interpretation, the rule of lenity has no application to this proceeding.[7]

[7] Enforcement does not concede that the rule of lenity would apply to any ambiguity that may exist in RESPA Section 8. Respondents have identified no case in which the rule of lenity was applied to a civil RESPA claim, and Enforcement is aware of no such case. The only authority Respondents cite is a concurring opinion from one Circuit Court. Resp. Br. at 5 (citing *Carter v. Welles-Bowen Realty, Inc.*, 736 F.3d 722, 729-736 (6th Cir. 2013) (J. Sutton, concurring)). Indeed, the only controlling decision directly on point rejected the contention that the rule of lenity applies to civil RESPA claims. *Barbosa v. Target Mortg. Corp.*, 968 F. Supp. 1548, 1559 n.11 (S.D. Tex. 1997) (distinguishing a criminal RESPA decision in part on the ground that "the rule of lenity aspect of [that opinion] does not apply in this civil [RESPA] case"). Furthermore, to the extent that the Bureau's regulations implementing RESPA bear on any alleged ambiguity in the statute, the Bureau's interpretation is entitled to deference and may not be subject to the interpretive rules applicable to the statute itself, including the rule of lenity. *See Babbitt v. Sweet Home Chapter of Cmtys. for a Great Oregon.* 515 U.S. 687, 703 (1995) (Court "owe[d] some degree of deference" to agency's "reasonable interpretation" of statute with both civil and criminal penalties, which "suffice[d] to decide th[e] case"); *see also Barbosa*, 968 F. Supp. at 1558-59 (deferring to HUD's interpretation of the RESPA term in question despite finding that interpretation to be "rather unlikely"). In *Babbitt*, the Supreme Court acknowledged that it had once "applied the rule of lenity in a [civil] case raising a narrow question concerning the

Even where ambiguities exist in a statute, other rules of statutory construction would apply before any resort to the general "rule of lenity." "Because the meaning of language is inherently contextual, [the Supreme Court has] declined to deem a statute 'ambiguous' for purposes of lenity merely because it was *possible* to articulate a construction more narrow than that urged by the Government." *Moskal v. United States*, 498 U.S. 103, 108 (1990) (emphasis in original). *See also id.* ("[A] division of judicial authority [is not] automatically sufficient to trigger lenity" because "one court's unduly narrow reading of a criminal statute would become binding on all other courts, including this one"). Courts "have always reserved lenity for those situations in which a reasonable doubt persists about a statute's intended scope even *after* resort to the language and structure, legislative history, and motivating policies of the statute." *Id.* at 108 (emphasis in original) (internal quotation marks and citation omitted). The rule of lenity "applies only if after a review of all applicable sources of legislative intent the statute remains truly ambiguous," because "[t]he rule comes into operation at the end of the process of construing what Congress has expressed, not at the beginning as an overriding consideration of being lenient to wrongdoers." *United States v. Rivera*, 265 F.3d 310, 312 (5th Cir. 2001) (internal quotation marks and citations omitted). *See also Adams v. Holder*, 692 F.3d 91, 107 (2d Cir. 2012) ("The rule of lenity is a rule of last resort, which we apply only when none of the other canons of statutory interpretation is

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application of a statute that contains criminal sanctions to a specific factual dispute . . . where no regulation was present," but declined to infer from that "narrow" prior application of the rule of lenity that the rule could trump administrative regulations interpreting the ambiguous statutory provision. *Babbitt*, 515 U.S. at 704 n.18 (citing *United States v. Thompson/Center Arms Co.,* 504 U.S. 505, 517–18, and n. 9 (1992)). In light of Respondents' failure to identify any allegedly ambiguous provision of Section 8 and the deference that the Bureau's interpretation of any such provision would be owed, the Tribunal should decline to issue an advisory decision regarding the general applicability of the rule of lenity to an unspecified, theoretical ambiguity.

capable of resolving the statute's meaning . . . ." (internal quotation marks and citation omitted)). It is likely that, had Respondents actually identified a provision of the statute they claimed was ambiguous, other canons of statutory interpretation would have supplied the meaning of the provision without a need to resort to the rule of lenity. The Tribunal should therefore reject Respondents' argument as irrelevant to the questions actually at issue.

Respondents' only discernible argument for application of the rule of lenity is that "the CFPB's action is premised on nothing more than the mere existence of the [captive] arrangements" and "Enforcement Counsel failed to show that Respondents violated the HUD Letter." Resp. Br. at 6. As Enforcement's post-hearing submission demonstrates, its claims against Respondents in this proceeding are based on the specific facts demonstrating that their use and manipulation of their captive arrangements violated RESPA. More importantly, Respondents' assertions are unrelated to the rule of lenity's applicability to any alleged ambiguity in RESPA.[8] Regardless of whether Enforcement has demonstrated that Respondents failed to meet the requirements for application of Section 8(c)(2) set forth in the Countrywide Letter (it has, despite not bearing the burden to do so), Respondents have identified no ambiguity in any authoritative statute, regulation, or any other document to which to apply the rule of lenity.

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[8] Respondents do not argue that the Countrywide Letter is itself ambiguous, or that any such ambiguity is subject to the rule of lenity. Such an argument would likewise be defeated by Respondents' failure to identify any specific provision of the Countrywide Letter that is supposedly ambiguous, propose an interpretation of such a provision, and explain why the rule of lenity requires the provision to be construed in the proposed manner. In any event, the Tribunal has already determined that the Countrywide Letter is unambiguous, describing it as a "straightforward application of Regulation X to captive reinsurance." May 22 Order at 6.

In sum, Respondents seek a ruling that the rule of lenity generally applies to civil RESPA claims, but fail to address the various limitations that courts have placed on the rule's application and do not even argue that this proceeding presents any opportunity to apply to the rule to a particular ambiguity. The Tribunal should decline to issue a broad ruling that would be irrelevant to any of the questions actually at issue in this proceeding.

C. The Tribunal Should Reject Respondents' Request to Reconsider its Rulings in this Proceeding

Respondents seek to re-litigate many issues previously decided by the Tribunal in its March 13 and May 22 Orders. As the Tribunal has held, an attempt to "revisit certain issues [that were] already resolved . . . properly construed as a motion for reconsideration." May 22 Order at 2. Reconsideration is normally appropriate only "if the movant establishes: (1) an intervening change in the controlling law; (2) the availability of new evidence that was not available when the court issued the prior order; or (3) the need to correct a clear error of law or fact or to prevent manifest injustice." *Id.* (quoting *In re Linerboard Antitrust Litig.*, 361 F. App'x 392, 396 (3d Cir. 2010)) (adopting same standard for administrative law judge order). Respondents have failed to make this showing with respect to any of the issues for which they seek reconsideration. Indeed, Respondents do not attempt to make the requisite showing or even acknowledge the existence of the requirement, despite the clear holding of the May 22 Order. The Tribunal should reject Respondents' effort to revisit previously decided issues for this reason alone.[9]

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[9] The May 22 Order arose out of the Tribunal's desire to address certain legal issues "'*now rather than in post-hearing briefs*.'" May 22 Order at 20-21 (emphasis added)

Among other things, the May 22 Order established that Respondents had violated RESPA Section 8(b), that all but one element of Enforcement's Section 8(a) claim were established beyond genuine dispute, that Respondents bore the burden of proof with respect to their Section 8(c)(2) affirmative defense, that, provided certain elementary facts were established, all of the Respondent entities fell under Bureau authority, that disgorgement is an available form of relief, and that Respondents' McCarran-Ferguson defense failed. May 22 Order. Enforcement structured the remainder of its evidentiary presentation accordingly. Respondents' attempts to re-litigate settled issues must be summarily denied as untimely.

1. The Tribunal has already held that Respondents bear the burden of proof with respect to their Section 8(c)(2) affirmative defense

Respondents assert that Enforcement bears the burden of proving that the RESPA Section 8(c)(2) affirmative defense does not apply. That issue has already been litigated by the parties and decided by the Tribunal. May 22 Order at 3-4 (holding that Respondents bear the burden of proving the applicability of Section 8(c)(2)). That ruling is now the law of the case. Reconsideration is not warranted because Respondents have failed to show that there is an intervening change in the law, newly discovered evidence, or any clear error that would result in manifest injustice, May 22 Order at 2, or even attempted to do so (despite the rejection of their prior effort at reconsideration for the same failure).

Regardless, Respondents have waived the particular *argument* they now advance by failing to make it when the *issue* was previously litigated. "A motion for reconsideration may not be used to advance *new* facts, issues or *arguments* not

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(quoting hearing transcript). Continuously re-litigating the same issues before this Tribunal wastes time and resources.

previously presented to the Court." *Davidson v. Scully*, 172 F. Supp. 2d 458, 461 (S.D.N.Y. 2001) (citing *Shrader v. CSX Transp. Inc.,* 70 F.3d 255, 257 (2d Cir. 1995)) (emphases added). Respondents' new argument is that "where the affirmative defense *negates* an element of the crime, the burden of proof stays with the government." Resp. Br. at 7 (emphasis in original), but they declined to assert that argument when they previously contended that Enforcement bears the burden of proof with respect to Section 8(c)(2). *See* Resp. Br. In Supp. Of Renewed Mot. To Dismiss (Dkt. # 101) at 8-9; Resp. Br. In Opp. To Enf. Counsel Mot. For Summ. Disp. (Dkt. # 121) at 6-7. Respondents have therefore waived their new argument.

In addition to its procedural defects, Respondents' argument is wrong on the merits. The rule on which Respondents rely, that an affirmative defense that negates an element of a crime places the burden of proof on the government, applies only to criminal cases, where the government carries a heightened burden and constitutional considerations prevent certain requirements from being placed on the defense. Respondents cite no authority applying the rule in a civil case. Respondents do not even offer an explanation as to why the rule should be applied in civil cases. Civil proceedings, including government enforcement proceedings, routinely employ burden-shifting frameworks. It is true that RESPA Section 8 "is both a civil and criminal statute," Resp. Br. at 7, but it does not follow that all rules of criminal procedure apply to civil proceedings to enforce Section 8.[10] Indeed, Respondents do not even assert as much. Rather, Respondents elide their contention that the rule of lenity should apply to this proceeding with their new argument that a criminal procedural rule regarding the

[10] For example, because this is a civil proceeding, the standard of proof applicable to Enforcement's claims is a preponderance of evidence, not proof beyond a reasonable doubt.

burden of proof for certain defenses should apply in this civil proceeding. But the one has nothing to do with the other. The criminal procedural rule invoked by Respondents derives from the Due Process Clause prohibition on shifting the burden to disprove an element of the crime onto the defendant. *See, e.g.*, *Smith v. United States*, 133 S. Ct. 714, 719 (2013) ("the Government must prove beyond a reasonable doubt every fact necessary to constitute the crime with which [the defendant] is charged" and as a result "[t]he State is foreclosed from shifting the burden of proof to the defendant . . . when an affirmative defense *does* negate an element of the crime." (emphasis in original; internal quotation marks and citations omitted)). This principle is unrelated to the rule of lenity.

Generally, criminal prosecutions involve complex rules for allocating burdens of production and persuasion among the parties that have split federal courts. *See, e.g.*, *United States v. Dodd*, 225 F.3d 340, 348 (3d Cir. 2000) ("An examination of appellate [criminal] decisions concerning the burden of persuasion on other affirmative defenses reveals a quite divided jurisprudence, without any clear default rule as to how affirmative defenses generally should be treated"). There is no reason to import these complex issues into a civil proceeding absent a clear requirement to do so. Respondents have cited no authority supporting the application of criminal procedural rules in civil proceedings simply because the statute in question provides for criminal penalties, and the Tribunal should not take such an extreme step in the absence of any precedent clearly mandating such an approach, nor any need to even address this untimely argument.

Even in a criminal case, it would not follow that the government must bear the burden of proof with respect to Section 8(c)(2). First, Respondents do not even identify any element of a Section 8 claim that is supposedly negated by the Section 8(c)(2)

defense, so their argument based on criminal procedure cannot apply regardless. In any event, the Tribunal has held that "proof of a kickback is therefore sufficient to establish liability under Section 8(a), *without any reference to a Section 8(c) exception*." May 22 Order at 4 (emphasis added). Because the elements of a Section 8(a) violation can be fully established independent of Section 8(c)(2), the Section 8(c)(2) affirmative defense must be established independent of the Section 8(a) elements. Accordingly, Section 8(c)(2) does not negate any element of Section 8(a).

The Tribunal also held that although Section 8(c)(2) does not negate legal liability, "in the general case" it "can limit *monetary* liability," May 22 Order at 5 (emphasis added), by "plac[ing] a limit on damages, disgorgement, restitution, and any other monetary sanction," *id.* at 7. In other words, the Tribunal has ruled that where a payment was made pursuant to an agreement to refer, liability under Section 8(a) would be established, but proof that some portion of the payment was a bona fide payment for an actual service would limit the monetary relief available.

Respondents' reliance on a single Eleventh Circuit case is misplaced because the affirmative defense at issue in that case directly contradicted the *mens rea* element of the offense charged. *See United States v. Kloess*, 251 F.3d 941, 948-49 (11th Cir. 2001). By contrast, Section 8(c)(2), as construed by the Tribunal's May 22 Order, is more akin to the justification defense asserted in *Dodd*. There, the defendant was charged with being a felon in possession of a firearm, but he asserted the justification defense that he had sought to prevent harm to others. *Dodd*, 225 F.3d at 342. Like Respondents here, Dodd claimed that his otherwise illegal conduct was permissible because the law carved out conduct undertaken for a particular purpose (there: preventing harm to others; here: receiving bona fide payment for services actually performed). The Third Circuit

had no trouble finding that the defense did not negate any element of the crime. *Id.* at 344 (finding the question to be "easily answered").

The Section 8(c)(2) defense as construed by the May 22 Order also closely resembles the safe harbor provisions of the Anti-Kickback Statute. That statute makes it both a crime and a civil offense "knowingly and willfully" to "solicit[] or receive[]" or to "offer[] or pay[]" "any remuneration (including any kickback, bribe, or rebate)" in return for certain types of referrals or payments. 42 U.S.C. § 1320a-7b(b)(1), (2). The statute provides various exemptions, including, *inter alia*, for "any amount paid by an employer to an employee (who has a bona fide employment relationship with such employer) for employment in the provision of covered items or services," 42 U.S.C. § 1320a-7b(b)(3)(B), as well as "any payment practice identify by the Secretary [of the Department of Health and Human Services (HHS)]," *id.* § 1320a-7b(b)(3)(E). The HHS regulation setting forth the exemptions from criminal (and civil) liability requires, among other things, that the "aggregate compensation" be "consistent with fair market value in arms-length transactions and is not determined in a manner that takes into account the volume or value of any referrals or business otherwise generated between the parties for which payment may be made" under the relevant government healthcare program. 42 C.F.R. §1001.952(d)(5).

Defendants bear the burden of proving that they meet the requirements of any of the exemptions to the Anti-Kickback Statute. *See United States v. Rogan*, 459 F. Supp. 2d 692, 714-16 (N.D. Ill. 2006) ("Once the United States has demonstrated proof of each element of a violation of the Anti-Kickback ... Statute[], the burden shifts to the defendant to establish that his conduct was protected by a safe harbor or exception; the United States need not prove, as an element of its case, that defendant's conduct does

not fit within a safe harbor or exception"); *U.S. ex rel. Gale v. Omnicare*, No. 1:10–cv–127, 2013 WL 3822152, at *5 & n.57 (N.D. Ohio July 23, 2013) (same); *United States v. Shaw*, 106 F. Supp. 2d 103, 121-22 (D. Mass. 2000) (defendant bears burden of proving that exemption under the Anti-Kickback Statute applies). In other words, even a criminal statute prohibiting the receipt of "remuneration," including a "kickback," in exchange for referrals of business may legitimately place on the defendant the burden of proving a defense based on its provision of services for which the "aggregate compensation" is "consistent with fair market value in arms-length transactions." That is precisely what the Tribunal has ruled that Respondents must do in order to avail themselves of the RESPA Section 8(c)(2) defense in this proceeding.

2. The Tribunal has already held that Atrium and Atrium Re are proper Respondents in this proceeding

Respondents acknowledge that "the Tribunal rejected Respondents' arguments regarding jurisdiction [over Atrium and Atrium Re]," Resp. Br. at 53, but they nevertheless ask that the Tribunal "revisit th[is] issue." *Id.* The Tribunal should decline to do so. Respondents' current argument is identical to their earlier argument seeking dismissal of Enforcement's claims against Atrium and Atrium Re. Therefore, Enforcement incorporates by reference its response to Respondents' prior argument in its entirety. EC Opp. to 2nd MTD (Dkt. # 123) at 39-43 (Atrium and Atrium Re are "service providers" and "related persons" and are also liable for the Lender Entities violations by virtue of reverse veil piercing).[11]

[11] Enforcement also refers the Tribunal to its argument in its post-hearing brief that the corporate veil should be pierced to hold PHH liable for Atrium's conduct in violation of RESPA. EC Br. at 68 n.22. PHH meets many of the factors that courts in the Third Circuit "consider when deciding whether to pierce the corporate veil," *Pricaspian Dev. Corp. v. Martucci*, Civil Action No. 11–cv–1459 (DMC–JBC), 2014 WL 105898, at *3

As the Tribunal has previously noted, a "related person" includes "an agent for a covered person and a person who materially participates in the conduct of the affairs of a covered person," and is himself deemed to be a covered person. May 22 Order at 8 (citing 12 U.S.C. § 5481(25)(B), (C)). The evidence conclusively establishes the following facts, which the Tribunal has held are "sufficient to reach [the] conclusion" that Atrium and Atrium Re are related persons with respect to the Lender Entities. *Id.* at 8-9.

- Atrium and Atrium Re are wholly owned subsidiaries of PHH Corporation. **Ans. ¶¶ 7-8**. These entities were formed to provide purported reinsurance to MIs that insured PHH-originated loans, and they never "reinsured" a single loan that was originated by a lender other than PHH. **Ans. ¶¶ 8, 16**; **ECX 0653** (PHH NORA submission) at 9-10; **ECX 0123** (UGI/Atrium agreement 3-38); **ECX 0200** (Radian/Atrium agreement); **ECX 0202** (CMG/Atrium reinsurance agreement); **ECX 0503** (Genworth/Atrium agreement); **ECX 0584** (UGI/Atrium agreement 3-44).

- Atrium never had any employee who was not also a PHH employee. **Hrg. Tr. 126:5-6** (3/24 Rosenthal) ("[t]he business strategy of Atrium was handled by a group of individuals at PHH Mortgage"), **125:8-127:8** (Rosenthal knows of no employees nor any office for Atrium); **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).

- Atrium paid PHH dividends out of the captive trust accounts. **Crawshaw Rebuttal Rep.** at 129, Table 11, column C (PHH took dividends from Atrium in the amounts of $17 million in 2005, $16.5 million in 2007, $19.25 million in 2009, $17 million in 2010, and $5 million in 2011).

(D.N.J. Jan. 9, 2014), including "failure to observe corporate formalities … siphoning of funds of the corporation by the dominant stockholder … and the fact that the corporation is merely a facade for the operations of the dominant stockholder or stockholders," *id.* The facts supporting veil piercing, including PHH's control over Atrium and its siphoning of funds from Atrium, were adequately pled. *See* Notice of Charges ¶¶ 8, 16, 21, 22, 28, 38, 40-55, 60-62, 64, 68, 71, 73, 76-80, 93-94. In addition, setting aside veil piercing, PHH Corporation should be held liable for the separate reason that it owned 100% of Atrium, so any "thing of value" that Atrium received in violation of RESPA enriched PHH Corporation to the same extent as Atrium. PHH Corporation should therefore be subject to full disgorgement of any amounts Atrium received in violation of RESPA.

- Atrium Re assumed Atrium's captive business in 2010. **Ans. ¶ 8**; **ECX 0653** at 11-12; **Hrg. Tr. 122:3-22** (3/24 Rosenthal). *See generally* **EC Br.** at 68.

These facts establish that Atrium and Atrium Re "were the agents of, and materially participated in the conduct of the affairs of, PHH Corporation, PHH Mortgage Corporation, and PHH Home Loans LLC," May 22 Order at 8-9, thereby rendering Atrium and Atrium Re "related persons" to the PHH Entities.

Atrium and Atrium Re are also subject to the Bureau's authority because they are "service providers" to the Lender Entities. A service provider is "any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service." 12 U.S.C. § 5481(26)(A).[12] Atrium's role in collecting and funneling MI ceded premiums to the other PHH entities, as detailed in Enforcement's opening post-hearing brief, EC Br. at 8-64, was material to PHH's origination of the underlying mortgage loans and its selection of the particular MIs to insure those loans. Atrium's collection and disbursement of premiums enabled PHH to originate consumer mortgage loans that generated a stream of income in addition to the traditional mortgage- and servicing-related income (e.g., interest, origination fees, secondary market sales, servicing fees). Atrium's service affected the profitability of originating mortgage loans with mortgage insurance and was therefore material to PHH's offer and provision of such loans.[13]

[12] The statute provides two examples of "service providers" that are "includ[ed]" within this definition. *Id.* § 5481(26)(A)(i)-(ii).
[13] Even Respondents assert that Atrium's existence influenced its mortgage origination practices. Resp. Br. at 11 (arguing that Atrium's purported reinsurance gave PHH "an additional incentive to originate quality loans").

3. The Tribunal has already held that the McCarran-Ferguson Act does not affect the claims in this matter

Respondents once again contend that the McCarran-Ferguson Act shields them from RESPA liability. Resp. Br. at 57-60. Although they acknowledge that the Tribunal has already rejected their argument, they "renew their objection" nonetheless. *Id.* at 57. They do so despite making no effort to demonstrate that they meet the standard for reconsideration of a prior ruling. The Tribunal has rejected Respondents' arguments twice. **Hrg. Tr. 18:21-23:14** (3/24); May 22 Order at 3 (noting that Tribunal had "previously held . . . that RESPA does not run afoul of the McCarran-Ferguson Act," that "Respondents point[ed] to no intervening legal authority, newly available evidence, clear error, or manifest injustice" and therefore the Tribunal "will not reconsider this holding"). The Tribunal should continue to refuse to reconsider its holding.

As to the substance of Respondents' arguments (which the Tribunal should not reach), Enforcement incorporates its prior arguments on this issue by reference. EC Opp. to 2nd MTD (Doc. # 123) at 36-39. Respondents cite evidence that they say demonstrates "state insurance regulators['] . . . role in regulating the very same captive insurers [Enforcement] now seeks to regulate through this enforcement action." Resp. Br. at 59. Since "Congress contemplated that RESPA's provisions apply to insurers generally," and thereby removed RESPA from the limitations of the McCarran-Ferguson Act, *Patton v. Triad Guar. Ins. Corp.*, 277 F.3d 1294, 1299 (11th Cir. 2002), the fact that the same entities may be subject to both an Enforcement RESPA proceeding and a state insurance regulator's authority is of no consequence.

Respondents also rely on the CFPA's preservation of state authority, which provides that "[n]o provision of this title shall be construed as altering, limiting, or

affecting the authority of a State insurance commission or State insurance regulator under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or regulator." 12 U.S.C. § 5552(d)(3). First, RESPA is not a "provision of this title" within the meaning of the CFPA. The definition of "Federal Consumer Financial Law" includes both "the provisions of this title" and "the enumerated consumer laws," which include RESPA, demonstrating that "the provisions of this title" are distinct from enumerated consumer laws like RESPA. 12 U.S.C. § 5481(14). Second, this enforcement proceeding does not alter, limit, or affect any state regulator's authority under state law. State regulators remain free to administer state law as they see fit. Respondents provide no basis for concluding otherwise. Neither the McCarran-Ferguson Act nor the CFPA's preservation of state authority provision bars this proceeding.

4. The Tribunal has already held that Respondents' judicial estoppel argument is meritless

This Tribunal has twice denied Respondents' judicial estoppel defense. March 13 Order at 13-15; May 22 Order at 9-10. Although the Tribunal stated that there remained genuine issues of material fact as to this defense, Respondents raise no new facts or arguments to support the defense; they simply reiterate arguments that the Tribunal has already rejected. Accordingly, they raise no basis for reconsideration. Enforcement incorporates herein its arguments in prior briefing responsive to this issue. EC Opp. to 1st MTD (Doc. # 41) at 10-14; EC Opp. to 2nd MTD (Doc. # 123) at 43-49. The Tribunal should deny Respondents' judicial estoppel defense once and for all.

In the Third Circuit, judicial estoppel may be granted only if the party to be estopped: (1) took "two positions that are irreconcilably inconsistent"; (2) "convince[d]

the [first court] to accept its earlier position," and (3) "changed [its] position in bad faith."[14] *In re Prosser*, 534 Fed. App'x 126, 130 (3d Cir. 2013); *MD Mall Assocs., LLC v. CSX Transp., Inc.*, 715 F.3d 479, 486 (3d. Cir. 2013). The Third Circuit has "consistently stated that *the doctrine should only be applied to avoid a miscarriage of justice*" and is "not intended to eliminate all inconsistencies no matter how slight or inadvertent." *In re Kane*, 628 F.3d 631, 638 (3d Cir. 2010) (emphasis added).[15] Respondents cannot establish any of these requirements, much less all of them, and they certainly cannot show that a miscarriage of justice will occur if their request is denied.

As to the first element, the Tribunal has held that Respondents failed to demonstrate that the Bureau took two inconsistent positions. March 13 Order at 15; May 22 Order at 9. Respondents provide no basis for the Tribunal to reverse its clearly correct ruling on this element. Accordingly, Respondents' judicial estoppel defense must be rejected.

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[14] If these three elements are met, judicial estoppel may be granted only if it is "tailored to address the harm identified and no lesser sanction would adequately remedy the damage done by the litigant's misconduct. *In re Prosser*, 534 Fed. App'x at 130.

[15] *See also* March 13 Order at 14 (noting that the Supreme Court has identified, but has not adopted, three factors that courts typically consider in deciding whether judicial estoppel applies: (1) whether the two arguments are clearly inconsistent; (2) whether the party was successful in asserting the earlier position, so that judicial acceptance of an inconsistent position in a later proceeding would create the perception that the first or second court was misled; and (3) whether the party seeking to assert the position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped (citing *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001))). In describing these factors, the Supreme Court was summarizing common elements of the doctrine of judicial estoppel applied in various Circuits across the country, rather than promulgating a fixed, uniform set of elements that displaces the formulations of the doctrine applied in specific Circuits. The Supreme Court noted that the factors it identified do "not establish inflexible prerequisites or an exhaustive formula for determining the applicability of judicial estoppel" and that "additional considerations" may inform a court's decision as to whether judicial estoppel applies. *New Hampshire v. Maine*, 532 U.S. at 743-751. The elements cited in *New Hampshire v. Maine* are similar to those required in the Third Circuit. PHH cannot meet any element under either formulation, so its judicial estoppel defense fails regardless of which is applied.

Second, even if Respondents could identify irreconcilably inconsistent statements (they cannot), they could not establish that the Bureau convinced the district court to accept any position given the express provisions of the Consent Order stating that the case was settled without adjudication of any factual or legal issue. Consent Order at 2, ¶¶ 3, 4.[16] Moreover, Judge Kathleen Williams, who entered the Consent Order, confirmed this point at the hearing on Respondents' motion to intervene in the Florida action, when she stated that the Consent Order was just "a settlement document" that "adjudicated nothing," and concluded: "*I don't know how you can now be heard to say you can raise [the Consent Order] as a defense*, as you have before the Administrative Law Judge." *Id.* (emphasis added). Respondents' judicial estoppel defense must be dismissed because the judge who entered the Consent Order stated that she did not accept any position and that she saw no merit to their judicial estoppel defense in this proceeding.

Third, Respondents cannot show that the Bureau changed any position in bad faith. The Bureau did not change its position at all, but in any event, the Bureau did not act in bad faith by agreeing to a narrow carve-out on the scope of prohibited conduct. That decision was fully consistent with Eleventh Circuit law, which does not allow parties to a consent decree to agree to provisions that impair the contractual rights of non-parties to the decree. *See Reynolds v. G.M. Roberts*, 251 F.3d 1350, 1357 n.12 (11th Cir. 2001) ("The clear law of this circuit is that 'a consent decree requires the consent of

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[16] For the same reason, the Tribunal must reject Respondents' argument that *Freeman v. Quicken Loans, Inc.*, 132 S. Ct. 2034 (2012), requires a finding that Atrium's acceptance of ceded premiums from UGI must be legal under because UGI's ceding of those premiums was supposedly determined to be legal under RESPA per the Consent Order. Resp. Br. at 61. The Consent Order did not determine that UGI's ceding of premiums was legal under RESPA.

all parties whose legal rights would be adversely affected by the decree.'") (quoting *United States v. City of Hialeah*, 140 F.3d 968, 975 (11th Cir. 1998)); *see also United States v. Miami*, 664 F.2d 435, 442, 447 (5th Cir. 1981). When the Bureau was negotiating the settlement agreement with UGI, it was aware that UGI's existing captive agreements with lenders required it to cede premiums to those lenders. In order to resolve the matter with the settling parties (the MIs), potential conflicts with third-party contractual rights needed to be avoided for pragmatic reasons. In light of the law of the Eleventh Circuit, a provision impacting the contractual rights of lenders who were not parties might not even have been permissible. It is not bad faith to follow the governing law.[17]

Nonetheless, in an apparent attempt to support their bad faith claim, Respondents assert that a court cannot enter an order that permits "clearly illegal conduct," and that Enforcement's request for entry of the Consent Order was therefore "inexcusable" because it permitted clearly illegal activity to continue. Resp. Br. at 42 (citing *Robertson v. N.B.A.*, 556 F.2d 682 (2d Cir. 1977)). As Enforcement has previously argued, accepting this argument would require this Tribunal to determine that the conduct at issue in this proceeding was "clearly illegal," thus establishing Respondents' liability. EC Opp. to 2nd MTD (Doc. # 123) at 47. In any event, the cases

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[17] The Bureau's agreement to a limited carve-out against the broad prohibitions of the settlement agreement was also reasonable and in good faith because settlement agreements are compromises. The Supreme Court has explained that "[c]onsent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms" and "[n]aturally, the agreement reached normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation." *United States v. Armour*, 402 U.S. 673, 681 (1971). Because of this practical reality, a rule prohibiting federal agencies from entering into any settlement agreements unless they can obtain the defendant's agreement to complete cessation of all activity that the agency alleges to be illegal would severely hamper their ability to enforce the law.

cited by Respondents to support their position do not show that the Bureau acted in bad faith because there is a difference between conduct that has been *alleged* to be illegal and conduct has been *previously determined* to be illegal. *Id.* at 47-48. No court or tribunal has ever determined that any captive mortgage reinsurance arrangement violates RESPA Section 8.[18]

Finally, it must be emphasized that the injunctive relief in the settlement agreement applies only to UGI. Not one of the Respondents was a party to the settlement agreement. Respondents did not agree to pay a civil money penalty, or to relinquish rights to funds held in captive trusts, or to an injunction preventing them from participating in captive mortgage reinsurance arrangements. The Bureau did not release any claims it had against Respondents or forgo its right to obtain broader relief against Respondents than it had obtained in its negotiated settlement with UGI. Consent Order at 12. Respondents' asserted belief that any limitations on the scope of the consent order's provisions *enjoining UGI* somehow immunized *Respondents* from liability for their actions is simply implausible. Settlement agreements, by their very nature, only bind the parties that have agreed to them. The only legal effect of the provision on which Respondents rely would be to provide UGI a defense if the Bureau

[18] In *Robertson v. N.B.A.*, one of the cases cited by Respondents, the Second Circuit cautioned that courts "in approving a settlement should not in effect try the case by deciding unsettled legal questions." 556 F.2d 682 (2d Cir. 1977). Because the legality of the captive arrangements in which UGI participated was an unsettled question, there is no merit to Respondents' argument that the Consent Order was a "sham" because it did not prohibit UGI from continuing to cede premiums or from accounting for the arrangements as reinsurance. Resp. Br. at 60. Moreover, Respondents' argument that the Bureau should have monitored and corrected UGI's accounting treatment of its captive arrangements, without any adjudication of the issue of whether those arrangements provided genuine reinsurance services, would require the Bureau to get far more involved in the business of insurance than anything it has done thus far. This argument cannot be reconciled with Respondents' contention that the Bureau is precluded from regulating the business of insurance.

ever claimed that UGI violated the Consent Order by "ceding premiums on policies originated as of, and subject to Arrangements already in existence as of [April 8, 2013]." Allowing Respondents to use that provision of the Consent Order to avoid any adjudication of Enforcement's claims against them and escape liability for their violations of RESPA would be a miscarriage of justice.

II. ENFORCEMENT HAS ESTABLISHED LIABILITY UNDER RESPA SECTION 8

A. Respondents Violated RESPA Section 8(a)

1. There is no basis for reconsideration of the Tribunal's ruling that Respondents made referrals

Respondents offer no basis for the Tribunal to reconsider its clear – and correct – ruling that they made referrals of business to certain mortgage insurers using the dialer and other mechanisms. May 22 Order at 15-16. Instead, Respondents ignore the May 22 holding and proceed as if this were still an open issue. Having failed to show a change in the law, newly available evidence, or manifest injustice, Respondents should not be permitted to put this previously resolved issue back into play.

For all the reasons stated in the May 22 Order, it cannot be seriously disputed that PHH took actions which "ha[d] the effect of affirmatively influencing the selection by any person of a provider of a settlement service" through the use of the dialer and the preferred provider list. 12 C.F.R. § 1024.14(f) (defining a "referral"). PHH's own representatives have described their systematic "control" over MI selection for borrowers. **ECX 0773** (6/4/2008 email, Rosenthal to Kennedy) (PHH "completely control[led]" the selection of MIs for borrowers on its retail loans through the use of its "dialer"); **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 provider 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 . . . ."), **108:14-17** (agreeing that "the dialer is set [at] various times for specified percentages corresponding to specified MIs").[19] In addition, by charging an added fee on loans originated with certain (non-captive) MI providers, PHH "affirmatively influenc[ed]" any MI selection made for borrowers by members of their correspondent network. EC Br. at 25-27.[20]

Respondents attempt to confuse the issue of what constitutes a referral, but the law is clear: a referral includes any action which "has the effect of affirmatively influencing the selection by any person of a provider of a settlement service." 12 C.F.R. § 1024.14(f).[21] For example, Respondents quibble with the evidence that they "exercised veto power over the selection of an MI," Resp. Br. at 19 (quoting May 22 Order at 15), but this is not the critical question. [22] Though there is ample evidence that Respondents controlled their MI referrals so thoroughly that they could, in effect, prevent borrower

[19] Respondents claim that Rosenthal was not part of the group that set the dialer. Resp. Br. at 20, n. 10. In fact, Rosenthal himself testified that "at different times, I was part of that group," **Hrg. Tr. 109:7-11** (3/24), and that even at other times, he was "the recipient of information from the individuals making the decision in establishing where the dialer should be," *id.* **109:12-110:2**.
[20] To be clear, any payment received by Respondents pursuant to an agreement to "affirmatively influence" the selection of a MI provider by their correspondents in any manner would violate RESPA.
[21] Nowhere in their argument about what constitutes a "referral" do Respondents cite the definition of the term.
[22] Similarly, Respondents make the irrelevant contentions that they never "denied anyone's request for a different MI provider," Resp. Br. at 19, and that RESPA does not "obligate a lender to conduct business with specific MIs," *id.* at 22.

choice, the proof that Respondents made referrals to MI providers in this case does not rest on such a "veto" power, nor does the law require such proof.

As the Tribunal noted, "the existence of the dialer alone is sufficient" to prove referrals in this case. May 22 Order at 16. Respondents claim that this ruling is "clearly erroneous" because it would mean that "any selection of an MI by the Lender Respondents was a 'referral' within the meaning of Section 8(a)," Resp. Br. at 20, but that holding is not erroneous: it is precisely correct. Selecting the MI provider for a borrower is a classic referral under Regulation X and proves that this element has been met. *See* 12 C.F.R. § 1024.14(f). Even "influencing the selection" of the MI provider, short of directly making that selection, also constitutes a referral. *Id.* Further, Respondents incorrectly claim that this view "cannot be squared with the HUD Letter[]" because "[c]learly HUD … did not characterize the 'selection' of the MI under such circumstances as a Section 8(a) 'referral.'" In fact, the Countrywide Letter makes clear that "in instances in which a lender *selects* the mortgage insurer, including under a captive reinsurance arrangement, *the lender's actions would constitute a referral of loans to a mortgage insurer*, by influencing the borrower's *selection* of his or her mortgage insurer." Countrywide Letter (Attachment A to **ECX 0194**) at 3 (emphases added) (citing Regulation X).

Respondents also imply that the use of affiliated business disclosures for the captive reinsurance arrangements and the theoretical option of the borrower to choose a different MI from the MI selected for them by Respondents could somehow erase the existence of referrals in this case. These points are irrelevant. First, so long as Respondents "influenc[ed] the selection" of the MI, they made a referral even if they concurrently disclosed that the borrower was ultimately free to make her own choice.

Second, the record is clear that, in practice, consumers rarely choose their MI providers and MIs market themselves instead to the lenders – their "customers" – in full recognition of that reality.[23] EC Br. at 18; **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. 119:10-14** (3/24 Rosenthal) (testifying that borrowers do not very often select the MI), *id.* **2203:11-13** (6/4 Walker) (with regard to lenders, "[t]hey're the customer"). The fact that consumers could have possibly tried to refuse the referral made by PHH (there is no evidence in the record that any such efforts were made) cannot negate the fact that PHH took steps to "affirmatively influence" their choice. There is no evidence in the record of how any purported affiliated business disclosures might have been used, or when. Respondents point only to a "sample" disclosure attached to a declaration from one of their former employees.[24] Even more critically, in disclosing the fact that Atrium had a "relationship" with United Guaranty, Genworth, and Radian, the form expressly states that "[b]ecause of this relationship, *this referral* may provide [PHH and its affiliates] a financial or other benefit." **RCX 0790** (affiliated

[23] Similarly, the fact that "pmi rates are filed with state insurance regulators" is irrelevant to a RESPA analysis, as is the degree to which the rates vary from provider to provider.

[24] Though it was attached to an admitted exhibit, **ECX 0653**, the Declaration of Mark Danahy dated April 19, 2010 should not be deemed admitted into evidence in this case. The Tribunal made clear that out-of-court witness statements were generally not admitted into the record and were excluded. **Hrg. Tr. 1007:10-1008:5** (5/28). **ECX 0153**, Mr. Danahy's deposition, was offered into evidence by Enforcement as an isolated exception to this rule because it contains statements which constitute party-opponent admissions and could be offered under the Federal Rules of Civil Procedure on that basis. *See* CFPB Rules of Practice for Adjudication Proceedings, 12 C.F.R. § 1081.303(b)(4). Under the Bureau's Rules, there is no basis for Respondents to offer a declaration of one of their former employees into evidence to advance their own case. In federal court, this would be plainly barred by the hearsay rules. If Respondents desired to offer Mr. Danahy's testimony for the truth of the matter asserted, they had the opportunity to call him as a witness. Statements made in his declaration are not in evidence and cannot now be proffered by Respondents or relied upon by the Tribunal.

business disclosure statement) at, *e.g.*, PHH MUNOZ 027020, ¶ 1. It is preposterous for Respondents to use this same form to claim that a referral did not occur, when the fact of a referral is the very thing that the form purports to disclose.

Lastly, Respondents argue that because "the financial strength of the MI was a significant factor for the Lender Respondents" in selecting MIs for referrals, these selections somehow do not constitute "referrals." Resp. Br. at 21-22. The purported reasons for making a referral, however, do not change the fact that referrals were made. As the Tribunal aptly observed, Rosenthal's testimony that he "did not choose to do business with Triad or PMI," combined with the undisputed fact that PHH had virtually no loans placed with these companies, bolsters the evidence of referrals because it demonstrates that PHH did business only with MIs subject to PHH's central command and, at minimum, that PHH "influenc[ed]" the selection of MIs. May 22 Order at 15, 16 (internal citations omitted). Respondents cannot dispute this reality. If anything, Respondents' assertion regarding their claimed motivations for the referrals goes to an entirely separate element of Section 8(a): the existence of an agreement to refer in exchange for participation in Respondents' captive reinsurance scheme. For the reasons set forth below, Respondents cannot overcome the voluminous evidence of referral agreements.

2. There is overwhelming evidence of an agreement to refer in violation of RESPA Section 8(a)

Respondents fail to overcome the vast evidence of agreements to refer present in this case. Enforcement presented a voluminous trail of explicit admissions in the documents as well as the undeniable circumstantial evidence correlating referrals to captive reinsurance payments and benefits. EC Br. at 8-71. Respondents' only argument

that their selection of MIs was for legitimate purposes is that "the Lender Respondents certainly took into account a number of factors including . . . the existence of a reinsurance arrangement" in "the selection of the MI." Resp. Br. at 31.[25] But this argument inherently concedes that captive agreements were a reason for the referrals.

Respondents rely on the general testimony of Rosenthal that "the decision to partner with a particular MI is based on a panoply of factors," Resp. Br. at 23, 25-26, as well as their counsel's unsupported assertions that "[f]irst and foremost, the Lender Respondents' primary interest has always been originating high quality mortgage loans for qualified borrowers" and next "working with the MIs with which they have a good relationship and which offer the products and services the lenders need to originate," *id.* at 23 (citing no evidence whatsoever). Even if true, this is irrelevant to the legal issue, because captive reinsurance was among those influential factors (and was in fact the dominant, and potentially dispositive, factor). The question is not whether captive reinsurance was the *only* reason that Respondents would "partner" with a given MI; it is whether the parties engaged in captive reinsurance pursuant to an agreement to refer. Captive reinsurance need not be the stand-alone "but for" cause to run afoul of Section 8(a). 12 U.S.C. § 2607(a) (prohibiting payments made "pursuant to any agreement or understanding" that real estate settlement service business "shall be referred," without referencing reasons for the referral) An agreement to refer business only to competent MIs in exchange for kickbacks is just as illegal as an agreement to refer business to incompetent or insolvent MIs in exchange for kickbacks.

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[25] Respondents also quote Rosenthal's testimony that "captive is definitely one of" the factors on which "the Lender Respondents' use of particular MIs was based." Resp. Br. at 25.

In any event, the contemporaneous documents reflect limited concern at PHH with the "customer service" or other characteristics of the MIs, in contrast to the strong emphasis placed on captive reinsurance. Broad, self-serving pronouncements cannot cover up the voluminous evidence present in the record which shows a pattern and practice of specific referral decisions influenced by captive reinsurance – primarily from Rosenthal's own emails and written work.[26] EC Br. at 8-71.

Therefore, Respondents' assertion that "the financial strength of the MI was a significant factor for the Lender Respondents" does not diminish the existence of an agreement to refer in violation of RESPA Section 8(a). Resp. Br. at 21. Equally unavailing is Respondents' claim that "it makes sense that the Lender Respondents did little, if any business" with RMIC, PMI, and Triad because in retrospect, each of these companies suffered financially as a result of the financial crisis. First, there is no evidence in the record that "financial strength" (or lack thereof) was ever the reason that Respondents did not do business with those particular MIs at any given point in time. Respondents' *post-hoc* rationalizations cannot be credited given the total lack of contemporaneous evidence to support this claim. Second, the extensive documentary evidence shows that during the RFP process, Respondents evaluated RMIC, PMI and Triad based on their willingness to offer an attractive captive arrangement. *See, e.g.,* EC Br. at 32-34. Third, Respondents actually began doing substantial business with RMIC during the height of the financial crisis – adding RMIC to the preferred provider list in

[26] Respondents' suggestion that any conduct prior to July 21, 2008 should be ignored is clearly wrong. Irrespective of any statute of limitations applied by the Tribunal, evidence of the prior history of Respondents' conduct with respect to these same arrangements is relevant to understand their context – particularly where, as here, Enforcement has alleged an ongoing cyclical scheme of repeated violations.

2008, and to the dialer in 2009. **ECX 0654** at Exs. M, O.[27] That is, Respondents began doing business with RMIC at the exact time that RMIC began to encounter serious financial difficulties (and when its financial strength would have mattered most). This conduct is squarely at odds with Respondents' argument. Fourth, even if financial strength was an additional factor in Respondents' decisions, it is irrelevant. Fifth, Respondents' argument provides no neutral explanation for why Respondents did virtually no business with MGIC, the market leader, from 1995 through late 2008. In sum, Respondents' argument based on RMIC, PMI, and Triad cannot overcome the mountain of evidence demonstrating the strong influence of captive reinsurance on Respondents' MI selections. RESPA prohibits any agreement to refer business that is affected by the payment of kickbacks, whether the kickbacks are the sole factor or one of many.

Respondents simply fail to grapple with the facts of this case. For example, Respondents admit that in order to fulfill their basic origination goals, "the Lender Respondents need to ensure that there are an adequate number of MIs that cover the available array of loan products being offered." Resp. Br. at 23. Yet Respondents' conduct directly conflicts with any notion that Respondents' needed an "adequate number of MIs" to cover the variety of loan products they offered. It is undisputed that

[27] In fact, the use of the preferred provider list is particularly telling. Though PHH implies that PMI, for example, was potentially excluded due to its financial condition – again, a claim that is unsupported by evidence in the record – PMI was considered an "approved" provider until at least August 2008. *See* **ECX 0654**, Ex. O. That is, PMI could be used by correspondents, but they would be subject to Respondents' "price adjustment." If PHH were solely concerned with avoiding MIs who could not provide adequate services, it would have made more sense to exclude or disapprove these MIs altogether. The April 2006 version of the policy similarly lists MGIC, RMIC, PMI, and Triad, along with a fifth company, CMAC (which merged with Radian), each as "approved" but subjected to the price adjustment because they were not "preferred." **ECX 0132** (4/3/2006 Preferred Provider Policy) at CFPB-PHH-00093167.

from approximately 1995-2001, Respondents worked almost exclusively with a single MI, UGI. EC Br. at 22. From 2001-2008, they had only two MIs on their dialer, UGI and Genworth. *Id.* at 23. Even after late November 2008, when MGIC was added to the dialer, MI referrals remained closely controlled and constricted. Further, none of this explains the price adjustment charged for MIs who were not on Respondents' "preferred provider" list. If Respondents concede that there is value in working with multiple MIs, this only heightens suspicion as to why they would so tightly narrow their business referrals for so many years.

Nowhere do Respondents address the evidence of their longstanding referral arrangements with UGI or Genworth, or the fact that participating in captive arrangements with Respondents was the price of admission to the dialer for those companies. Nowhere do they provide any explanation for any particular decision to do business with one MI over another, to add MIs to the dialer, to add MIs to the preferred provider list, or to adjust dialer allocations. Nowhere do they cite any contemporaneous documents explaining their actions.[28] Instead, Respondents seek to blur the issues by pointing out a handful of selective facts: that late in 2008 they began allowing some business with MGIC, that RMIC was also added in 2009, and that Radian was not added to the dialer until its captive reinsurance arrangement was commuted. As discussed at length in Enforcement's initial brief, the facts and circumstances of these changes reflect Respondents' continuation of agreements to refer business pursuant to promised

[28] The only document Respondents cite that they contend shows the factors that they considered in allocating business to MIs (other than captive participation) is **ECX 0495**. Resp. Br. at 31. But that document was generated in 2012, more than sixteen years after the referral scheme commenced, and in any event it shows that even as late as 2012, Respondents' allocation decisions continued to be affected by the captive arrangements (including Genworth's willingness to streamline dividend payments to Atrium and to commute its arrangement). EC Br. at 52, 180 (discussing **ECX 0495**).

captive arrangements and the attendant benefits despite drastic market conditions that forced Respondents to diversify and restricted the use of captive arrangements. *See* EC Br. at 53-67. In the case of Radian, PHH plainly withheld access to its dialer in the face of explicit appeals for referrals as it tried to pressure Radian for more advantageous captive terms, and ultimately admitted Radian to its dialer only after the existing arrangement – the continuation of which would have required Atrium to make a substantial additional capital contribution just as claims were finally being paid – was commuted to PHH's benefit. *Id.* at 53-57. Even as the market plunged into turmoil, Respondents' agreements to refer business to UGI and Genworth endured. In the end, the evidence clearly shows that referrals were heavily steered to PHH's captive MI partners over the period from 1995 through at least 2011, with only a brief dip in early 2009 allowing "non-captive" MIs to compete. *See* **EC Demonstrative Ex. 1** at 2.

Unable to overcome this evidence, Respondents resort to arguing that "an agreement to refer settlement business to a particular MI in exchange for placing the loan in a reinsurance book" has not been proven. Resp. Br. at 24. While Enforcement submits that there is ample proof of such loan-by-loan violations in its initial brief, *see* EC Br. at 8-71, this description misapprehends the nature of the case. This is not merely a case about a one-for-one exchange on the level of individual loans, limited to the notion of sending a referral in exchange for reinsurance ceding on that singular loan. The conduct at issue, alleged in the Notice of Charges and pursued through the hearing, is that Respondents engaged in a systematic cycle of creating, manipulating, and exploiting captive reinsurance arrangements as a means to extract kickback payments in exchange for referrals to certain MIs. For example, captive reinsurance influenced the setting of the captive dialer, which thereafter generated referrals to MIs – only some of

which resulted in ceding to Atrium. Many loans were referred to MIs pursuant to this scheme which were not placed into Atrium's "reinsurance" at all – for example, subprime loans which Respondents excluded from the agreements but continued to originate and expected the MIs to fully insure. EC Br. at 69. Dividends, commutation payments, and continued ceding on multiple already-referred loans continued to influence PHH's allocation of MI business well past July 21, 2008, and perpetuated the agreements to refer, even after newly-originated loans could no longer result in new streams of ceding payments to Atrium. All of this conduct violates RESPA.

B. There is No Basis for Reconsideration of the Tribunal's Ruling on RESPA Section 8(b)

Respondents fail to identify any intervening change in controlling law, any newly-available evidence, or any clear error of law or fact that could warrant reconsideration of the Tribunal's holding that they engaged in a prima facie violation of RESPA Section 8(b). As a result, the Tribunal should reject Respondents' motion for reconsideration of this issue and uphold its correct prior ruling.

Respondents appear to claim that the Tribunal should revisit its ruling because (1) the term "services" under 8(b) should not be limited to settlement services; (2) affiliated business disclosures were provided to borrowers; and (3) it was incorrect for the Tribunal to conclude that there was a prima facie violation of Section 8(b) without first incorporating an analysis under Section 8(c)(2).

First, the interpretation of the term "services" in Section 8(b) was carefully and accurately considered by the Tribunal, and Respondents offer no analysis to show why it that reasoning was incorrect. *See* May 22 Order at 18-20. Though Respondents invoke the idea that the "[p]rovision of services involving mortgage insurance" can be a

settlement service under Regulation X, Resp. Br. at 27, they do not claim that Atrium's reinsurance in fact was a settlement service. To the contrary, Respondents have expressly argued in the past that Atrium's reinsurance was not a settlement service. Nor do Respondents otherwise explain how their conduct is permissible under Section 8(b) of RESPA. *See* May 22 Order at 18. Second, the provision of affiliated business disclosures is totally irrelevant to this issue, as it is irrelevant to the Section 8(a) claims.

Third, the Tribunal clearly and correctly determined that Respondents' Section 8(b) violations were subject to the Section 8(c)(2) affirmative defense. Respondents' argument that this ruling is "inconsistent" with the Countrywide Letter, Resp. Br. at 27, n.16, completely misreads the Countrywide Letter. In its very first paragraph, the Countrywide Letter makes clear that it is offering an analysis under Section 8(c)(2) of RESPA – the same affirmative defense that was reserved for the hearing by the Tribunal. Countrywide Letter (Attachment A to **ECX 0194**) at 1. In laying out the issue posed by captive mortgage reinsurance arrangements, the Countrywide Letter also specifically recognizes that "[i]n addition [to 8(a)], subsection 8(b) prohibits the giving or receipt of any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service 'other than for services actually performed.'" *Id.* at 3. The letter continues: "These prohibitions against paying for referrals and against splitting fees are very broad and cover a variety of activities." *Id.* The HUD Letter made clear that absent proof of the Section 8(c)(2) defense, captive reinsurance arrangements would risk violating both Sections 8(a) and 8(b) of RESPA.

C. Respondents Cannot Avail Themselves of the RESPA Section 8(c)(2) Affirmative Defense

Section 8(c)(2) exempts "bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed" from the prohibitions of RESPA Sections 8(a) and 8(b). 12 U.S.C. § 2607(c)(2); May 22 Order at 3. The Tribunal has held that "Respondents bear the burden of proving that the ceded premiums at issue were bona fide" and that a "*kickback by its very nature is not a bona fide payment*." *Id.* at 4 (emphasis added). Therefore, evidence that the payments obtained by Respondents through their captive arrangements were kickback payments should inform the Tribunal's evaluation of Respondents' assertion that those same payments were bona fide payments for reinsurance services actually performed. As discussed below, Respondents failed to show that those payments were anything other than kickback payments in exchange for referrals.

1. The payment of claims does not constitute "services actually performed" under Section 8(c)(2)

Respondents contend that the mere payment of claims, or expected claims, establishes that "services [were] actually performed" under Section 8(c)(2). Resp. Br. at 34. But Respondents already raised this issue,[29] and the Tribunal held that "the circumstances surrounding the payment of this money raise a genuine issue of material fact as to whether Respondents provided bona fide reinsurance." March 13 Order at 16; *see also* May 22 Order at 5 ("If Section 8(c)(2) completely exempts liability for payment

[29] In their January 31, 2014 dispositive motion, Respondents contended that they were "entitled to summary disposition because it is undisputed that Atrium paid more than $156 million in claims." Resp. Mot. to Dismiss or, in the Alternative, for Summary Disposition (Dkt. # 18) at 31-32. Enforcement's response to that argument, which is incorporated herein, is contained on pages 30-32 of its response to Respondents' motion. EC Opp. to 1st MTD (Doc. # 41).

'for services actually performed,' regardless of the size of the payment relative to the consideration, or whether some of the payment is not bona fide, any potential RESPA violator could avoid liability by the simple expedient of providing or receiving some de minimis service.").

Thus, the Tribunal has already held that the mere payment of claims does not establish a defense under Section 8(c)(2), and there is no basis for reconsideration. The Tribunal's decision was correct because accepting Respondents' argument would nullify RESPA Section 8. There is no dispute that Respondents' payment of claims, or expected claims, under the UGI or Genworth arrangements was funded entirely by premiums previously ceded by those MIs. Respondents did not pay any claims to UGI and Genworth until 2009, **Crawshaw Rep.** at 33 (Table 1), 45 (Table 2), but by then, the respective trust accounts had already accumulated enough in premiums to pay all claims incurred as a result of the real estate crisis with tens of millions of dollars to spare. In short, Respondents' payment of claims, or expected claims, was just a return of a portion of the kickback payments they previously accepted. Under Respondents' view, mortgage lenders could collect any amount of money in exchange for referrals, as long as the lender did more than "nothing" to receive those funds, and the mere act of returning a dollar (or even penny) of the kickback to the payor qualifies as doing "something" to establish complete protection under Section 8(c)(2).[30] That is not the law.

[30] Likewise, if merely making a payment to the other party to the fee splitting were enough to defeat a claim under Section 8(b), then all that a recipient of an otherwise illegal fee split would have to do to escape liability is to pay some nominal portion of its illegal share back to the other party to the split.

Respondents' argument also finds no support in the accounting principles on which they so heavily rely. SSAP No. 62 states: "The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time." **ECX 0790** at 22. Although the parties disagree about what constitutes a "contract" here, there is no disagreement that a risk transfer analysis must be prospective.[31] A risk transfer analysis of a purported reinsurance contract that is based on the payment of claims is not prospective because the payment of actual or expected claims reflects information not available at the inception of a contract.

2. Schmitz's actuarial opinions do not establish "services actually performed" under Section 8(c)(2)

The Countrywide letter states that a captive arrangement can be permissible under RESPA Section 8(c)(2) only if "reinsurance is actually being provided in return for the compensation." Countrywide Letter (Attachment A to **ECX 0194**) at 5. HUD explained that "a real service – reinsurance – is performed" only if there is "a real transfer of risk." *Id.* at 6. This is consistent with Statutory Accounting Principle No. 62:

> *The essential ingredient of a reinsurance contract is the transfer of risk.* The essential element of every true reinsurance contract is the undertaking by the reinsurer to indemnify the ceding insurer, i.e. reinsured entity, *not only in form but in fact*, against loss or liability by reason of the original insurance."
>
> [**ECX 0790** (SSAP No. 62) at 5, ¶ 9 (emphases added).]

As explained in Enforcement's initial brief, there was no transfer of risk to Atrium because it was virtually impossible for Atrium to sustain a significant economic loss at

[31] To the extent that Respondents argue that their payment of some claims constitutes a "service" regardless of whether their arrangements involved a transfer of risk, their argument runs afoul of the Countrywide Letter's clear requirement, discussed below, that "[t]here must be a real transfer of risk." Attachment A to ECX 0194 (Countrywide Letter) at 6.

any point in time. Enforcement's expert, Dr. Mark Crawshaw, explained why this is so in his initial and rebuttal reports. Crawshaw's detailed and well-supported analysis was almost entirely unchallenged by Respondents. Indeed, even though risk transfer is essential to any reinsurance arrangement, Respondents assert nowhere in their brief that Atrium ever faced a reasonable possibility of sustaining an *actual economic loss* under their arrangements. They do not assert that there was ever a real risk that Atrium would be required to pay claims using its own contributed capital, rather than simply returning ceded premiums to the MI.[32] This is fatal to any claim that Respondents' arrangements transferred significant risk to Atrium – as explained by the American Academy of Actuaries, in determining "whether a reinsurance contract meets the standards of SSAP 62," it is "essential" to consider the "potential magnitude of an *economic loss* to the reinsurer." **ECX 0632** (Reinsurance Attestation Supplement 20-1: Risk Transfer Testing Practice Note) at 2 (emphasis added).[33]

Respondents' entire argument regarding risk transfer rests on an actuarial opinion prepared by Milliman's Michael Schmitz regarding the Genworth 2008.B book

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[32] It is not even clear that all of the capital contributions identified in the cession statements were actually assets contributed by Atrium. There is evidence that Atrium treated increased *investment income* – which would include primarily investment income from ceded premiums – as its contributed capital. **ECX 0002** (Atrium "Review of Strategic Initiatives") ("*Increased investment income is reflected as a contribution* to the respective trust accounts, which limits the possibility of future contributions.") (emphasis added). Much like the letters of credit that apparently sufficed as capital contributions in lieu of cash, EC Br. at 197, this further undermines any claim of risk transfer, and provides an additional reason not to offset any disgorgement award with Atrium's purported capital contributions.

[33] *See also id.* (a risk transfer determination must consider "the actuarial evaluation of the *economics of the transaction*.") (emphasis added). Cascio appears to understand this point, although he does not apply it. He believes that the "issue to satisfy is, at contract inception, does the reinsurer assume ample risk so that there is a reasonable possibility of suffering an *economic loss* of reasonable proportions." **Cascio Rep.** at 10 (emphasis added).

year and what they refer to as a "draft report" prepared by Schmitz regarding the "UGI 25% excess-of-loss structure." Resp. Br. at 36, 38. In these opinions, Schmitz concluded that it was reasonably possible for claims to significantly exceed premiums for those individual book years. **ECX 0194**; **RCX 2002**.

First, for reasons Respondents do not explain, Schmitz's analysis of the "UGI 25% excess-of-loss structure" was never officially issued. It was neither finalized nor signed. **RCX 2002**. Respondents could not have reasonably relied upon this "preliminary draft analysis" then, nor can they rely upon it now. As a result, the UGI arrangement lacks even this thin veil.

In any event, Enforcement has already addressed in its initial brief why Respondents cannot rely on the Schmitz actuarial opinions to establish an affirmative defense under Section 8(c)(2). To summarize:

(1) RESPA Section 8(c)(2) requires Respondents to prove that each arrangement – evaluated in its entirety – provided a genuine reinsurance service to the MI and that the payments they received were bona fide payments for that service. It does not permit arrangements to be evaluated in pieces. EC Br. at 71-77.

(2) A single book year within an arrangement does not constitute an entire agreement under a Section 8(c)(2) analysis because the overarching arrangement had many structural features that tied the performance of the individual book years to one another and permitted a loss to occur on one book year only if it was offset by profits on the other book years. EC Br. at 90-95. Interdependence of this sort requires treating the multiple book years as one single contract for the purpose of risk transfer analysis. Therefore, in assessing whether Atrium could suffer an economic loss, each "book year"

within a reinsurance arrangement cannot be evaluated separately. EC Br. at 90, 117-24.

(3) The Schmitz actuarial opinions do not take into account the fact that the later book years existed *only* because earlier book years had been sufficiently profitable. After the risk-free "trial period," Respondents chose to continue with the UGI and Genworth arrangements only because premiums ceded under the first few book years were more than enough to pay any claims that might be incurred under later book years, thereby insulating Atrium's capital from any real risk. Had those earlier book years not been sufficiently profitable, Respondents would have terminated those arrangements without incurring significant losses (as they did with the CMG and Radian arrangements). EC Br. at 122-23.

(4) Because RESPA Section 8(c)(2) is concerned with the actual economic value of the arrangements as a whole, any interpretation of accounting principles that does not evaluate the arrangement as a whole is irrelevant to Section 8(c)(2). EC Br. at 110-13.

(5) Even accounting principles required Milliman's risk transfer analysis to be performed for the arrangements as a whole. EC Br. at 117-20.

(6) Schmitz's actuarial analysis of the Genworth 2008.B book year assumed that a commutation was not a reasonably possible outcome under any of their projected scenarios, even though a commutation was being seriously considered at the time.[34] Had Schmitz accounted for a potential commutation

[34] The same is true with respect to Milliman's draft report for "the UGI 25% cede arrangement." **RCX 2002** at PHH MUNOZ 04145.

in some scenarios, that book year would have certainly failed even Schmitz's artificial test of risk transfer. EC Br. at 124-27.

Accordingly, the Schmitz actuarial opinions regarding risk transfer under the Genworth 2008.B book year and the "UGI 25% excess-of-loss structure" say nothing about whether Atrium ever faced a reasonable possibility of sustaining a significant economic loss. Schmitz relied on claim projections for a single, isolated book year, but it is undisputed that those claims could – and almost certainly would – be paid entirely using premiums previously ceded by the MI. That is not real reinsurance.

Nonetheless, Respondents contend that they were "entitled to rely on Milliman," as if by handing over their entire legal compliance function to an actuary, they could obtain complete immunity from RESPA. Resp. Br. at 42-43. They make two flawed arguments to support their contention. The first is the *ipse dixit* assertion that such reliance was proper because Respondents and the MIs did rely on Milliman. The second is a misuse of Crawshaw's testimony that he believes it was "reasonable … for [Atrium] to hire Milliman and rely on what Milliman said." Resp. Br. at 42 (citing Hrg. Tr. 807:7-11 (3/28)).

Crawshaw's testimony provides no support for Respondents' argument that obtaining an actuarial opinion settles the legal question of whether Respondents can avail themselves of Section 8(c)(2). First, experts cannot opine about legal issues, and the question of whether obtaining an actuarial opinion from Schmitz rendered Respondents' referral scheme completely immune from RESPA is a question for this Tribunal. Second, the cited testimony from Crawshaw means only that a company can rely on an *actuary* to perform *actuarial* work. But even with respect to actuarial work, Crawshaw also testified that he believes Respondents should have, in addition to using

Milliman, obtained "careful review by internal experts and external experts" and that he "wouldn't just rely on one source." **Hrg. Tr. 960:25-961:12** (3/28).[35] Crawshaw also believes Respondents should have secured "legal review." *Id.* Indeed, even on the issue of whether an arrangement can be accounted for as reinsurance, while an actuary may take the lead role in performing a risk transfer analysis, the risk transfer determination is an accounting decision, not an actuarial decision. EC Br. at 114. Moreover, all parties agree that the *ultimate* decision as to whether an arrangement can properly be accounted for as reinsurance is solely the responsibility of management, who is uniquely positioned to understand all of the features of their arrangements that might impact risk transfer (including their own intentions and likely behavior under various circumstances, as well as the existence and impact of agreements other than the one under analysis by the outside actuary). EC Br. at 115. None of the above is sufficient, however, to establish legal compliance with RESPA Section 8, which is not equivalent to or restricted by accounting principles.

This is why Schmitz expressly included in all of his opinions the qualification that they involve "financial and actuarial analysis and judgment," but that with respect to RESPA compliance "nothing in this report is intended to provide legal assurance that the requirements of these laws are met." *E.g.*, **ECX 0194** at 19; **ECX 0466** at 20; **RCX 0025** at 17. Indeed, Schmitz stated in all of his opinions that he has not even opined on "whether there is compliance with any applicable accounting or auditing standards." *Id.*

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[35] Even Burke admits that he typically does not rely on a single actuary to analyze complex arrangements such as Atrium's. **Hrg. Tr. 1726:2-1727:7** (5/30). But other than Schmitz, Respondents did not call any other actuary who performed work on the Atrium arrangements who vouched for Schmitz's methodology or conclusions.

Respondent's "reliance" argument is defeated by the very documents they claim they relied on.

3. Schmitz's actuarial opinions do not establish the reasonableness of the price paid by the MIs

As with their argument regarding risk transfer, to show that the price paid by the MIs was reasonable in relation to the value of the purported reinsurance, Respondents rely entirely on the Schmitz opinions. Resp. Br. at 37-38. The fallacy of Schmitz's pricing analysis is discussed in Enforcement's initial brief. EC Br. at 147-48. Enforcement incorporates by reference that discussion, and provides the following additional responses.

a. The draft UGI 25% XOL opinion provides further evidence that the price Atrium charged was grossly excessive

To support their claim that the UGI 2009 book year was reasonably priced, Respondents cite the so-called "draft report" for the "UGI 25% excess-of-loss structure." Resp. Br. at 38. But in that draft, Schmitz projected Atrium's expected loss ratio for the book year to be 31%, which translates to an expected underwriting profit margin to Atrium of *more than 65*%. **RCX 2002** at MUNOZ 04142.[36] This is approximately the same as Atrium's expected underwriting profit margin for the Genworth 2008.B book year. EC Br. at 146.

Both sides' experts agree that an expected underwriting profit margin of approximately 40% is normally appropriate for providers of true catastrophe coverage. **Cascio Rebuttal Rep.** at 7 (Cascio believes Atrium's "higher expected profit margins" are "normally indicative of catastrophic, excess-of-loss ('XOL') agreements.");

[36] The exact underwriting profit margin would depend on Atrium's expected expenses, which were usually around 1-2% of ceded premiums. *See* **Crawshaw Rep.** Attachment 5.

Crawshaw Rebuttal Rep. at 24. Their consensus on this point is consistent with the only documents in the record reflecting expected underwriting profit margins typical in the insurance industry. Those documents, which are cited in Crawshaw's rebuttal report, show examples of typical *catastrophe* arrangements with expected underwriting profit margins to the reinsurer between 31.5% and approximately 45%. *Id.* at 21- 22. In comparison, according to one of the papers referenced in Crawshaw's report, the pricing of a layer of *non-catastrophe* coverage – which exposes the reinsurer to significant, but not catastrophic risk –produces an expected underwriting profit margin of just 8.3%. *Id.* at 22.

Respondents do not (for they cannot) explain what value they provided to the MIs – other than illegal referrals - to possibly deserve an expected underwriting profit margin that is far higher than even what might be appropriate if their arrangements had exposed Atrium not just significant risk, but catastrophic risk – that is, the risk of a loss so severe as to result in Atrium paying claims that are many multiples of the premiums ceded. **Crawshaw Rebuttal Rep.** at 8-12. Respondents cannot, with a straight face, claim that Atrium provided catastrophe coverage. They cite Walker's testimony that MI is a "catastrophe line of business," Resp. Br. at 11, but a *reinsurance* arrangement does not provide catastrophe coverage simply because the underlying *insurance* is a "catastrophe line of business." As Crawshaw explains, while "the *mortgage insurance industry* is characterized by infrequent but high loss events, that does not mean that *Atrium* itself actually assumed the risk of such high losses." **Crawshaw Rebuttal Rep.** at 56 (emphasis in original). Even Cascio agrees that Atrium did not provide catastrophe coverage because claims that are "catastrophic in nature" are those "from 14%-25%" of aggregate risk. **Cascio Report** at 6. The Genworth 2008.B book year and

UGI 2009 book year did not even cover much of the layer *below* the 14%-25% catastrophe layer because the detachment points for those book years were just 9.5% and 10%, respectively. **RCX 0057** (UGI/Atrium agreement, Amendment #9), ¶ 6; **RCX 0051** (Genworth/Atrium agreement, Amendment #5), ¶ 1.

Nothing in the draft Schmitz opinion for the "UGI 25% excess-of-loss structure" supports a conclusion that Atrium provided catastrophe coverage; indeed, it forecloses such a conclusion. Schmitz determined that this structure had a 10% chance of claims exceeding premiums under that book year by 17% (a loss ratio of 117%). **RCX 2002** at PHH MUNOZ 04135. Thus, like the Genworth 2008.B book year, this book year also barely passed the 10/10 test under Schmitz's artificial single-book year analysis. Schmitz also determined that there was a 5% chance of claims exceeding premiums under that book year by 44%. *Id.* These two scenarios were the least likely scenarios projected by Milliman. Even if one were to assume – contrary to reality – that the *entire* excess of claims over premiums in those scenarios could be paid using Atrium's contributed capital rather than accumulated premiums in the trust account, thereby resulting in an economic loss to Atrium, a 117% or 144% loss ratio is far below the type of loss ratio that could justify an expected underwriting profit margin of over 65%. **Crawshaw Rebuttal Rep.** at 8-9, 21-22 (Casualty Actuarial Society example of typical catastrophe excess-of-loss arrangement shows that an expected underwriting profit margin of approximately 45% is correlated with a potential loss ratio of 1000%). Atrium, of course, could not have incurred an economic loss even if claims exceeded premiums under the 2009 book year by 17% or 44% because premiums in the trust account were so bountiful they could pay that excess many times over, and in any event, Respondents had already

removed all of their contributed capital from the UGI trust account by 2007.[37] EC Br. at 77-78, 98-100.

Schmitz's "draft report" for the "UGI 25% excess-of-loss structure" compels a finding that premiums ceded under the UGI 2009 book year were not bona fide payments for reinsurance.

b. The distinguishing characteristics of captive mortgage reinsurance identified by Respondents further demonstrate that the price charged was extreme

Unable to point to anything in the record justifying the extreme price Respondents charged to the MIs, Respondents are left with the argument that it is not appropriate to compare an MI reinsurer's expected underwriting profit margin to those of insurance or reinsurance providers outside of the MI industry because "fundamental differences in those products" cause MI reinsurers to assume *more* risk than other types of reinsurance and insurance companies. Resp. Br. at 41. But Respondents do not explain how, mechanically, the "fundamental differences" they identify could have increased risk transfer – let alone exposed Atrium's capital to the type of catastrophe risk that could justify a profit margin of 40%, let alone more than 65%. This is because those "fundamental differences" are some of the very features of Respondents' arrangements that prevented any conceivable risk transfer.

They argue, for example, that unlike other types of reinsurance companies, the "cross-collateralization of book years and the long tail period" meant that: (1) "the potential losses to a particular book year may not occur until many years in the future" and (2) "the reinsurer is required to maintain capital in the arrangements potentially for

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[37] Similarly, Respondents removed their contributed capital from the Genworth trust account as claims were finally being paid. EC Br. at 101-02.

this entire period." Resp. Br. at 41. First, Respondents' contention that the "cross-collateralization of book years" was a "fundamental" feature of their arrangements that affected risk transfer is a concession that the coverage of multiple book years was itself a 'fundamental" feature that affected transfer. Schmitz therefore incorrectly failed to account for this fundamental feature in performing a single-book year risk transfer analyses.

The cross-collateralization of multiple book years, working in combination with "the long tail period" in which "potential losses to a particular book year" were deferred "many years into the future," protected Respondents from any significant risk by allowing the trust accounts to build up a massive reservoir of premiums before claims under any book year would be incurred, even if a stress scenario occurred early on in the arrangement. These features also allowed multiple book years to be implemented, securing a significant source of *future* premiums to supplement the already-accumulated reservoir of premiums. Respondents' contributed capital could be called upon only if the accumulation of claims above the attachment point outstripped the accumulation of premiums in the trust at any point in time. In the race between premiums and claims, the "long tail period" (a function of the high attachment point) gave premiums a virtually insurmountable head start and significant momentum from ongoing ceding under multiple book years. Thus, if claims for any particular book year did eventually exceed the attachment point "many years into the future," cross-collateralization of multiple book years allowed those claims to be paid using premiums from other book years.

The "long tail period" also meant that any claims incurred by Atrium would be distributed over several years, rather than occur all at once. Respondents could use that

time – the end of the "long tail period" – to study the situation and adjust their actions accordingly to prevent any conceivable risk transfer. They could carefully evaluate the risk of continuing with the arrangement, and if there was anything more than a remote chance that claims might have to be paid using their own capital (as opposed to premiums), they could either: (1) take dividends to remove their existing capital from the trust account, or (2) they could force a termination with, at most, a minimal loss.

The former scenario unfolded with the Genworth and UGI arrangements. In those arrangements, despite the occurrence of a catastrophic real estate crisis, claims were spread out over a period of several years. **Crawshaw Rep.** at 33 (Table 1, column F), 45 (Table 2, column F). But because Respondents took dividends which recovered all of their previously contributed capital claims, those claims could not possibly result in an economic loss to Respondents. EC Br. at 98-105.

The latter scenario occurred with the Radian and CMG arrangements. In both cases, continuing with the arrangement would have required Atrium to contribute additional capital to the trust account. Crawshaw explains that because the "full impact" of the real estate crisis "was not evident on the first day or even the first week that real estate prices began to fall," Respondents could, as the crisis unfolded, "more accurately evaluate the severity of the crisis and the risk that any additional capital contributed to the Trust Account would actually be called upon." **Crawshaw Rebuttal Rep.** at 78. Indeed, on February 18, 2009, shortly before Atrium decided to commute the Radian arrangement but long after the real estate market's decline began, Danahy emailed Bogansky: "At this point I do not want to put additional capital at risk with this trust . . . If we choose not to fund additional capital [R]adian can take back the trust and re-assume the risk." **ECX 0254**, at 2.

Thus, far from requiring Atrium to "maintain capital in the arrangements potentially for this entire period," Resp. Br. at 41, the cross-collateralization of multiple book years and the "long tail period" is precisely what allowed Atrium to avoid any significant risk to its capital. Nonetheless, Respondents go even further by contending that reinsurance companies outside of the MI industry differ from Atrium in that they are *not* required to maintain their capital in the arrangement for an extended period of time. *Id.* Using the example of a hurricane that "happens on a day," they assert that in other lines of property and casualty insurance, "the period of time for filing claims is defined, and the reinsurer will be on notice of potential claims much more closely in time to the covered period." *Id.* But as Crawshaw explains, in other lines of property and casualty insurance business, "the adverse events that will require the coverage provider to use its own capital usually begin and end quickly, and occur *without notice* – for example, an earthquake, a terrorist event, or a hurricane." **Crawshaw Rebuttal Rep.** at 77 (emphasis added). Thus, once an adverse event strikes, "claims must be paid using the large amount of capital that has already been committed to the arrangement, and those obligations cannot be avoided simply by terminating or commutating the arrangement." *Id.* In addition, the proximity of the underlying event to the incurrence of a claim prevents these other types of insurers from shirking economic loss by ensuring that premiums will outstrip claims; the possibility of large losses after receipt of only minimal premiums exposes them to potentially massive loss ratios. Their commitment to providing capital far in excess of premiums, which can result in a loss ratios approaching or exceeding 1000%, is why true catastrophe coverage providers earn expected underwriting profit margins in the range of 40%. *Id.* at 11 (providing real-life

examples of hurricane and earthquake reinsurance contracts with maximum loss ratios of 896%, 1337%, 636% and 1786%).

Another characteristic of captive mortgage reinsurance that Respondents contend resulted in Atrium assuming greater risk than other types of (non-catastrophe) insurance or reinsurance companies is the higher attachment point. Resp. Br. at 41 n.22.

[REDACTED] Obviously, all other things equal, a *higher* attachment point should entitle Atrium to a *lower* – not higher – expected underwriting profit margin because that feature *reduced* the likelihood and extent of claims to Atrium. *See also* **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). Accordingly, this distinguishing characteristic means Respondents' arrangements should have had a lower expected underwriting profit margin than the approximately 8% expected profit margin that is typical of non-catastrophe arrangements.

Finally, Respondents contend that Atrium deserved a much higher profit margin than most catastrophe coverage providers because Atrium had the "ability to exclude certain loans from the reinsurance agreement." Resp. Br. at 41. This, too, is nonsensical. As discussed below, Respondents obtained amendments to their existing captive

agreements to carve-out subprime loans from coverage by Atrium (even though the MI would still insure the subprime loans under the primary policies). *See* pp. 66-67 *infra*. Because subprime loans are the loans most likely to result in claims, excluding them from coverage under the captive arrangement further *reduced* any risk transfer to Atrium compared to other types of non-catastrophe coverage providers. Therefore, this distinguishing characteristic also supports a finding that Atrium's expected underwriting profit margin was wildly excessive in relation to any "risk" it purported to assume.[38]

c. Any comparison of expected loss ratios for Atrium and the MI would not establish that the price was reasonable in relation to any risk transferred

Citing Schmitz's opinion on the Genworth 2008.B book year, Respondents argue that because "Milliman … looked at the loss ratio comparison between Genworth and Atrium" and concluded that Atrium's expected loss ratios were "reasonable in relation to the loss ratios" for Genworth, the price charged to Genworth was reasonable in relation to the risk transferred. Resp. Br. at 38. As discussed in Enforcement's initial brief, any similarity between the expected loss ratios of Atrium and the MI would only show that the expected result of the arrangement was to provide Atrium a share of the MI's profits. EC Br. at 107-09. That comparison does not show that Atrium did anything to deserve that profit.

For example, the Schmitz opinion for the Genworth 2008.B book year shows that Genworth's expected loss ratio for that book year was 37% and Atrium's expected loss

[38] Respondents also contend that "the fact that the primary beneficiaries of the pmi may be subsequent investors and not the original lenders" is another distinguishing characteristic. Resp. Br. at 41. This does not in any way increase risk transfer under Respondents' arrangements compared to other types of property and casualty reinsurance arrangements.

ratio for that book year was 32%. **ECX 0194** at 16. Because both expected loss ratios are well under 100%, this comparison shows that both entities were expected to profit on that book year. But any profit to Atrium must have reduced the profit to the MI, so similar loss ratios would merely show that the MI's profit was shared with Atrium. **Hrg. Tr. 1453:20-22** (5/29 Cascio) ("anytime a reinsurer makes money with hindsight, the insurer would have been better off retaining the business 100 percent"). This does not prove the reasonableness of the price charged because profit can be shared regardless of the extent of risk transferred (if any). **Crawshaw Rebuttal Rep.** at 32-45; EC Br. at 107-09; **Hrg. Tr. 751:21-23** (3/28 Crawshaw) ("[T]here's certainly no justification for any underwriting profit because there's no ... risk to the capital.").[39]

d. Culver's testimony does not support the reasonableness of the 25% ceding rate

To support their reliance on Schmitz's conclusion that the 25% ceding rate was reasonable, Respondents point to the testimony of Culver that Protective Order [redacted]

[redacted] Whether Culver may have concluded that ceding 25% of MGIC's premiums to captive reinsurers was an acceptable price to pay for illegal referrals (as opposed to 40% or 45%) is beside the point. But in

[39] Cascio testified that comparing the MI's potential loss ratio with Atrium's potential loss ratio also shows the value of the arrangements because the MI supposedly "know[s] PHH's captive is going to take it on the chin before I'm suffering a net economic loss." **Hrg. Tr. 1352:13-21** (5/29). But as Crawshaw explained, Cascio's opinion fails to consider that "the first transaction is the MI giving premium to Atrium" which results in a "loss to the MI," and "in that sense, the MI takes it on the chin" each time it ceded premiums to Atrium. **Hrg. Tr. 2286:18-2287:6** (6/4). *See also* **Crawshaw Rebuttal Rep.** at 16 ("It is important to understand that UGI's losses were not limited to just the claims it paid. UGI's losses also included every dollar of premiums it ceded to Atrium that was not returned to it as either a claim or commutation payment by Atrium.").

any case, the contemporaneous documents refute Respondents' claim that Culver believed the 5/5/25 structure provided economic value to MGIC (excluding the value of illegal referrals). During a 2003 earnings conference call, an analyst noted that MGIC had capped its ceding at 25% and asked Culver "where would you rather be?" **RCX 1048** at MGIC-CFPB00192322. Culver responded that MGIC's "*first preference* is to write flow business, *no captive*," its "second preference is to write bulk business," and its "*third preference* is to write flow business with the *5-5-25 cap activities*." *Id.* at MGIC-CFPB00192323 (emphasis added). He stated that "what we'd really like is to be back to the days of old where there were no captives and just writing flow business, but that's not reality." *Id.* Culver could not have been clearer that he believed the 5/5/25 structures provided less value to MGIC than having no captive arrangements at all.

e. Schmitz's opinion that the 25% ceding rate was "squarely in the range" of other captive agreements is based on a market price that is tainted by RESPA violations

In a final gambit to justify the price charged, Respondents weave a fictional tale regarding the development of the captive mortgage reinsurance "market." Respondents assert that MIs such as UGI "wanted to purchase reinsurance but it was generally not available from any non-lender affiliated reinsurers." Resp. Br. at 38. As a result, "the only reinsurance that was available was through lender-captives," and the "market rate was defined by the industry." *Id.* According to Respondents, this resulted in the 25% ceding rate for the Genworth 2008.B. book year and the UGI 2009 book year, which Schmitz found to be "squarely in the range" of other captive agreements he reviewed. *Id.*

Respondents' creative rendition of history is supported by no documents. For example, they cite no documents showing that MIs generally "wanted to purchase reinsurance," or that they ever prized their captive arrangements for their reinsurance

value. Key events in the history of captive arrangements, which are omitted in Respondents' story, are detailed in Section III.A.2.a of Enforcement's initial brief. EC Br. at 9-16. In truth, Respondents introduced the first captive arrangement in the industry, and then led the industry towards arrangements that were ever more favorable to the lender-captives, against strong resistance by the MIs. The MIs were compelled to participate because they wanted referrals, not reinsurance. The reinsurance premiums were simply the price they had pay to obtain those referrals. *Id.*

Respondents' contention that the MIs wanted reinsurance but that only lender-affiliated captives were willing to provide it is contrary to the basic laws of economics. Had MIs wanted reinsurance, surely other companies would have been willing to meet the need. When asked at PHH Corporation's 30(b)(6) deposition whether there were "any other ways for MIs to get reinsurance other than through a lender's affiliated" captive, Danahy responded: "I'm sure there are, yes." **ECX 0153** (Danahy Dep.), Tr. 202:6-9. He testified that "big reinsurance businesses" such as Lloyd's, Berkshire, and Gen Re would have provided reinsurance if an MI wanted it. *Id.* 203:5-11. Similarly, Culver testified that in the 1980s, when MGIC needed reinsurance due to some financial difficulties it was having, it obtained a quota share reinsurance arrangement with a non-lender affiliated company. **Hrg. Tr. 345:6-22** (3/25 Culver). And MGIC currently uses non-lender affiliate reinsurance provided by companies such as Partner Re and Arch Re. *Id.* **344:19-345:2**.

Schmitz's testimony that the 25% ceding rate was "squarely in the range" of other agreements he reviewed cannot establish the reasonableness of that price because it is likely that other captive arrangements with a similar structure that he reviewed were also overpriced or transferred no significant risk. The evidence does not support any

notion that the 25% ceding rate was the result of a matching of supply and demand forces in a fair and competitive market, or that it a product of a pricing analysis tailored to the risks covered by captive arrangements. **ECX 0153** (Danahy Dep.), Tr. 127:23-128:6. In 2008, lender-captives were effectively forced to reduce the ceding percentage because of Freddie Mac's decision in 2008 to no longer purchase loans subject to captive arrangements with a ceding rate higher than 25%. **ECX 0153** (Danahy Dep.), Tr. 107:4-6 ("So we have a 25% max cede limit, and that was effectively dictated by Freddie Mac.").[40] There is no evidence that any underwriting was ever done by Respondents to determine any ceding rate, let alone the 25% rate. The reason for this is simple: the market in which Respondents and the MIs continued to operate after 2008 remained a market for illegal referrals, not legitimate reinsurance.

4. The other "benefits of reinsurance" advanced by Respondents are unsupported and cannot compensate for their failure to show risk transfer

Section III of Respondents' brief touts various supposed "benefits of reinsurance" – other than risk transfer – that the MIs received from their captive arrangements with Respondents. Notably absent from this discussion is a citation to a single contemporaneous document from Respondents or any of their MI partners reflecting those "benefits." For example, given that UGI and Genworth together ceded over $400 million of their revenue to Respondents over more than 15 years, there should be a vast number of documents generated by the MIs over that time period discussing each of those "benefits" in detail, including business plans, proposals, cost-benefit analyses, and internal justification documents. There should be numerous documents demonstrating

[40] It appears that Freddie Mac considered mandating a lower maximum rate than 25%, but "some MI companies argued with Freddie to preserve at least a 25% cede for captives," in an apparent effort to appease lenders. EC Br. at 45; **ECX 0378**.

that these alleged factors actually motivated the MIs to enter into a captive arrangement with Respondents and to continue with those arrangements for so many years. One would also expect there to be documents from Respondents emphasizing these "benefits" as a selling point, as well as documents showing frequent monitoring by the MIs of their arrangements to ensure that these "benefits" were actually being obtained. And given the prevalence of captive arrangements throughout the MI industry, there should be extensive discussion of the alleged "benefits" in the media, analyst reports, and other third-party documents. Instead, there is not so much as a passing reference in an email to any of the alleged "benefits."[41]

Respondents are left to rely on self-serving testimony from industry representatives – Walker, Rosenthal and Danahy – who have a strong interest in defending the practice of captive mortgage reinsurance, which they or the companies they represent pioneered and for which their companies have been subjected to lawsuits. The captive arrangement between Atrium and UGI in 1995 was the first one in the industry, and Walker personally helped design that arrangement. **Hrg. Tr. 2183:23-2185:1** (6/4 Walker). Rosenthal represents Respondents in this proceeding, and he managed PHH's relationship with the MIs. *Id.* **99:20-101:19** (3/24 Rosenthal).

[41] Respondents cite only two documents discussing any of these "benefits." The Tribunal should give neither any weight. The first is a Schmitz opinion stating that captive arrangements "provid[e] the lender with an incentive for better loan originations," Resp. Br. at 12 (citing **ECX 0194**), but Schmitz heavily promoted captive arrangements and is not independent and objective for the reasons discussed in Enforcement's initial brief. EC Br. at 148-54. Also, he is an actuary with no evident training in business or in creating "incentive[s] for better originations." The second is a 2013 press release from MGIC discussing its settlement with the Bureau regarding its captive reinsurance arrangements, in which MGIC stated that captive reinsurance was used "to stabilize claims experience and protect against catastrophic losses." Resp. Br. at 12-13 (citing **RCX 0816**). This document was not created in the ordinary course of business; rather, it provides justifications for MGIC's participation in captive arrangements in the wake of the settlement.

Danahy was the President and CEO of PHH Mortgage and a Director of Atrium, and his deposition was taken pursuant to Fed. R. Civ. P. 30(b)(6) in the class action lawsuit against PHH and Atrium asserting that their captive arrangements violated RESPA. **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. 17:19-24.

Their testimony regarding the alleged benefits of captive arrangements is not only unsupported by contemporaneous documents, it is contradicted by the extensive and highly detailed record in this proceeding (discussed Section III.A of Enforcement's initial brief) showing that the real purpose of the captive arrangements was to transfer kickback payments to Respondents in exchange for referrals.

While Respondents assert that the testimony of Walker and Rosenthal on the "various business justifications of obtaining excess-of-loss reinsurance in an arrangement with a lender ... stands unrefuted," in fact it is conclusively refuted by the documentary evidence, including numerous documents they authored.

Enforcement has explained in Section III.B of its initial brief how Respondents' arrangements were designed to prevent the transfer of significant risk to Atrium. Before addressing the other purported "benefits of reinsurance" advanced by Respondents, it is important to emphasize that without a transfer of significant risk, an arrangement cannot qualify as "reinsurance" in the first place. This is because risk transfer is the *sine qua non* of any reinsurance arrangement. *See* **ECX 0790** (SSAP No. 62) at 5, ¶ 9 ("The essential ingredient of a reinsurance contract is the transfer of risk."). Accordingly, an arrangement that does not transfer risk is not "reinsurance" at all, so there can be no

"benefits of reinsurance" from such an arrangement. It is therefore telling that the only "evidence" Respondents cite in their section on the "benefits of reinsurance" to support their claim that their captive arrangements transferred risk is the testimony discussed earlier in the same section regarding various other "business justifications of obtaining excess-of-loss reinsurance in an arrangement with a lender." Resp. Br. at 15. Those other purported justifications include: (1) giving the lender "skin in the game"; (2) smoothing the MI's financial results; and (3) providing the MI "capital relief." Resp. Br. at 12-14. But Respondents cannot avoid the risk transfer requirement by pointing to other supposed "benefits of reinsurance." These other "benefits" cannot compensate for Respondents' failure to show that they faced any risk of incurring a significant loss of their capital through their arrangements.

In any event, even if the other "benefits" advanced by Respondents could stand on their own (they cannot), they are all unavailing. Indeed, they do not even withstand the test of simple logic.

a. "Skin in the game"

Respondents contend that the "*[m]ost significant* of [the] benefits" of captive reinsurance is "the alignment of the interests of the MI and the lender, or 'skin in the game.'" Resp. Br. at 12 (emphasis added). The "skin in the game" theory of captive participation fails because it requires the arrangement to transfer significant risk to the lender – that is, for the theory to make sense, the lender must face a reasonable possibility of incurring a significant *economic loss* (*i.e.*, lose its "skin") if it places poorly underwritten loans into the captive. The exposure to the lender must be both real and substantial – it cannot the product of an accounting gimmick. The lender's actual exposure does not depend on which accounting model is applied. **Hrg. Tr. 1771:25-**

1772:3, **1785:18-1786:3** (5/30). As Burke emphasized at the hearing, the question of whether Respondents' arrangements "meets the reinsurance accounting requirements" is 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**.

Thus, the illusory single-book year "loss ratios" projected by Milliman would not suffice because they do not show that Respondents faced a real risk of economic loss at any point in time over their arrangements; Atrium could simply pay the excess of claims over premiums for the single book year under analysis using the enormous reserve of premiums collected from other book years. Enforcement has shown that it was virtually impossible for Respondents to incur a significant economic loss under any of their arrangements. EC Br. at 77-105. In fact, in every Milliman report, Atrium's loss ratio projected over multiple book years (rather than just the single book year under analysis) was far below 100% even in the stress scenario, showing that Atrium had no *real* exposure to loss on the arrangement.[42]

The "skin in the game" justification is especially fantastical here because the MIs agreed to amend their contracts with Atrium to *exclude* subprime loans from coverage. For example, Amendment No. 6 to the UGI/Atrium agreement provides: "Loans with a representative credit score of 600 and less (as determined and reported to the Ceding Company by the underwriting guidelines of PHH Mortgage Corporation) are not eligible to be insured under this Agreement on or after April 1, 2006." **ECX 0584** at CFPB-

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[42] *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.

PHH-00116638, ¶ 1.F. *See also* **RCX 0049** (Genworth/Atrium agreement, Amendment # 3), ¶ 1 (excluding "any Loan where the Lender's [sic] credit score is less than 600"); **RCX 0043** (Radian/Atrium agreement, Amendment # 1), ¶ 1.B.i (excluding loans with "a Representative Credit Score less than 600 and greater than zero as defined by PHH's Underwriting Guidelines").[43] If the MIs were interested in incentivizing PHH to originate higher quality loans, excluding subprime loans originated by PHH from the captive (while the MI continued to insure the subprime loans under the primary policies) would have defeated that objective. These amendments also show that PHH was in fact originating subprime loans; otherwise, there would have been no need to exclude them. Yet the MIs continued to cede premiums to Respondents after 2006, further demonstrating that incentivizing PHH to originate better loans was not what drove the MIs to cede those premiums to Respondents.[44]

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[43] These amendments were made at Respondents' request. For example, on May 10, 2006, Rosenthal emailed Dave Tubolino of Genworth that "effective immediately, we desire to stop placing loans with Credit Scores of less than six hundred …." **ECX 0502** at CFPB-PHH-00124509-10. On May 15, Tubolino responded that Genworth would "honor your request to remove loans with FICO scores less than 600 from PHH's captive structure (Atrium Insurance Corp) on a go forward basis with an effective date of today" and that Genworth's legal department would be "drafting the contract amendments." *Id.* After receiving the draft amendments, Rosenthal responded that "Mark Danahy and I have consulted with Milliman and are convinced that this is an acceptable modification to the transaction." *Id.* at CFPB-PHH-00124508-09. But Rosenthal was not satisfied, and pressed for the amendment to retroactively exclude subprime loans originated from the beginning of the quarter rather than starting on May 15. *Id.* at CFPB-PHH-00124507-08. Genworth accepted his request without objection. *Id.* at CFPB-PHH-00124507. The amendment excluding subprime loans from the Genworth captive was signed in July of 2007 and was "effective as of April 1, 2006." **RCX 0049**, ¶ 3.

[44] Moreover, during the same time period over which captive arrangements were in place in the industry, lenders' underwriting criteria totally deteriorated. So even if someone, somewhere, believed that a captive arrangement could theoretically be valuable to the MI because it gave the lender some "skin in the game," it would have been obvious that improved underwriting criteria were not being achieved. In addition to the lack of documentary evidence reflecting this alleged benefit, the MIs' continued

b. "Smoothing of financial results"

Next, Respondents contend that "by purchasing reinsurance, the MIs could smooth their financial results by reducing the volatility of their earnings." Resp. Br. at 12-13. Again, Respondents cite no contemporaneous documents showing that this was a factor in the decision of any MI to cede premiums to Atrium. This is because, as Culver testified, MIs did not participate in captive arrangements to stabilize their claims experience. **Hrg. Tr. 399:18-400:4** (3/25).

As explained above, risk transfer is essential to any reinsurance contract, and Respondents cannot salvage an arrangement lacking in risk transfer by claiming that the arrangement stabilizes financial results. *See* p. 44 *supra*. If it were otherwise, a free savings account, which could have stabilized the MIs' financial results far more effectively than Respondents' arrangements, would qualify as "reinsurance." As Crawshaw explains in his rebuttal report, a savings account would have guaranteed the MI a return of *all* of its deposited funds, with interest, to be called upon to pay any claims that Respondents' arrangements could pay, and any money left over would belong to the MI. In contrast, any funds not used to pay claims under Respondents' arrangements would be lost to the lender. **Crawshaw Rebuttal Rep.** at 113-14.

Indeed, the law is clear that companies may not use accounting devices, such as transactions accounted for as "reinsurance" even though they do not transfer risk, to artificially "smooth" their earnings. For example, in *SEC v. Stanard*, the defendant admitted that "the true purpose of the transaction was to 'smooth' earnings, though he continued to insist that he wanted to accomplish this result by means of a transaction

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participation in captive arrangements throughout the industry even as underwriting criteria deteriorated, requiring them to cede to the lender close to half of their revenue on the loans covered, shows "skin in the game" was not the reason they did so.

that would transfer the minimum amount of risk necessary to satisfy the accounting standard for reinsurance accounting." No. 06 Civ. 7736 (GEL), 2009 WL 196023 at *11 (S.D.N.Y. Jan. 27, 2009). The court held that because the transactions did not transfer risk, any smoothing of earnings achieved by the arrangement was illegitimate:

> Accordingly, accounting for a transaction as reinsurance that should not be so accounted for because *no risk is actually transferred*, and the reinsured company will be able to make a claim with certainty and with no risk of loss to the reinsuring company *permits the insured to 'smooth' earnings by reducing its apparent profit in exceptionally good years in which earnings targets have been exceeded, and 'parking' funds with a reinsurer to be reclaimed, and increase apparent profits, in a future year in which earnings targets have not been reached.*
>
> [*Id.* at *3 (emphasis added).]

See also SEC v. Worldcom, Inc., No. 02 Civ. 4963(JSR), 2003 WL 22004827 (S.D.N.Y. Aug. 26, 2003) (noting with disapproval trend of companies using "very aggressive accounting interpretations" to "spread current profits into future earnings to facilitate earnings smoothing").

Even if it were lawful to smooth a company's financial results using an arrangement that does not transfer risk, Respondents failed to show how their captive arrangements achieved a result that could not have been achieved with a savings account.

. But depositing those funds into a savings account instead would also have resulted in a very substantial reserve, without UGI risking any loss of its capital. Walker admitted that

And Respondents' experts did not contend that the "smoothing" effect of Respondents' arrangements was superior to what a savings account could achieve at no risk to the MI. They effectively conceded the point. *See also* **Hrg. Tr. 610:14-19** (3/26 Crawshaw) (explaining "the essence of reinsurance … is something more than a savings account").

Any conceivable smoothing achievable through captive arrangements was greatly outweighed by the destabilizing impact caused by the segregation of premiums across captive trust accounts. The immense amount of premiums ceded by UGI that were not returned to UGI through claim payments could not be used by UGI to pay claims on other MI policies which were not covered by its captive arrangement with Respondents. Premiums ceded by UGI were locked within the captive trust, with only two possible destinies – either they were returned as claim payments to UGI on the limited layer for loans covered by the captive or taken by Respondents through a dividend or commutation payment. Had UGI not entered into a captive arrangement with Respondents, those excess premiums could have been freely used to pay claims under *any* of UGI's MI policies, not just those covering loans originated by PHH and covered by Atrium. In 1998, all of the country's major MIs, including Genworth and UGI, expressed concern that this segmentation of MI premiums would jeopardize "the overall strength and claims-paying ability of the private mortgage insurance industry." **ECX**

0035 (1/22/1998 Presentation to Arizona Department of Insurance, "Captive Reinsurance and Other Risk Sharing Arrangements") at CFPB-PHH-00609392, 405-08. *See also* **Hrg. Tr. 2265:22-2268:3** (6/4 Crawshaw) (captive arrangements had "the effect of basically balkanizing the resources of the MI and destabilizing" the industry), **2330:9-2332:7** (captive arrangements "actually impaired the mortgage insurance industry" because "a company like UGI has its whole portfolio broken up into all these little balkanized captive arrangements, it's not good for the industry as a whole and it's not good for their stability, and it increased their risk").

Culver's testimony that Protective Order [redacted] does not turn Respondents' arrangements into legitimate reinsurance. Resp. Br. at 13 (citing Protective Order [redacted]. First, as discussed above, risk transfer is essential to every reinsurance arrangement, and a risk transfer analysis must be performed prospectively. *See* pp. 44-45 *supra*. Claim payments are retrospective and therefore cannot establish that MGIC's captive arrangements transferred significant risk. SSAP No. 62 states: "The status of a contract should be determinable *at inception*" such that "[i]f the risk of significant loss was not deemed reasonably possible at inception, and a *significant loss subsequently occurred*, the initial assessment was not necessarily wrong, because remote events do occur." **ECX 0790** (SSAP No. 62) at 22-23 (emphasis added).

It would be particularly inappropriate to use claim payments received by MGIC under its various arrangements to retrospectively establish "risk transfer" under MGIC's various captive arrangements (let alone Respondents' arrangements) because Culver's testimony demonstrates that it was not even the case that a "significant loss [to the captive reinsurers] subsequently occurred" under those arrangements. Culver testified

that Protective Order

This also necessarily means that a savings account could have achieved an equal or superior result, without the transfer of massive profits to lenders and the segmentation of premiums that impaired the MI's ability to pay claims. In contrast, Culver testified Protective Order

Although Culver testified that, Protective Order

Indeed, had it not ceded premiums to any lenders through captive arrangements, MGIC would have been statutorily required to maintain a sufficient portion of those premiums (half of them) in a "contingency reserve" set up for the precise purpose of enabling the MI to survive a catastrophic real estate crisis. As Atrium explained in its financial statements, the contingency reserve is a "*special statutory reserve designed to protect policyholders against loss during a period of extreme economic contraction*" and requires insurers to "set aside fifty cents of each premium dollar earned and maintain the contingency reserve for a period of ten years, regardless of the length of coverage of the particular policy for which premium was paid . . . ." **ECX 0191** (12/31/2010 Atrium Financial Statements) at CFPB-PHH-00103655 (emphasis added); *see also* **Hrg. Tr. 775:14-25** (3/28 Crawshaw) (the contingency reserve requirement "recognize[s] that mortgage insurance is catastrophe prone, and that's the whole purpose of the contingency reserve;

it's a device to enhance a solvency of the mortgage insurance industry"). Thus, the contingency reserve requirement would have restricted the extent to which MGIC could reduce its retained premiums through a stock buyback, thereby ensuring that the company could survive a "period of extreme economic contraction." And even if MGIC had spent the other half of the premiums to buy back stocks, it would have acquired assets of equivalent value in exchange for that money, instead of giving some or possibly all of it away to Respondents.

Captive arrangements also impaired the effectiveness of the contingency reserve because they segmented the reserve across each captive. When MGIC ceded premiums to its various lender captives, each captive was required to set aside half of every dollar of ceded premiums in a separate contingency reserve, but the premiums in each such reserve (like all ceded premiums in the captive) could only be used to pay claims on policies covered by that specific captive. **Hrg. Tr. 639:20-25** (3/26 Crawshaw) (the MI cannot "reach the . . . piece of contingency reserve that's sitting" in the captive). Without captive arrangements, premiums in the contingency reserve could be used to pay claims on *any* MI policy. In this way, captive arrangements (such as those MGIC participated in) impaired the overall claims-paying ability of MIs.

At bottom, Respondents' argument that captive arrangements constituted "services actually performed" for the MI because they returned ceded premiums to the MI during the real estate crisis is a restatement of their already-rejected argument that the payment of claims establishes entitlement to protection under Section 8(c)(2). That ruling should not turn on the *amount* of ceded premiums returned to the MI.

Finally, Respondents' "smoothing" theory ignores the negative impact of ceding 40% of revenues on captive loans on the MIs' financial results, and illogically assumes

that MIs preferred substantially *worse* financial results as long as they were more stable than they might otherwise be without captive ceding. The investment community expressed concerns about the substantial negative impact of captive ceding on the profitability of MIs. The 2003 Bear Stearns report, for example, found that the increasing use of deep-cede arrangements was eroding the MI industry's financial results. Bear Stearns stated:

- "*The wider use of deep-cede, excess of loss structures should lead to lower returns for MIs* as business subject to captive arrangements and revenue sharing account for an increasing share of total business."
- "Despite the fact that *the economics of these structures have been unfavorable to the MIs*, lenders have been able to pressure the industry into ceding very high percentages of premium ...."
- "[B]y the time they start getting paid by reinsurers under excess of loss captive arrangements, it is too late, and *their returns have already been negatively affected by large premium cessions*."

[**ECX 0793** (3/2003 Bear Stearns Equity Research report, "The Trouble with Captive Reinsurance") at 1, 9, 12 (emphases added).]

Respondents presented no basis to conclude that the MIs entered into captive arrangements with Respondents because they wanted smoother, but demonstrably worse, financial results.

c. "Capital relief"

Respondents claim that their arrangements provided the MIs "capital relief." Resp. Br. at 13-14. Respondents do not define what they mean by "capital relief," or explain why the Tribunal should conclude that any of the MIs participated in the captive arrangements with Respondents to obtain "capital relief." They cite no documents reflecting any need or desire for "capital relief," nor do they point to any financial statements demonstrating the extent of "capital relief."

Based on their citation to Culver's testimony, it appears that Respondents are referring to the effect of reinsurance transactions on the MI's "risk-to-capital" ratio. **Hrg. Tr. 339:8-21** (3/25). As of June 2011, 16 states required MI companies to maintain a risk-to-capital ratio below 25-to-1. **Crawshaw Rebuttal Rep.** at 121. Culver testified Protective Order [redacted] Nonetheless, Respondents assert that it is possible that other MIs were interested in obtaining "capital relief." Resp. Br. at 13-14. This unsupported theory is insufficient to meet their burden under Section 8(c)(2).

In his rebuttal report, Crawshaw explains in detail why it is illogical to conclude that "capital relief – or "surplus relief," as Cascio calls it – was a benefit that any of Respondents' MI partners sought or obtained through participating in captive arrangements with Respondents. **Crawshaw Rebuttal Rep.** at 118-24. No witness at the hearing disputed any aspect of Crawshaw's opinions on this matter. Rather, Cascio affirmed that, as he testified at his deposition, he would be "really speculating" to say that "surplus relief" was a driver of either UGI's or Genworth's decision to enter into captive arrangements and that "I'm not sure I would hang my hat on [surplus relief]" as a factor. **Hrg. Tr. 1496:16-1497:25** (5/29). Enforcement respectfully refers the Tribunal to Crawshaw's discussion of this issue in his rebuttal report, which Enforcement incorporates herein in its entirety. Crawshaw's opinions are summarized below.

First, while transferring a portion of the MI's risk to a reinsurer could result in a short-term reduction of the MI's risk to capital ratio (reflected in a reduction of the

numerator[45]), over the long run, the ceding 40% of their premiums (on a net basis) would likely have resulted in an even greater reduction in the MI's capital and therefore *increased* its risk-to-capital ratio. **Crawshaw Rebuttal Rep.** at 121-22. The "capital" in the ratio (the denominator) consists of the MI's "policyholder surplus" and its "contingency reserve." *Id.* at 120. The "policyholder surplus" is the difference between the MI's assets and liabilities. *Id.* at 120 n.237. As Crawshaw explains, "[c]eding 40% of premiums would reduce the MI's assets, and thus reduce its policyholder surplus[46] – a main component of capital – over time, and would do so in greater proportion than the reduction in risk achieved by ceding only 10% of aggregate risk (the 14% detachment point minus the 4% attachment point)."[47] *Id.* at 122. Crawshaw concludes that, "while it is conceivable that a primary insurer might decide to enter into a single reinsurance arrangement at a given point in time to reduce its risk-to-capital ratio as a short-term measure (for example, if it is at or near the maximum risk-to-capital ratios allowed by statute), it would not make much sense for the MIs to do so on a long-term basis, given the ultimate impact . . . ." *Id.*

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[45] Crawshaw explains that, because the MIs knew Respondents' arrangements did not actually transfer significant risk to Atrium, the MIs should not have reflected any reduction of risk in their financial statements. Because the MIs retained the risk, he concludes that any "reduction in their risk-to-capital ratio would have been illusory and not consistent with the purpose of maximum risk-to-capital requirements" and any "capital relief" would not have been legitimate. **Crawshaw Rebuttal Rep.** at 121.

[46] While the MI could also take credit for the reinsurance transaction on its balance sheet by reducing its liabilities, reflected in a reduction of certain reserves that are based on potential claims, the reduction in assets caused by the ceding of 40% of the MI's premiums (on a net basis) would exceed any reduction in liabilities because premiums ceded were "excessive relative to the expected amount of claims." **Crawshaw Rebuttal Rep.** at 118-19. As a result, "the ultimate negative impact on the MI's assets would likely exceed any reduction in liabilities." *Id.*

[47] The MI's contingency reserve – another component of capital – is a function of the premiums retained by the MI, so ceding 40% of premiums to Atrium would reduce the MI's contingency reserve as well. **Crawshaw Rebuttal Rep.** at 122.

Second, while Respondents characterize MGIC's low risk-to-capital ratio as anomalous, all of Respondents' MI partners had risk-to-capital ratios far below 25-to-1 until the real estate crisis struck. According to a 2003 report from Bear Stearns, "private mortgage insurers do not have to be concerned about capital levels" because "they are very well capitalized" and have "excess capital." **ECX 0793** at 9, 28. As of September 30, 2007, the risk-to-capital ratios of UGI, Genworth, Radian, and CMG were only 13.9-to-1, 11.3-to-1, 9.7-to-1 and 14.5-to-1, respectively. **Crawshaw Rebuttal Rep.** at 122-23. Because their risk-to-capital ratios were already so low, the MIs could not have been motivated to enter into captive arrangements with Respondents to reduce those ratios below the 25-to-1 maximum.

Third, even if there had been pressure on the MIs to reduce their risk-to-capital ratios, they had readily-available options to address such a situation other than entering into highly disadvantageous captive arrangements. As Crawshaw explains, both UGI and Genworth "have a much larger capital base than Atrium and are part of large enterprises with access to large amounts of capital." *Id.* at 123. For example, in late 2011, when Genworth's risk-to-capital ratio breached the 25-to-1 limit, Genworth's parent company ultimately implemented a "capital plan" to reduce Genworth's risk-to-capital ratio by as much as 15 points. *Id.* at 123-24. Under that plan, Genworth's parent company injected $100 million of capital to Genworth, and allowed Genworth to set up a "NewCo" structure through which Genworth could continue writing new business even in states that imposed the 25-t0-1 limit. *Id.* Similarly, UGI was able to stay below the 25-to-1 limit during the financial crisis due to support from its parent, AIG. *Id.* at 124.

5. Purported review or approval of Respondents' arrangements by accountants and state regulators are irrelevant to Section 8(c)(2)

Respondents contend that the Atrium arrangements qualify for protection under Section 8(c)(2) because various third party entities, such as state insurance regulators or accountants, purportedly reviewed or approved those arrangements. *See*, *e.g.*, Resp. Br. at 2, 32. This argument fails for several reasons.

First, third-party approvals cannot shield Respondents' conduct from scrutiny under RESPA. Nothing in RESPA, including the applicability of Section 8(c)(2), turns on whether an arrangement was approved by a third party entity not responsible for enforcing RESPA. Section 8(c)(2) is solely concerned with whether a genuine service was in fact performed, and whether the payments received were bona fide payments for that service. No third-party approval can turn a sham arrangement into a genuine service, and conversely, the lack of third-party approvals would be irrelevant if a genuine service was actually performed.

Second, as Burke testified, only management can make the ultimate determination that an arrangement transfers significant risk. **Hrg. Tr. 1736:23-1739:12** (5/30 Burke). Burke expressly disavowed any notion that any state insurance regulator or accountant could make this ultimate determination. *Id.* Accordingly, Respondents cannot seek refuge in purported third-party approvals from such other entities.

Third, even if third-party approvals were relevant to RESPA (they are not), Respondents presented no evidence that any third party ever determined that Respondents' arrangements provided economic value to the MIs. Respondents were apparently unable to find a single witness from any state regulatory agency or

accounting firm willing to testify that they made such a determination. As discussed below, the evidence shows that any review of Respondents' arrangements performed by state insurance regulators and accountants did not include such a determination.

a. State regulators did not determine that Respondents' arrangements constituted "services actually performed" for the MIs

Section VI of Crawshaw's rebuttal report contains a detailed discussion of why the mere fact that a captive arrangement was known to state regulators and not identified to be in violation of any state insurance regulation does not establish that the arrangement transferred significant risk or was otherwise valuable to the ceding company (or that it is worth the price paid). **Crawshaw Rebuttal Rep.** at 82-110. Enforcement incorporates herein Crawshaw's entire discussion of this issue in response to Respondents' argument that state regulators' review or approval of their arrangements establishes compliance with RESPA.[48]

As Crawshaw explains, state insurance regulators and the American Academy of Actuaries have recognized that only management is in a position to definitively determine that an arrangement transfers significant risk; therefore, state regulators must rely on management to make a truthful determination. *Id.* This is particularly the

[48] Respondents have previously contended that Crawshaw is not qualified to opine about this issue. Crawshaw has vast experience working with state insurance regulators, including evaluating risk transfer under reinsurance arrangements on behalf of state insurance regulators, and performing financial examinations of captive reinsurance companies on behalf of state insurance regulators. **Hrg. Tr. 593:8-594:17, 595:8-21, 685:16-23** (3/26), **838:14-18** (3/28), **1020:14-1024:23** (5/28). Throughout his career, he personally performed substantial work for numerous state insurance departments, and his work for many of those clients spanned many years. *Id.* **1020:21-1022:20** (3/28). The state insurance regulators who hired Crawshaw relied on his judgment, expertise, and understanding of their regulatory authority. *Id.* **1023:225-1024:23** (5/28). *Cf. id.* **1744:14-1746:3** (5/30 Burke) (testifying that he is qualified to offer opinions about the relevance of state insurance regulations to the issue of risk transfer despite having substantially less experience than Crawshaw on that issue).

case where, as here, the purported reinsurance arrangements are "uniquely complex, with multiple features potentially working in combination to reduce risk transfer, even though the impact of those features may not be readily apparent to a third party." *Id.* at 94. Burke, who has experience working with state insurance regulators, agrees that state insurance regulators do not typically perform risk transfer analyses to determine whether arrangements satisfy the standards set forth in SSAP No. 62. **Hrg. Tr. 1746:4-11** (5/30); **Crawshaw Rebuttal Rep.** at 93 ("State regulators do not, as a matter of course, analyze specific arrangements for risk transfer").

Nonetheless, Respondents assert that their arrangements "were reviewed by the New York Department of Insurance." Resp. Br.at 32. But the documents they introduced at the hearing reflecting this review were focused on the integrity of the statutory financial statements as of a particular point in time, and contain nothing resembling an assessment of risk transfer under Respondents' arrangements.[49] **RCX 0129** (12/31/2001 NYID Report on Examination of Atrium); **RCX 014 3** (12/31/2007 NYID Report on Examination of Atrium); **Crawshaw Rebuttal Rep.** at 104-05. Notably, the 2001 report contains significant errors in the NYID's description of the structure of the UGI arrangement, including fundamental terms such as when Atrium's liability is triggered and the premium ceding percentage, which "suggests that the New York

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[49] Crawshaw explains: "Neither report contains any reference to a risk transfer analysis or discussion of any features of the arrangements that would either increase or reduce risk transfer. There is no mention of whether there is a reasonable probability of significant loss to Atrium under any of the arrangements. In fact, the reports mention nothing about Atrium's specific captive arrangements other than providing a brief, high-level summary of Atrium's agreements with each MI. There is no mention of whether there is a reasonable probability of significant loss to Atrium under any of the arrangements." **Crawshaw Rebuttal Rep.** at 104.

Insurance Department did not closely examine each specific arrangement, and that risk transfer was not of primary concern to the examiners." *Id.* at 105-06.

Respondents also assert that the New York Department of Insurance (NYID) "found Atrium's reserves to be adequate" and that Milliman consistently determined that Atrium "met the requirements of the insurance laws of the State of New York," "maintained sufficient reserves in accordance with the Standards of Practice issued by the Actuarial Standards Board" and made "a reasonable provision for all unpaid losses and loss expense obligations of the Company under the terms of its contracts and agreements." Resp. Br.at 32. But any compliance with state law insurance requirements is irrelevant to the issue of risk transfer because, as Burke testified, he is not aware of any state law insurance requirement for which compliance can establish risk transfer.[50] **Hrg. Tr. 1743:10-1744:5** (5/30). Crawshaw explained at the hearing that none of the state law requirements or other "reserve" metrics Respondents have relied on establishes risk transfer because they are largely or entirely driven by ceded premiums and do not measure the risk of economic loss to Atrium. To the contrary, even though a higher ceding rate under their arrangements reduced risk transfer, it *increased* Atrium's reserves. For example:

- Contingency reserve. This reserve is funded with premiums, so the greater the premium ceding percentage, the higher the contingency reserve. The reserve does not include any contributed capital from Atrium. **Hrg. Tr. 1027:15-1029:16** (5/28 Crawshaw).

- Total assets. This metric is "largely driven by the premium" ceded by the MIs because it includes all of the premiums residing in any trust account. *Id.* **1030:12-1031:2** (5/28 Crawshaw). Therefore, the less risk transferred

[50] Although Burke has never served as a state insurance regulator, he has performed some work for state insurance regulators and therefore believes he is qualified to offer opinions about the significance or relevance, if any, of state insurance regulations to the issue of risk transfer. **Hrg. Tr. 1744:14-1746:3** (5/30).

under Respondents' arrangements – due to a higher ceding rate – the higher the total assets of Atrium. This metric is also a function of claims, since the payment of claims reduces assets. Therefore, the less risk is transferred under Respondents' arrangements – due to the incurrence of few claims – the higher the total assets of Atrium.

- Risk-to-capital ratio. The "capital" portion of this metric (the denominator) consists of Atrium's contingency reserve and policyholder surplus, both of which are largely driven by premiums. Thus, while a higher ceding rate under Respondents' arrangements would reduce risk transfer, it would also make it easier for Atrium to maintain a lower risk-to-capital ratio (thereby facilitating its ability to meet any maximum risk-to-capital ratio required by its contracts or state law). *Id.* **1034:20-1038:14**.

- Trust balances. This metric does not indicate anything about risk transfer because the trust account balances are "largely or significantly driven by premiums that's provided over the years by the MIs to Atrium." *Id.* **1026:17-1027:14**.

- Net premiums written to surplus. This metric is driven by premiums and does not isolate Atrium's contributed capital, so it does not indicate anything about risk transfer. *Id.* **1031:12-1033:8**.

- Premiums in course of collection to surplus. This metric is driven by premiums and does not indicate anything about risk transfer. *Id.* **1033:9-1034:11**.

Respondents cannot use purported compliance with state insurance regulations requiring that Atrium's reserves (which includes premiums) be adequate to save their arrangements from scrutiny under the RESPA requirement that Atrium's capital be at significant risk. As Respondents admit, risk transfer is a "completely different concept" from the adequacy of reserves. Resp. Br. at 40. State insurance regulations are "basic requirements to conduct business" in the state, and not "an ultimate affirmation of the overall legitimacy of captive arrangements or their value to MIs as risk transfer mechanisms (much less a finding of compliance with RESPA)." **Crawshaw Rebuttal Rep.** at 85-86.

To the contrary, the NYID made clear in a 1999 Circular Letter that captive arrangements *would* violate New York insurance law *unless* they were "legitimate risk sharing relationships" and "arms length reinsurance agreements with properly capitalized reinsurers." **ECX 0583** (1999 Circular Letter No. 2) at 1-2. Crawshaw explains that this "type of statement . . . is commonly understood to be a warning to insurance and reinsurance companies that they, not the state regulator, are responsible for ensuring compliance with the applicable state laws." **Crawshaw Rebuttal Rep.** at 109. The NYID also indicated that it was "in the process of developing guidelines and, if appropriate, a regulation which will articulate the parameters under which these reinsurance arrangements will be permitted" and that such "guidelines will insure that the transactions constitute a legitimate transfer of risk . . . ." **ECX 0583** (1999 Circular Letter No. 2) at 1. At least as of 2006 (more than seven years later), the NYID had not issued the more specific guidance indicated in the 1999 Circular Letter. **ECX 0179** (3/10/2006 email, Walker to Bradfield) (referring to 1999 Circular Letter and noting that the NYID "did not follow through in developing specific regulations regarding captives."). According to Crawshaw, this "suggests that risk transfer under captive arrangements may not have been a priority for New York's insurance regulators." **Crawshaw Rebuttal Rep.** at 109-10.

Nevertheless, when the NYID did seek information from Atrium that might help determine whether their captive arrangements were legitimate reinsurance arrangements, Atrium was not forthcoming. For example, in 2006, the NYID sent a letter to Terry Edwards, the President of Atrium, requesting "documentation and a description of the due diligence the company used in the selection of the reinsurer that one could use to deflect any assertion that the payment was used as inducement or

compensation for the placement of the primary business by the originating bank." **Crawshaw Rebuttal Rep.** at 91-92 (discussing Ex. 30 to Rebuttal Report). Atrium's response was completely evasive in that it assumed Atrium was the *MI* and that UGI, Genworth and Radian were *captive reinsurers*. **ECX 0011** (3/30/2006 Letter, Zaitzeff to NYID) ("Atrium does not have any reinsurance agreements with reinsurers owned by banks .... None of UGI, GEMICO or Radian is a subsidiary, affiliate or otherwise related insurance company of the lending institution where Atrium has issued a policy covering a mortgager of the lending institution"). The NYID was largely reliant on truthful disclosures from Atrium, without which they could not feasibly determine whether Respondents' captive arrangements were (or were not) for a legitimate purpose. **Crawshaw Rebuttal Rep.** at 92-94; *id.* at 86 (citing statement in Casualty Actuarial Society paper that "ferreting out the motives and intent of the producers of financial statements" is difficult for regulators).

At the time, Respondents fully understood that their captive practices had not been sanctioned by the NYID. In June 2007, for example, Rosenthal told RMIC that despite the ongoing RFP discussions, "we are on hold right now because of the acquisition and the recent focus on captives in NY so we are not inclined to make any changes to our list of captive MI companies" **ECX 0288** (6/25/2007 email).

In 2009, the NYID increased its scrutiny of Atrium. On April 4, 2009, the NYID notified Atrium that its reserves violated two state regulations, one prohibiting Atrium from investing more than 10% of its assets in a single institution and another requiring at least 60% of its reserves to be invested in specified asset classes. **ECX 0279**. On September 14, 2009, the NYID sent a follow-up inquiry, noting that no response had been received to its April letter, and requesting a prompt response within 15 days. **ECX**

0458. It appears that Respondents never replied. The same day, September 14, 2009, the NYID sent another letter, raising certain concerns with respect to Atrium's Tax Allocation agreement with PHH Corporation. **ECX 0470**. This letter sought a response within 30 days, but again, it appears that Respondents never replied.

On November 16, 2009, the NYID notified Atrium that it had mistakenly granted Atrium's earlier request to release $51 million from its contingency reserve because the amount withdrawn exceeded the amount allowed by state law. **ECX 0464** at 2. Within weeks, by December 1, 2009, Respondents established an alternate Atrium Reinsurance entity domiciled in Vermont to assume the business of Atrium. **ECX 0018**.

PHH decided to re-domicile Atrium to Vermont in late 2009 specifically to avoid further scrutiny and any impediment to their ability to siphon funds from Atrium. An internal Atrium document regarding the proposed move to Vermont lists the following "Benefits" of the move: (1) "Reduced capital requirements in Vermont would lead to *an immediate return of capital to PHH Corporation* and a better return on its investment in Atrium. *PHH would likely receive a $45-$50 million return of capital immediately upon re-domestication.*"; and (2) "Provide the ability for routine dividends." **ECX 0002** (Atrium "Review of Strategic Initiatives") (emphases added). Further motivating the move was Respondents' belief that in Vermont, the "[r]egulatory environment is more favorable to captive reinsurance structures." *Id.* Notably, UGI and Genworth declined to object to the re-domestication. *Id.*[51] By 2010, Respondents promptly implemented their strategy. **ECX 0395** (1/11/2010 email) ("Since we are domiciled in

[51] UGI's and Genworth's acquiescence to the re-domestication, as the record reflects, transferred an additional thing of value to Respondents on the order of $45-50 million in 2010. This amount is subsumed within the disgorgement relief sought by Enforcement.

VT, we can send the money to PHH as soon as it is dividended."); *id.* (3/30/2010 email) ("Since we are officially in Vermont, we can start releasing the excess capital from the trusts on a routine basis."); **ECX 0250** (4/21/2011 internal PHH email) ("We moved from NY to VT, because VT was more reasonable in allowing to us get cash out once the legal requirements had been met.").

If anything, the record shows that Respondents took steps to evade and avoid thorough regulation by state authorities. Nothing in the record supports Respondents' claim that these same authorities sanctioned their captive arrangements (or that they were even aware that Respondents were using those arrangements to extract payments in exchange for referrals to the MIs).

b. Accountants did not determine that Respondents' arrangements constituted "services actually performed" for the MIs

Having failed to call an accountant who performed any work relating to Respondents' arrangements, Respondents sought to rectify that deficiency by calling Vincent Burke, an accountant with no prior involvement, as an expert witness. Burke did not speak with the auditors or review their workpapers, and he has no idea what the auditors of Atrium actually did with respect to Respondents' arrangements. **Hrg. Tr. 1804:1-2, 1815:2-10** (5/30 Burke). Nonetheless, Burke asserts that it was reasonable for an accountant such as KPMG (PHH's accountant) to rely on the Schmitz actuarial opinions to conclude that the arrangements could be accounted for as reinsurance on their financial statements. Respondents seek to use Burke's opinions to support their argument that KPMG's purported accounting determination means their captive arrangements must have provided a genuine reinsurance service to the MIs.

Burke's opinions preclude any argument that an accountant's determination regarding risk transfer can establish "services actually performed" under Section 8(c)(2). Burke repeatedly made clear both in his report and testimony that the accounting treatment has nothing to do with whether that the arrangement provides economic value to the MI. EC Br. at 111-12. Indeed, he emphasized at the hearing 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." **Hrg. Tr. 1809:6-1810:4** (5/30).

Therefore, like the purported determination of an accountant such as KPMG that Respondents' arrangement could be accounted for as reinsurance, Burke's accounting opinions to the same effect are totally irrelevant to Section 8(c)(2). Section 8(c)(2) concerns the economic substance of an arrangement and not the application of accounting principles, so his opinions should also be disregarded because they espouse an accounting result that does not match the economic reality of the Atrium arrangements.

The irrelevance of Respondents' accounting arguments to the Section 8(c)(2) analysis is most clearly revealed by Burke's testimony that an arrangement can be accounted for as reinsurance even if the reinsurer faces a zero chance of sustaining an economic loss under the arrangement. At the hearing, Burke was asked to assume that "the reinsurance company's liability is limited to the assets in the trust" and that "the trust contains exclusively premiums ceded by the insurance company and contains no capital contributed by the reinsurance company." **Hrg. Tr. 1769:13-24** (5/30). Even though in this hypothetical, there is no chance that claims can be paid with any funds other than ceded premiums, Burke believes "there could be" risk transfer, as an

accounting matter. *Id.* **1769:13-24, 1771:8-17**.[52] Regardless of whether such an arrangement structured to prevent any possibility of economic loss to the reinsurer can be deemed "reinsurance" in Burke's world, it would obviously not qualify as "services actually performed" under Section 8(c)(2).[53]

Another example of the irrelevance of Respondents' accounting arguments is the opinion in Burke's report that Respondents' arrangements were "short-duration contracts" under Statement of Financial Accounting Standards No. 60 ("FAS No. 60"), and thus, accountants properly relied on Schmitz's single-year risk transfer analysis. On cross examination, Burke admitted that "the accounting model for short-duration versus long-duration contracts really has nothing to do with the economic aspects of the transaction itself." **Hrg. Tr. 1786:4-12** (5/30). He admitted that FAS No. 60 provides no guidance as to whether Respondents' arrangements are single-book year contracts or multiple book year contracts, *id.* **1795:9-1796:8**, and that he is unaware of any rule or industry guidance, whether in FAS No. 60 or elsewhere, that would preclude classifying a multiple-book year mortgage reinsurance arrangement as a short-duration contract,

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[52] Burke's rationale is that, once they are ceded, premiums immediately become the "assets of the reinsurance company," so the payment of claims using those premiums represents a "loss to the reinsurance company." *Id.* **1769:25-1770:6, 1771:18-20 (5/30 Burke).** Under his view, however, a reinsurer would suffer a "loss" if it returns just one penny of premiums to the MI. Following Burke's reasoning, a contract that required an MI to cede 100% of premiums to Atrium and which limited the MI's recovery to ceded premiums could still qualify as genuine reinsurance. Such a contract is a sham. It would be far worse for the MI than a savings account because, unlike a savings account which virtually guarantees a return of the deposited funds plus interest, the MI would be virtually guaranteed to lose most of the ceded premiums to the reinsurer, and would have no chance of recovering more than the ceded premiums.

[53] Burke's view is incorrect even as an accounting matter. As noted above, the American Academy of Actuaries has explained that an actuarial evaluation of risk transfer must consider the "potential magnitude of an *economic loss* to the reinsurer." **ECX 0632** at 2 (emphasis added). A return of ceded premiums obviously does not result in an economic loss to the reinsurer.

id. **1793:14-24**. Even though in his report, Burke equated multi-year contracts with long-duration contracts, **Burke Rebuttal Rep.** at 10 (referring to "a multi-year, or long-duration, contract"), at the hearing, he testified that a multi-year contract is not synonymous with a long-duration contract, *id.* **1796:10-24**. This is because, as Burke admitted, a multi-year contract can also be a short-duration contract. *Id.* **1787:1-1788:12**. Finally, Burke admitted that the concept of a book year is different from the concept of the duration of coverage. ***Id.*** **1793:3-13**.[54]

In short, Burke conceded that the opinions expressed in his report about short-duration vs. long-duration accounting are irrelevant to whether a risk transfer analysis should cover a single book year or multiple book years.[55]

Respondents' attempt to use Burke in place of testimony from an accountant from KPMG should also be rejected because Burke's analysis of Respondents' arrangements was exceedingly superficial. His testimony at the hearing revealed a lack of knowledge about even the most basic facts of the arrangements. To reach the conclusion that it was reasonable for KPMG to rely on Schmitz's opinions, he merely

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[54] An accounting classification system that relates to the *duration of coverage* cannot shed any light on the *number of book years covered* under Atrium's arrangements, because they are totally different concepts. The latter relates to the set of loans covered, whereas the former relates to how long such coverage remains in force. Coverage of a single book year does not equate to a single calendar year of coverage. For example, under the UGI arrangement, the duration of coverage for a single book year was ten years. *Id.* **1792:21-1793:2.** The duration of coverage for a single book year could be 35 years, or 7 days, depending on whatever parties agree to. *Id.* **1792:10-20.**

[55] As Burke explained in his testimony, long-duration contracts generally refer to contracts that contain "mortality and morbidity risk" – namely, life insurance contracts – and which can often have a duration of coverage of 50 years or more. *Id.* **1787:1-16**. Mortality risk "has to do with loss of life" and morbidity risk "has to do with your health." *Id.* **1786:19-25** . Short-duration contracts refer to property and casualty insurance and reinsurance contracts. *Id.* **1787:17-20.** Although short-duration contracts "are usually contracts that are for short periods of time," *id.* **1788:2-9**, they also include property and casualty insurance contracts that last multiple years, including some that provide coverage "forever," *id.* **1787:1-1788:12.**

perused those opinions, spending about thirty minutes looking at each one. **Hrg. Tr. 1760:4-21** (5/30). Thus, it is not surprising that, at the time he prepared his report, Burke was under the mistaken belief that:

- the UGI arrangement "was not a very large program" that commenced sometime in the mid-2000s;
- the Radian arrangement "was a larger program" that commenced in the late 1990s; and
- the CMG arrangement commenced in the early to mid-2000s.

Id. **1749:25-1752:1**.[56]

In addition, Burke believes that, when auditing a risk transfer analysis, it is "important to understand the terms of the contract" such as "how the amount of claims the reinsurer is responsible for are calculated," *id.* **1747:25-1748:10**, but he did not know the most elementary fact about how Atrium's responsibility for claims was calculated. Burke admits that measuring liability using "percent of losses" is different from measuring liability using "percent of aggregate risk." *Id.* **1749:8-11**. Yet his understanding is that the "attachment point" under Atrium's arrangements was "4 percent of *losses*," rather than 4% of *aggregate risk*. *Id.* **1748:11-1748:22**. Similarly, he believes that the 14% detachment point refers to 14% of losses, rather than 14% of aggregate risk. *Id.* **1748:19-22**. The attachment/detachment points were in fact based on aggregate risk, not losses. **Crawshaw Rep.** at 18 n.34 (citing contract provisions).

Burke's failure to learn the basics of the arrangements does not meet his own standard for analyzing complex arrangements such as Atrium's captive arrangements. He believes that because the Atrium arrangements were so complex, a proper risk

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[56] The UGI arrangement was, by far, the largest of Atrium's four captive arrangements, and it commenced in 1995. The Radian arrangement was one of the two smallest arrangements, and it commenced in 2004. The CMG arrangement commenced in 2006.

transfer assessment would have required "deep knowledge of the product" including a detailed understanding of "everything from what the estimated premiums are, how many claims are expected to come in, the timing of those claims, what discount rate to use." *Id.* **1725:20-23**, **1730:19-1733:1**. Nothing Burke did for this proceeding can be characterized as reflecting a "deep knowledge of the product." He simply rubber-stamped the Schmitz opinions based on the most perfunctory review.

In sum, Respondents cannot rely on Burke's accounting opinions because, as discussed in Enforcement's initial brief, Section 8(c)(2) is not restricted by accounting principles. Therefore, the Tribunal need not decide whether Respondents' interpretation of accounting principles is correct to reject their Section 8(c)(2) defense. EC Br. at 110-11. Regardless, to the extent that KPMG concluded that Respondents' arrangements as a whole transferred risk to Atrium based on either Schmitz's single-book year opinions or management's misrepresentations to KPMG that their arrangements with the MIs were intended to cover only a single book year,[57] such an accounting conclusion was misinformed and incorrect, and the Tribunal is not limited by it in adjudicating Respondents' Section 8(c)(2) defense.

Even as to the narrower accounting issue, the mere fact that an arrangement was accounted for as reinsurance on a financial statement does not mean the determination was accurate. **Crawshaw Rebuttal Rep.** at 88 (identifying several examples of companies found to have improperly accounted for transactions as reinsurance on their

[57] Burke testified that GAAP requires accountants to obtain a letter from management representing that "there's no relevant information that affects the financial statements that [management] has not made [the accountant] aware of, or that [management] has not disclosed to [the accountant]." **Hrg. Tr. 1802:7-1803:13** (5/30). If this letter fails to disclose to the accountant any intentions that might impact risk transfer, "then they have effectively misrepresented to you." *Id.* Burke did not review the management letters from any MI or Atrium.

financial statements); **Hrg. Tr. 1572:7-1573:10** (5/30 Cascio) (providing examples of improper reinsurance accounting treatment), **1776:6-20** (5/30 Burke) (providing example of improper reinsurance accounting treatment). These include financial statements audited by some of the nation's most reputable accounting firms. *Id.* **1777:10-15** (5/30 Burke) (admitting that financial statements in which transactions were improperly accounted for as accounting were audited by "one of the big four accounting firms"), **1573:21-1574:1** (5/30 Cascio).

To the extent KPMG concluded there was risk transfer under Respondents' arrangements based on an analysis that isolated each book year from the arrangements as a whole, their conclusion was just as incorrect as Schmitz's. The case of *SEC v. Stanard*, No. 06 Civ. 7736(GEL), 2009 WL 196023 (Jan. 27, 2009), is instructive. In *Stanard*, RenaissanceRe "accounted for the two agreements separately" as reinsurance on the company's financial statements. *Id.* at *5. Although there may have been risk transfer under each agreement when analyzed separately, "*when the two contracts were considered together*, the entire transaction should actually have been accounted for as a deposit" because "the ultimate effect of the transactions was that insufficient risk transferred to [the purported reinsurer] . . . ." *Id.* (emphasis added). Under the arrangement as a whole, the purported reinsurer was guaranteed to never have to return to the insured entity any more than the premiums previously ceded. *Id.* The court held that because the two agreements were "part of a single, linked transaction," RenaissanceRe improperly accounted for the whole arrangement as reinsurance. *Id.*[58] *See also* **ECX 0790** (SSAP No. 62) at 22-23 ("Therefore, if agreements with the

[58] The interrelated agreements at issue in *Stanard* failed to transfer risk even though the reinsured was certain to get all of its premiums back. *Stanard*, 2009 WL 196023 at *3. Respondents arrangements did not even provide the MIs such a guarantee.

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.”).[59]

6. Rather than address Crawshaw’s opinions, Respondents mischaracterize them

Apparently unable to respond to the substance of Crawshaw’s opinions, instead Respondents simply mischaracterize them. They assert that: (1) Crawshaw’s analysis of risk transfer was retrospective; (2) Crawshaw’s opinions regarding risk transfer and pricing apply only to book years with a 40% ceding rate; (3) Crawshaw approves of all structures with a 25% ceding rate; (4) Crawshaw’s analysis of the price charged to the MIs is inconsistent with his belief that an appropriate price was “less than zero”; and (5) Crawshaw provided no support for his opinion that a risk transfer for Respondents’ arrangements should have accounted for multiple book years. As shown below, these statements do not accurately describe Crawshaw’s opinions. Respondents simply fail to engage his analysis as presented.

a. Crawshaw’s risk transfer analysis is prospective because it is based on structural features of the arrangements at their inception

Respondents assert that “Dr. Crawshaw never performed a *prospective* risk transfer analysis.” Resp. Br. at 39 (emphasis in original). But the features of Respondents’ arrangements that Crawshaw concludes prevented significant risk transfer were an integral part of the structure of those arrangements from their inception.

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[59] In direct contravention with SSAP No. 62 and the holding of *Stanard*, Schmitz insisted at the hearing that a series of transactions need not be evaluated for risk transfer as a whole even if the transactions are “related with one another such that the experience under one transaction affects the possible experience under another of the transactions.” **Hrg. Tr. 2032:12-2033:8** (6/3).

Indeed, they were codified in the written agreements. Accordingly, Crawshaw's analysis of how those features reduced or eliminated risk transfer is necessarily prospective. These features include:

- Rate of premium accumulation: This is a function of the premium ceding percentages memorialized in the written agreements.

- High attachment point: The point at which Atrium's liability was triggered is reflected in the written agreements.

- Low detachment point: The point at which Atrium's liability ends is reflected in the written agreements.

- Limitation of Atrium's liability to trust accounts: The provisions of the written agreements reflecting this limitation are described on pages 83-90 of Enforcement's initial brief.

- Atrium's ability to force termination of its arrangements to minimize risk to its capital: The provisions of the written agreement relating to termination and commutation are discussed on pages 21-23 of Crawshaw's initial report.

- Segregation of risk, claims and premiums by MI: For example, the Genworth agreement states: "The trust . . . is not available to support or secure obligations of the Reinsurer arising out of any agreement other than this Agreement . . . . The assets of the Reinsurer held in different trusts are intentionally segregated . . . ." **RCX 0044** (Genworth/Atrium agreement) at 12, ¶12.02 at CFPB-PHH-00091578.

In his rebuttal report, to determine whether there was any possibility that Respondents could have sustained a significant loss of capital under the UGI and Genworth arrangements, Crawshaw performed an analysis that compared ceded premiums to claims in a hypothetical scenario in which the real estate market suffered multiple, successive crises throughout the entire duration of those arrangements. **Crawshaw Rebuttal Rep.** at 16-21. He found that even in that virtually impossible scenario, Atrium would have incurred no significant economic loss. *Id.* This was an entirely prospective analysis because Crawshaw's calculations are solely dependent on

structural features of the arrangements, including the rate of premium accumulation (which was a function of the premium ceding rate in the agreements) and the maximum potential claims under each book year (which was a function of the attachment and detachment points for each book year).[60]

To be sure, Crawshaw *also* considered how the arrangements unfolded in practice, including reviewing data regarding (1) the amount of premiums ceded, both on a book year and calendar year basis; (2) the amount of capital Atrium contributed to the trust accounts; and (3) the amount of dividend payments Respondents took from the trust accounts, which recovered any previously-contributed capital. **Crawshaw Rep.** at 30-59. But the actual outcome of each arrangement was one of the "reasonably possible outcomes" at the inception of the arrangement. Crawshaw used the actual outcome of each arrangement to demonstrate concretely the way in which each of the many risk-limiting features he had described[61] actually constrained and ultimately eliminated any possibility of a significant loss. Because SSAP No. 62 requires a prospective risk transfer analysis to consider all "reasonably possible outcomes," Crawshaw properly considered the actual outcome of each arrangement in order to place it within the context of his prospective analysis. Indeed, it was especially appropriate for him to do so because he

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[60] Respondent contend that Crawshaw did not perform any type of risk transfer analysis. Resp. Br. at 38. But the American Academy of Actuaries explains that one type of prospective risk transfer analysis is a "premium to loss limit" comparison. **ECX 0632** at 13. The analysis on pages 16-21 of Crawshaw's rebuttal report was a risk transfer analysis because it compared Atrium's premiums to its loss limits. In addition, as discussed below, *see* pp. 95-96, 116-19 *infra*, Crawshaw analyzed the range of "reasonably possible outcomes" under Respondents' arrangements, consistent with the guidance in SSAP No. 62. **ECX 790** at 6.

[61] The American Academy of Actuaries states that in analyzing risk transfer, "important considerations include an evaluation of the substance of the arrangement, the *existence, impact, and role of risk-limiting features*." **ECX 0632** at 10 (emphasis added). Unlike Schmitz and Cascio, Crawshaw's analysis accounted for the array of risk-limiting features in Respondents' arrangements.

believes that the actual outcomes of Respondents' four arrangements reflected the full range of all "reasonably possible outcomes" at the inception of those arrangements, given that the four arrangements "started at different points in time" and were subjected to "different economic circumstances" and yet the "bottom line was that none of them worked out for an MI better than a savings account, and two of them were much worse." **Hrg. Tr. 733:18-734:22** (3/28 Crawshaw). The actual outcome of the arrangements simply shows that the risk-limiting features worked as originally intended.

To the extent the actual outcome of an arrangement was the result of the parties' agreement to deviate from a structural feature they initially agreed to, the change was always in Respondents' favor. EC Br. at 95-96; **Crawshaw Rebuttal Rep.** at 96-103. From the start of their arrangements, Respondents had significant leverage over the MIs, which they could use to obtain favorable concessions to further reduce or eliminate risk transfer. While Crawshaw considered the historical fact that Respondents did use this leverage multiple times – for example, by failing to meet minimum contractual capitalization requirements without objection from the MIs and by extracting one-sided amendments from the MIs – these instances were simply manifestations of the leverage Respondents possessed from the outset. As Walker testified, PHH "always" had leverage over the MIs due to their ability to steer MI business to them. **Hrg. Tr. 2202:23-2203:13** (6/4). Indeed, the arrangements themselves originated as a result of this leverage. EC Br. at 9-16, 30-31. No prospective risk transfer analysis can properly ignore this inherent and fundamental aspect of the relationship between Respondents and the MIs, which undoubtedly affected risk transfer.[62] Moreover, each of the concessions from

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[62] Atrium and the MIs must have been aware of their own intentions to allow these types of concessions when the arrangement began, and the only limitation in the actuary's

the MIs reduced risk transfer going forward, and Crawshaw properly considered these changes in his analysis by giving a prospective account of their expected future effect as of the time of their occurrence.

Crawshaw does note that Respondents never lost a significant amount of money under their arrangements, and in the case of UGI and Genworth, profited substantially, even though their arrangements were all supposedly operational during the most severe real estate crisis in decades, but his risk transfer analysis does not depend on that fact. As Crawshaw explains, "the ultimate results of an arrangement, based on the actual development of claims under the arrangement, are not themselves used to establish the existence or absence of risk transfer." **Crawshaw Rebuttal Rep.** at 45-46 n. 84. But "the ultimate result of an arrangement can provide some evidence that tends to support or undermine the accuracy of a prospective risk transfer analysis" and "if historical results turn out to be equally or more severe than what was expected at the outset of an arrangement, and the reinsurer nonetheless makes a massive profit from the arrangement while the insurer recovers nothing but a fraction of its ceded premiums, that would tend to support a conclusion that, prospectively, there was no risk transfer." *Id.*

b. Crawshaw's opinions regarding risk transfer apply to book years with a 25% ceding rate

Respondents contend that Crawshaw did not analyze the 5/10/25 structure or any other structure with a 25% ceding rate. Resp. Br. at 15-16. But the risk-limiting

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ability to account for those intentions would be the unwillingness of the parties to disclose them to the actuary. But even if the parties had no such intentions at the outset, any subsequent concessions would have rendered invalid a risk transfer analysis performed at the inception of the arrangement that incorrectly assumed that the integrity of the reinsurance structure would not be undermined by such concessions.

features discussed in Crawshaw's reports apply to Respondents' arrangements regardless of the specific ceding rate or risk band for any particular book year. For example, the limitation of Atrium's liability to the trust accounts and the segregation of risk by MI apply to the arrangements regardless of the ceding rate or risk band. Likewise, Respondent had the ability under any structure to avoid having to place additional capital at risk in the trust account by commuting their arrangements. Nor did Respondents' ability to use their leverage to extract one-sided concessions diminish when the ceding rate for particular book years was set to 25%.

The risk-limiting effect of some of the features identified by Crawshaw was even stronger under the structures with a 25% ceding rate. For example, Crawshaw's opinion that the attachment point in Respondents' arrangements was high, and that as a result, claims were extremely unlikely to be incurred by Atrium in the first few years of coverage for a book year (even in a stress scenario), is even more applicable to the 5/5/25 structure because a 5% attachment point is higher than a 4% attachment point. Likewise, Crawshaw's opinion that the detachment point in Respondents' arrangement was low, and that as a result, Respondents were not exposed to claims in the catastrophe layer, applied with even greater force to the 5/5/25 structure because a 10% detachment point is lower than a 14% detachment point.

The risk-reducing impact of a commutation, discussed in both of Crawshaw's reports, is particularly significant in relation to structures with a 25% ceding rate. The commutation of the Genworth arrangement rendered invalid even Respondents' purported claim of risk transfer for the 2008.B book year (which had a 25% ceding rate). As discussed in Enforcement's initial brief, that book year barely passed Schmitz's artificial test of risk transfer because Schmitz determined that Atrium faced a 10%

chance of incurring a 111% loss ratio under that book year. EC Br. at 181-82. But Schmitz failed to account for the possibility of a commutation in any of his projected scenarios (even though PHH and Genworth were actively discussing a potential commutation at the time). Had Schmitz accounted for a potential commutation in at least some of his projected scenarios, the Genworth 2008.B book year would certainly have failed even his test. *Id.*

c. Crawshaw's opinions regarding pricing apply to book years with a 25% ceding rate

Crawshaw's opinion that the premium ceding percentage under Respondents' arrangement resulted in an unjustifiably high expected underwriting profit margin to Atrium is even more compelling as applied to the Genworth 2008.B book year and UGI 2009 book year. The 25% ceding rate under those book years resulted in an expected underwriting profit margin to Atrium of over 65% – *six to eight times* the typical expected underwriting profit margin for insurance or reinsurance arrangements that, unlike Respondents' arrangements, do transfer significant risk (8% to 10%) and also far higher than the expected underwriting profit margins typical of true catastrophe coverage (approximately 40%). EC Br. at 143. The expected underwriting profit margin under those book years was significantly higher than the already high average expected profit margin for book years with the 4/10/40 structure (which was around 40% of ceded premiums).

Nonetheless, Respondents contend that Crawshaw's pricing opinions "cannot be applied to" the Genworth 2008.B book year and the UGI 2009 book year "because his analysis necessarily includes all books of business for the entire life of each of the arrangements." Resp. Br. at 38-39. But his opinions would apply to those book years

even if one were to ignore the premiums ceded by Genworth and UGI under previous book years. As explained above, even if one were to adopt the impossible[63] assumption that all claims incurred under the Genworth 2008.B book year and the UGI 2009 book year could be paid entirely using Respondents' contributed capital rather than premiums from other book years, the maximum loss ratios under those book years could not possibly justify an expected underwriting profit margin to Atrium of 40%, much less one over 65%. *See* pp. 50-53 *supra*.

Respondents also assert that Crawshaw "appears not to take issue with" structures with a 25% ceding rate because he cited in his rebuttal report a 1997 letter from state insurance regulators stating that it would be "imprudent" to allow captive mortgage reinsurance arrangements with ceding rates above 25%. Resp. Br. at 15. But the fact that state regulators considered ceding rates above 25% to be presumptively "imprudent" does not establish that the converse – that they considered rates of 25% or lower to be presumptively "prudent" – is true. *See NLRB v. General Electric Co.*, 418 F.2d 736, 749 n.5 (2d Cir. 1969) ("[A]ssuming that the converse principle is necessarily true" is "indefensible in logic, and with a nod to Justice Holmes, equally so in law."). The proposed imposition of a maximum ceding rate does not lead to the conclusion that *any* rate below the ceiling is reasonable, regardless of the structure of the arrangement.[64]

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[63] This assumption was impossible because: (1) the premiums in the trust accounts were so plentiful that they could pay any excess many times over; and (2) Respondents removed all of their purported contributed capital before, or just as, claims were finally being paid. EC Br. at 97-105; **Crawshaw Rep.** at 33, 45. Indeed, Schmitz admitted that in analyzing risk transfer under the Genworth 2008.B book year, he simply designated $2,060,488 of the funds already present in the Genworth trust account as "capital contributions" made by Atrium. EC Br. at 147.

[64] Under Respondents' rationale, even if they changed the risk band from 4%-14% to 99%-100% – that is, the risk band was narrowed to one-tenth its original size and the

This is particularly the case with Respondents' arrangements because the reduction in the ceding rate from 45% to 25% for particular book years was accompanied by a greater narrowing of the risk band – for example, from 4%-14% to 4.5%-9.5% for the Genworth 2008.B book year (that is, the risk band was cut in half and the attachment point was raised) – and as a result, the expected underwriting profit margin *increased* from approximately 40% to approximately 68%.[65]

Respondents do not even respond to Crawshaw's testimony regarding the unreasonableness of the 25% ceding rate for the Genworth 2008.B book year. **Hrg. Tr. 2344:24-2356:15** (6/4) (discussing EC Demonstrative Ex. 3). They simply refer to his testimony as a "last ditch effort," Resp. Br. at 40, but provide no explanation for why it might have been reasonable for Genworth to cede 25% of its premiums for a bet that so heavily favored Atrium even with respect to that single book year.

d. Crawshaw's belief that the appropriate price for Respondents' arrangements was "less than zero" is consistent with his pricing analysis

Respondents argue, illogically, that Crawshaw's analysis of the price Atrium charged must be disregarded because he also testified that an appropriate price was "less than zero," and therefore any pricing analysis he performed is "fundamentally inconsistent with the conclusions of his two reports." Resp. Br. at 39 & n.21. Crawshaw concluded that the price Atrium charged would have been excessive even if Atrium were a genuine risk-bearing entity (it was not). **Crawshaw Rep.** at 74. Because the price charged by Respondents would be excessive even if significant risk had been transferred

attachment point raised 95 points – such an arrangement would have complied with RESPA as long as the ceding rate was 25%.

[65] There is no evidence that any legitimate underwriting was done to arrive at the 25% cede. Rather, it is clear that Respondents simply demanded the maximum cede allowable at the time per Freddie Mac's policy. *See* pp. 10, 62 *supra*; EC Br. at 140.

to Atrium, *a fortiori* the same price is even more excessive given that no significant risk was transferred. The two propositions are fully consistent.

e. Crawshaw's opinion that Respondents' arrangements were multi-year arrangements is well-supported

Respondents contend that Crawshaw's opinion that a risk transfer analysis should have accounted for multiple book years is "novel" and has "no support." Resp. Br. at 38, 40. Enforcement has already described the wealth of support for his opinion in its initial brief. EC Br. at 90-95, 117-24. In addition, Enforcement notes that the American Academy of Actuaries, in its "Risk Transfer Testing Practice Note," states that "Multiple year arrangements" may have "contractual features that reduce the risk to the reinsurer through clauses that are very difficult to reflect when modeling the contractual cash flows" or "provisions that protect the reinsurer from changes in exposure over the contract period and make the analysis complicated, and/or have features that adjust the terms of later years explicitly or implicitly based on results in earlier years." **ECX 0632** at 11, 16. As discussed in Enforcement's initial brief, the trust cap in Respondents' arrangements and cross-collateralization across book years were features that reduced risk transfer and caused the terms of later book years (the maximum loss ratio), and even the existence of later book years, to be affected by the results of earlier book years. EC Br. at 119, 122-23.

Thus, the American Academy of Actuaries expressly recognizes that a reinsurance arrangement can be a multiple-year arrangement, and clearly any risk transfer analysis for a multiple-year arrangement must evaluate the arrangement as a whole, including accounting for features such as those identified above. Unable to dispute this fact, Cascio asserts (without citation to any supporting documents) that a multiple-year risk

transfer analysis is appropriate *only* if the written contract "explicitly states that it is a multi-year agreement" or "contains provisions that make it punitive for the insurer not to renew." **Cascio Rebuttal Rep.** at 3-4. Cascio's claim that the written contract is the exclusive source of the parties' intentions finds no support even in accounting principles (and is certainly not relevant to the Section 8(c)(2) defense).

In its Risk Transfer Testing Practice Note, the American Academy of Actuaries identifies many other documents that can reflect the parties' intentions with respect to their arrangement other than the written contract, including "[a] memorandum from management describing the *business purpose and economic intent* of the reinsurance cession" and "[r]elevant correspondence between the ceding and assuming entities." **ECX 0632** at 8 (emphasis added). The American Academy of Actuaries also states that an actuary performing a risk transfer analysis should "understand the *substance of the agreement* before evaluating and quantifying the amount of the *economic losses* being transferred," and that this may require "discussions with management or other key personnel as applicable" and review of "internal accounting memoranda or other relevant internal documentation" to understand the "business purpose and the substance of the transaction." *Id.* at 13-14. *See also id.* at 14 (risk transfer modeling can be "difficult and, perhaps, impossible unless one were to make assumptions about the behavior of one or both parties to the contract"); **Hrg. Tr. 685:24-686:24** (3/26 Crawshaw) (explaining that an actuary should understand "the goals of the party, the economic incentives of the parties to how they would act over time" and that such information can be obtained by "talk[ing] to the … parties involved in the contract" and "review[ing] correspondence").

7. Respondents fail to meet their burden to show that their contracts were binding on them and contained terms that conformed to industry standards

Respondents' arrangements also fail the requirement in the Countrywide Letter that there be "a legally binding contract for reinsurance with terms and conditions conforming to industry standards." Countrywide Letter (Attachment A to **ECX 0194**) at 6. The "reinsurance" agreements were not binding on Respondents because the MIs repeatedly permitted Respondents to fail to meet contractual requirements or execute amendments that changed the terms of the contract solely in Respondents' favor. EC Br. at 39-40, 69, 95-96; **ECX 0254** (2/13/2009 email, Rosenthal to Danahy) (noting during the height of the financial crisis that "Radian has not called me on" an $823,904 shortfall in Atrium's capital contribution to the trust). Respondents also fail to meet their burden to show that the terms of their agreements conformed to industry standards. As explained above, *see* pp. 53-58 *supra*, Respondents' arrangements contained many features that distinguished them from arrangements in other lines of property and casualty insurance or reinsurance business, all of which reduced risk transfer.[66] The terms of the written agreements also resulted in an expected profit margin to Atrium that did not conform to industry standards.

[66] The American Academy of Actuaries explains the typical reinsurance contract as follows: "Risk transfer is reasonably self-evident in most traditional per-risk or per-occurrence excess of loss reinsurance contracts. For these contracts, a predetermined amount of premium is paid and the *reinsurer assumes nearly all or all of the potential variability in the underlying losses*, and it is *evident from reading the basic terms of the contract that the reinsurer can incur a significant loss*. In many cases, there is *no aggregate limit on the reinsurer's loss*." **ECX 0632** at 10 (emphasis added).

D. Respondents' Acceptance of 45% of MI Premiums for Most Book Years Has Central Relevance to This Proceeding

Respondents assert that "the 40% cede structures that were in place for the bulk of the period of time during which Atrium had such arrangements" are not "at issue in this proceeding." Resp. Br. at 15. The Tribunal should reject Respondents' attempt to artificially narrow the case by excluding some of the most relevant evidence of their illegal conduct.

1. Premiums ceded at the 45% rate were kickback payments causally connected to illegally referred loans that closed on or after July 21, 2008

UGI and Genworth did not stop ceding at a 45% gross rate[67] simply because they each agreed to add one final book year to their respective arrangements at the 25% rate. Rather, UGI and Genworth continued to cede at the 45% gross rate on all other open book years *until their arrangements were terminated*. When Respondents and UGI agreed in their Amendment No. 9 to a 25% ceding rate for the 2009 book year, they also explicitly reaffirmed the 45% gross ceding rate for book years 1997 to 2008. **RCX 0057** (3/1/2009 UGI/Atrium agreement, Amendment #9) at CFPB-PHH-00142264, ¶ 14 (requiring "forty five percent (45.00%) of the Ceding Company's unearned premium from January 1, 1998 and later for loans with an effective date of coverage from April 1, 1997 through May 31, 2008").[68] As a result, for book years 2003 through 2008, UGI

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[67] Due to the 11.1% ceding commission for book years 2000 and later, this 45% gross rate translates to a 40% net rate for those book years. **ECX 0584** (1/1/2000 UGI/Atrium agreement, Amendment # 2) at CFPB-PHH-00116625, ¶ 1. As discussed in Enforcement's initial brief, Respondents' ill-gotten gains are reflected in the gross ceding rate, because the ceding commission was a business expense for which no deduction should be applied. EC Br. at 171.

[68] Amendment No. 9 reaffirmed the 11.1% ceding commission for book years 2000 through 2008. *Id.* at CFPB-PHH-00142258 (requiring 11.1% ceding commission for

continued to cede at the 45% gross rate into 2013, when its arrangement was terminated. *See* **ECX 0839** (Milliman "Reinsurance Performance Metrics" report, 1st Quarter 2013) at 14 (table dated March 31, 2013 shows positive numbers in "Projected Total Future" premiums column for book years 2003 through 2008).

Likewise, Genworth and Respondents' agreement in their Amendment No. 4 to a 25% ceding rate was applied only to "business written on or after June 1, 2008" (*i.e.*, the 2008 book year). **RCX 0050** (6/1/2008 Genworth/Atrium agreement, Amendment # 4) at Second "Whereas" clause and ¶¶ 3, 6. For all other open book years, that amendment left unchanged the 45% gross ceding rate established in the original agreement. **RCX 0044** (10/9/2000 Genworth/Atrium agreement) at CFPB-PHH-00091572, § 4.01. Accordingly, for book years 2003 through 2008, Genworth continued to cede at the 45% gross rate into 2012, when its arrangement was terminated. **RCX 2004** (Milliman "Reinsurance Performance Metrics" report, 1st Quarter 2012) at pdf page 408 (table dated March 31, 2013 shows positive numbers in "Projected Total Future" premiums column for book years 2003 through 2007).

Radian and Respondents never agreed to a 25% ceding rate for any book year. At all times, their agreement required Radian to cede 40% of premiums for all book years. **RCX 0040** (7/26/2004 Radian/Atrium agreement) at CFPB-PHH-00091623, Ex. A.[69] Thus, for book years 2003 through 2008, Radian continued to cede at the 40% rate into 2009, when its arrangement was terminated. **ECX 0650** (Radian cession statement) at

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"loans with an effective date of coverage from January 1, 2000 through May 31, 2008"). Thus, the net ceding rate for those book years remained 40%.

[69] The Radian written agreement was amended once. **RCX 0043** (8/3/2006 Radian/Atrium agreement, Amendment #1). That amendment did not change the ceding rate. There was no ceding commission under the Radian arrangement.

tab "Cendant ETD," column "Reinsured Current Earned") (shows premiums ceding through June 2009 for every book year).

The vast majority of premiums accepted by Respondents in and after October 2006 (the period over which Enforcement's disgorgement claim is calculated) were ceded at the 45% rate (in the case of UGI and Genworth) or the 40% rate (in the case of Radian). Total ceded premiums under the Genworth 2008.B book year were approximately $5.5 million. **ECX 0257** at tab "Inception to Date," cell H109. Enforcement's estimate of the total ceded premiums under the UGI 2009 book year is $2.45 million. *See* pp. 124-25 *infra*. In comparison, between December 31, 2007 and March 31, 2012, Respondents accepted more than $110 million of premiums from "All MIs Combined" under book years 2001 through 2007 – all of which were ceded at the 45% or 40% rate.[70] Similarly, most of the premiums accepted by Respondents on or after July 21, 2008 was ceded at the 45% rate (in the case of UGI and Genworth) or the 40% rate (in the case of Radian). Between December 31, 2008 and March 31, 2012, Respondents accepted more than $52 million of premiums from "All MIs Combined" under book years 2000 through 2007 – all of which were ceded at the 45% or 40% rate.[71]

[70] *Compare* **RCX 0002** at pdf page 347 ("Reinsurer Written Premium To Date" column shows $153.9 million of total premiums ceded from "All MIs" under book years 2001 through 2007, as of December 31, 2007) *with* **RCX 2004** at pdf page 379 ("Written as of 3/31/12" column shows $264.7 million of total premiums ceded from "All MIs Combined" under book years 2001 through 2007, as of March 31, 2012).

[71] *Compare* **RCX 0004** at pdf page 379 ("Written as of 12/31/08" column shows $212 million of total premiums ceded from "All MIs" under book years 2000 through 2007, as of December 31, 2008) *with* **RCX 2004** at pdf page 379 ("Written as of 3/31/12" column shows $264.7 million of total premiums ceded from "All MIs Combined" under book years 2001 through 2007, as of March 31, 2012).

As discussed in Enforcement's initial brief, even if the holding in *Snow* applies to this proceeding, if an illegally referred loan closed on or after July 21, 2008, any kickback payment accepted by Respondents that is causally connected to the referral of that loan is reachable through disgorgement – regardless of when the payment was made. EC Br. at 156-58. Evidence that premium ceding – at any time – was so excessive as to either eliminate risk transfer entirely or result in a price that was too high in relation to any risk transferred would establish that those ceded premiums were entirely or partially kickback payments. *See* May 22 Order at 4 ("Kickbacks may involve overbilling …"). If those kickback payments influenced Respondents' allocation of business to MIs through the dialer or preferred provider list when either referral system was last set before July 21, 2008, or any subsequent setting after July 21, 2008, they are reachable through disgorgement.

The evidence demonstrating this causal link is discussed in detail throughout Enforcement's initial brief. Given the clear evidence of this causal link, it would make no sense to conclude that *only* premiums ceded at the 25% rate – and not premiums ceded at the 45% or 40% rates – influenced Respondents' allocation of MI business on and after July 21, 2008. First, it would be contrary to all of the evidence to infer that Respondents would have accepted anything less than full participation by the MIs in their respective captive arrangements, including ceding on all book years.

Second, the sequence of events precludes any conclusion that the allocation of referrals of loans that closed on or after July 21, 2008 was influenced solely by ceding at the 25% rate. The last time the dialer was reprogrammed *before* July 21, 2008 was on November 18, 2007. **ECX 0654** (PHH NORA submission) at Ex. M. The first time the dialer was reprogrammed *after* July 21, 2008 was on November 21, 2008. *Id.* Those

dialer settings indisputably affected the allocation of MI business to UGI and Genworth on or after July 21, 2008. *Id.* Genworth and Respondents did not implement the 25% ceding rate for the 2008.B book year until June 2008 – months after the dialer was programmed on November 18, 2007 to allocate 25% of PHH's retail business to Genworth. **RCX 0050** (Genworth/Atrium agreement, Amendment #4), ¶ 3; **ECX 0654** (PHH NORA submission) at Ex. M. UGI and Respondents did not implement the 25% ceding rate for the 2009 book year until April 2009 – well after both dialer settings were programmed to allocate business to UGI. **RCX 0057** (3/1/2009 UGI/Atrium agreement, Amendment #9). Those dialer settings were caused by the payment of massive amounts of premiums by UGI and Genworth on all other book years at the 45% rate, much of which was ceded before July 21, 2008. After July 21, 2008, UGI and Genworth had to continue to cede premiums to Respondents to receive referrals through the dialer. This flow of funds to Respondents included premiums ceded at the 25% rate and premiums ceded at the 45% or 40% rates.

Similarly, the preferred provider list as of April of 2006 included only UGI, Genworth, Radian and CMG, and that list remained unchanged until August 8, 2008, when MGIC and RMIC were added and UGI was removed. **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 (effective August 8, 2008, MGIC and RMIC were added to preferred provider list and UGI was removed). Because they were in effect on or after July 21, 2008, both iterations of the list resulted in Respondents' captive MI partners receiving referrals of loans that closed on or after that date. The inclusion of Genworth and UGI on the preferred provider list long predated their agreement to a 25% ceding rate for the final book years

under their arrangements. Radian received referrals through both iterations of the list by ceding premiums at the 40% rate (because it never agreed to a lower rate for any book year).

2. Respondents' acceptance of premiums ceded at the 45% rate on or after July 21, 2011 is relevant to the assessment of civil money penalties

Respondents continued to accept premiums ceded at the 45% rate or 40% rate after July 21, 2011. For example, during just the first quarter of 2012, Respondents accepted at least $2.95 million of ceded premiums from "All MIs Combined" under book years 2001 through 2007.[72] As discussed in Enforcement's initial brief, *all* premiums ceded after July 11, 2011 were kickback payments required for the ongoing referral of loans; therefore, 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). EC Br. at 210-11. This includes premiums ceded to Respondents under any book year, including those with a 25% ceding rate and those with a 45% ceding rate.

3. Respondents' acceptance of premiums ceded at the 45% rate is relevant evidence of the course of dealing under their captive arrangements

A significant question in this proceeding is why the MIs would enter into, and continue to participate in, captive arrangements with Respondents that were so clearly unfavorable to them. The evidence Enforcement presented at the hearing points to the obvious answer: the arrangements were mechanisms to transfer kickback payments to

[72] *Compare* **RCX 0007** at 14 ("Written as of 12/31/11" column shows $261.75 million of total premiums ceded from "All MIs" under book years 2001 through 2007, as of December 31, 2011) *with* **RCX 2004** at pdf page 379 ("Written as of 3/31/12" column shows $264.7 million of total premiums ceded from "All MIs Combined" under book years 2000 through 2007, as of March 31, 2012).

Respondents in exchange for the referrals on which they depended. The continuous acceptance by Respondents of 45% or 40% of the MIs' premiums demonstrates that illegal purpose, and there is no basis to exclude such evidence of the parties' course of dealing throughout their arrangement. Respondents' illegal referral scheme was not born with their agreement to cover the UGI 2009 book year and the Genworth 2008.B book year at a 25% ceding rate. In 2000, against strong resistance from the MI industry and state regulators, Respondents negotiated the first captive arrangement in the industry with a 40% ceding rate – the 4/10/40 structure for the UGI arrangement. **ECX 0733** (2006 UGI Proposal to PHH) at 13 ("Atrium negotiated the first 40% net excess cede in the MI industry."); **ECX 0584** (1/1/2000 UGI/Atrium agreement, Amendment #2); EC Br. at 13.

The purpose of captive arrangements was to "provide significant earnings" to the lender "with no operational steps" and "limited risk and capital" to the lender. **ECX 0580**. After accepting premiums at the 45% rate for years to achieve those objectives, Respondents were compelled to reduce the rate on the UGI 2009 book year and the Genworth 2008 book year to 25% only because Freddie Mac announced in February of 2008 that it would no longer accept loans on which captive ceding exceeded 25%. **Hrg. Tr. 461:10-13** (3/26 Rosenthal). But Respondents did so only because the MIs agreed to narrow the risk band *to an even greater degree*, causing Respondents' already enormous expected profit margin to grow even larger. For example, while the ceding rate for the Genworth 2008.B book year was 25%, down from the 45% rate for prior book years, Atrium's risk band was cut in half, from 4-14% to 4.5%-9.5%, with a higher attachment point. **RCX 0050** (Genworth/Atrium agreement, Amendment #4), ¶ 3; **RCX 0051** (Genworth/Atrium agreement, Amendment #5), ¶ 1. As a result,

Respondents' expected underwriting profit margin *increased* from approximately 40% to approximately 68%. EC Br. at 143, 146.

The UGI 2009 book year and Genworth 2008 book years were an extension of arrangements that had been in place for years, and they cannot be properly understood without considering the arrangements in their entirety. While Respondents were forced to cosmetically alter the structure of those final book years due to external market factors, they served the same purpose – to transfer profits to Respondents in exchange for referrals – with even greater efficacy.

E. The CMG and Radian Arrangements are at Issue

Contrary to Respondents' argument otherwise, Resp. Br. at 17-18, the Radian and CMG arrangements are at issue in this proceeding for the following reasons.

1. Respondents received ceded premiums from CMG on loans that closed on or after July 21, 2008 in violation of RESPA Section 8(b)

Any premium ceded to Respondents on a loan that closed on or after July 21, 2008 was an illegal fee split in violation of Section 8(b), and Respondents admit that CMG continued to cede premiums on approximately 106 loans originated on or after July 21, 2008. Resp. Br. at 17. Those premiums were therefore ceded in violation of Section 8(b) and must be disgorged.[73]

2. Radian and CMG received referrals of loans that closed on or after July 21, 2008 in violation of RESPA Section 8(a)

Both MIs received a substantial number of referrals of PHH loans that originated on or after July 21, 2008. Respondents state that "there were no loans originated after

[73] In Section III.B below, Enforcement includes a revised calculation of its proposed disgorgement amount for Respondents' violation of Section 8(b). As explained in that section, Enforcement is withdrawing its Section 8(b) disgorgement claim with respect to the Radian arrangement.

that date that were placed into the Radian reinsurance book" and "approximately 106 loans originated on or after July 21, 2008 that were placed into the CMG reinsurance book." Resp. Br. at 17. But Respondents' count includes only referred loans that were placed into the MI's captive arrangement. According to the spreadsheet they cite, Respondents' referrals to the MIs *also* included many loans that were *not placed into their captive arrangement*. **ECX 0159**; EC Br. at 159-60 (discussing ECX 0159).

Thus, while Respondents' spreadsheet indicates that, from August 2008 through December 2011, Radian was referred 2 loans[74] that were placed into its captive, it also indicates that Radian was referred a total of 1,945 loans over that time period – 1,943 of which were not placed into its captive. **ECX 0159** at tabs "2008," "2009," "2010," and "2011," column B, rows 46-58. Similarly, the spreadsheet shows that from August 2008 through December 2011, CMG was referred a total of 279 loans, far more than the approximately 106 referred loans that Respondents estimate were placed into its captive. **ECX 0159** at tabs "2008," "2009," "2010," and "2011," column B, rows 4-16. These referrals, including referrals of loans not placed into a captive, resulted from Radian and CMG's inclusion on the preferred provider list or Radian's inclusion on the dialer starting in August 2009. **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 (Radian and CMG remained on preferred provider list as of August 8, 2008); **ECX 0654** at Ex. M (Radian added to dialer in August 2009).

[74] Enforcement is unable to reconcile Respondents' claim that "there were no loans originated after [July 21, 2008] that were placed into the Radian reinsurance book" with the two loans that appear in cells D52 and D53 of tab "2009" of **ECX 0159**.

For its Section 8(a) disgorgement claim, Enforcement contends that premiums ceded by Radian and CMG in and after October 2006 were causally linked to their inclusion on the preferred provider list or the dialer, which generated these referrals.

3. The significance of the Radian and CMG arrangements is not diminished by the return of premiums to those MIs

The return of ceded premiums to Radian and CMG through their commutation payments does not defeat or diminish Enforcement's disgorgement claim for all of the reasons discussed in pages 191-206 of Enforcement's initial brief. Indeed, the arguments against giving Respondents any credit for those commutation payments apply with particular force to the Radian and CMG arrangements because the only reason Respondents returned premiums to Radian and CMG, and terminated their arrangements, was to avoid their obligation to contribute additional capital to the trust accounts as required by their written agreements.

As of June 2, 2009, Respondents' contributed capital in the Radian trust was $800,000 short of the amount required to maintain the trust at the contractual minimum level. **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."); **ECX 0246** (5/30/2008 email, Bogansky to Bowen-Ashwin) ("We never made the minimum capital requirements for Radian's trust from inception ...."). 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).

Similarly, Respondents terminated the CMG arrangement to avoid having to fund a shortfall of at least $1.7 million in the CMG trust account. **ECX 0429** at 5-7 (7/2009 CMG presentation) (CMG explained to PHH that the funds in the trust account were at

least $1.7 million short of the minimum capital required by the contract). On August 13, 2009, CMG's Alan Bahr wrote to Rosenthal to "express CMG MI's deep disappointment in" Atrium's decision "not to fund the Atrium trust deficiency." **ECX 0372**. Bahr noted: "We had anticipated a resolution that would support the integrity of the structure in place." *Id.*

Thus, by terminating the Radian and CMG arrangements and returning of premiums to those MIs, Respondents reaped an unfair gain of at least $800,000 and $1.7 million, respectively, in 2009. They were further unjustly enriched because terminating the arrangements prevented any possibility of Respondents incurring significant claims. The Radian and CMG arrangements were terminated in 2009, just as the first claims were finally being paid under Respondents' other two arrangements (Genworth and UGI). By terminating, Respondents escaped the Radian and CMG arrangements with a "loss" amounting to less than 10% of ceded premiums on a present value basis and avoided any conceivable possibility of significant risk transfer.

Returning premiums to Radian and CMG was simply the necessary cost to allow Respondents to obtain unfair benefits at the expense of those MIs. To reduce Enforcement's disgorgement amount based on the commutation payments would be to reward Respondents for their conduct.

For the same reasons, the return of ceded premiums to Radian and CMG does not undermine Enforcement's claim for injunctive relief, as Respondents contend. Resp. Br. at 17. Rather, they underscore the need for injunctive relief. Far from being a good faith decision to cease violating RESPA Section 8, Respondents' decision to terminate the Radian and CMG arrangement compounded their violations by preventing any possibility of significant risk transfer, even as Radian and CMG continued to receive

referrals through the preferred provider list or dialer through at least 2011 (including referrals of loans that closed on or after June 21, 2008). **ECX 0159** at tabs “2009,” “2010,” and “2011,” column B.

4. The Radian and CMG arrangements are relevant to understanding the UGI and Genworth arrangements

Crawshaw has cited Respondents’ conduct under the Radian and CMG arrangements, as well as the ultimate outcome for those MIs after their arrangements were commuted, to provide additional support for his conclusion that there was no transfer of significant risk under any of Respondents’ arrangements, including the UGI and Genworth arrangements. Because a risk transfer analysis should analyze all “reasonably possible outcomes” at the inception of an arrangement, *see* EC Br. at 120 (citing SSAP No. 62), Crawshaw believes that risk transfer under the UGI and Genworth arrangements cannot be fairly assessed solely by considering the actual outcome of those arrangements, which represents just one reasonably possible outcome at the inception of those arrangements. **Hrg. Tr. 644:13-647:18, 694:19-697:13** (3/26)**.** In that scenario, Respondents profited immensely, in large part because the real estate crisis did not strike immediately after the arrangements commenced, thereby allowing premiums to rapidly accumulate before any claims would be incurred. But the Radian and CMG arrangements show what might have happened under the UGI and Genworth arrangements if the real estate crisis had occurred shortly after those arrangements commenced. In other words, the Radian and CMG arrangements provide a picture of another “reasonably possible outcome” under the UGI and Genworth arrangements, at their inception.

Crawshaw explains: "Because the Radian and CMG arrangements commenced relatively close to the financial crisis (in 2004 and 2006, respectively), and thus unlike the UGI and Genworth arrangements did not have as long a period of time to accumulate premiums in the Trust Accounts, the outcomes of the Radian and CMG arrangements approximate a *'best-case scenario' to the MI for all of Atrium's captive arrangements*, and a 'worst-case scenario' for Atrium." **Crawshaw Rebuttal Rep.** at 13 (emphasis added). Despite this timing, rather than resulting in a loss ratio to Atrium on the order of 1000%, as one would expect if the arrangements provided true catastrophe coverage, Atrium's loss ratio was limited to less than 110% on a present value basis. *Id.;* **Crawshaw Rep.** Attachment 2; **Hrg. Tr. 2281:23-2282:24** (6/4 Crawshaw).

The characteristics of the Radian and CMG arrangements that allowed Respondents to avoid any conceivable possibility of sustaining a significant loss were not unique to those arrangements. First, the high attachment point delayed the onset of significant claims even in the midst of the worst real estate crisis in decades. Atrium paid no claims under the CMG arrangement and only $4,750 in claims under the Radian arrangement, even though both were in effect for more than two years after prices began to decline nationally. **ECX 0653** (PHH NORA submission) at Ex. A to Ex. C (Bogansky Decl.). The time lag afforded Respondents "time to more accurately evaluate the severity of the crisis and the risk that any additional capital contributed to the Trust Account would actually be called upon." **Crawshaw Rebuttal Rep.** at 78. Second, Radian and CMG permitted Respondents to commute their arrangements rather than contribute the contractually required minimum capital. **Crawshaw Rep.** at 54; EC Br. at 56-57.

Crawshaw's opinion that the outcome of the Radian and CMG arrangements represents a "reasonably possible outcome" for the UGI and Genworth arrangements at their inception is well supported. The factors that allowed Atrium to avoid any risk of significant loss under the Radian and CMG arrangements were present in the UGI and Genworth arrangements. The UGI and Genworth arrangements also had high attachment points, and Respondents were just as likely to fail to meet the minimum capital requirements under their agreements with UGI and Genworth – as demonstrated by their actual failure to do so, *see* **Crawshaw Rebuttal Rep.** at 96-101.

It is well-established that a party or its expert may draw conclusions about a particular transaction by analyzing closely comparable transactions, and that a party or its expert may rebut assertions of an opposing party or expert about a particular transaction by citing contrary evidence from such similar transactions. *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); *United States v. Walls*, 577 F.2d 690, 696-97 (9th Cir. 1978) (allowing "[e]vidence of other loan transactions in which appellant had defaulted" to be "submitted by the government to rebut appellant's claim that he borrowed from Mrs. Bjerke in good faith."); *United States v. Certain Real Property Located at 21090 Boulder Circle*, 9 F.3d 110 (Table), 1993 WL 432376 at *5 (6th Cir. 1993) ("The district court acted within its discretion in admitting the evidence of a prior similar transaction to rebut Betty's contention that she was an innocent party to this structuring scheme.").

With respect to analyzing risk transfer under the UGI and Genworth arrangements, the Radian and CMG arrangements are the *most* similar arrangements –

among other reasons, they share a common party (Atrium) and in the case of Radian, an identical 4/10/40 structure. The fact that Atrium is a common party is significant because the intentions and conduct of the parties to an arrangement are relevant to risk transfer. **ECX 0632** (11/2005, American Academy of Actuaries "Reinsurance Attestation Supplement 20-1: Risk Transfer Testing Practice Note") at 14 (risk transfer modeling can be "difficult and, perhaps, impossible unless one were to make assumptions about the behavior of one or both parties to the contract"); **Hrg. Tr. 2253:6-:19** (6/4 Crawshaw) (a risk transfer analysis must account for the "likely behavior of the parties"). Indeed, for their judicial estoppel defense, Respondents previously argued that a vastly larger and more diverse universe of arrangements – "at least 160 other captive arrangements" involving UGI, Radian, Genworth or MGIC, most of which do not involve Atrium – were "virtually identical in structure as the Atrium agreements." Resp. Prehearing Br. at 13, 14 n. 6 (Doc. # 78). While Respondents' claim that 160 other captive arrangements are "virtually identical" to Atrium's arrangements may have been hyperbole to support its judicial estoppel defense, they cannot argue that the Radian and CMG arrangements are irrelevant to the UGI and Genworth arrangements and the totality of their conduct.[75]

[75] Cascio apparently believes that the Radian and CMG arrangements are relevant to analyzing the UGI and Genworth arrangements. For example, responding to an opinion "on page 37 of [Crawshaw's] report" regarding the UGI arrangement, Cascio concedes that the Radian and CMG arrangements provide contrary "anecdotal proof." **Cascio Rebuttal Rep.** at 7-8 (Ex. E). Likewise, Cascio attempts to rebut Crawshaw's opinions regarding Atrium's ability to avoid losses under the UGI and Genworth arrangements by claiming that those opinions do "not mesh with the reality of two contracts suffering net economic losses, i.e., CMG & Radian." *Id.* at 9. He points to the "nearly $1 million in losses" that Atrium "suffered" as a result of the CMG and Radian arrangements as proof that Atrium could not have avoided significant losses under the UGI and Genworth arrangements. *Id.*

III. THE TRIBUNAL SHOULD AWARD ALL OF THE RELIEF REQUESTED BY ENFORCEMENT

A. Injunctive relief including disgorgement is available and necessary, and Respondents raise no new authority in arguing otherwise

Enforcement seeks an injunction to prevent future RESPA violations by Respondents similar to those they have committed to date, as proven in this case, arising from their leverage over MIs, and also seeks disgorgement of ill-gotten gains. Respondents argue that injunctive and other equitable relief is unavailable, and unjustified. In arguing that such relief is unavailable, Respondents are seeking a *third* bite at the apple, through reconsideration of arguments first raised in a motion in limine,[76] and again in their second dispositive motion.[77]

Indeed, every authority Respondents cite in support of the theory that injunctive and other equitable relief is unavailable, they have cited before. And the Tribunal has already, correctly, rejected the arguments.[78] There is nothing new here, and no merit to Respondents' arguments. As shown above, *see* § I.C, *supra*, there is no basis for reconsideration. To the extent the Tribunal does consider Respondents' arguments, however, Enforcement incorporates its prior briefing on these issues by reference. *See* EC Opp. to 2nd MTD (Dkt. # 123) at 20-30.

Reading Respondents' arguments in isolation, one might conclude that the Bureau has no express statutory grant of authority to impose restitution, disgorgement,

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[76] *See* "Respondents' Motion in Limine to Strike the Bureau's Claims for Remedies Other than Injunctive Relief for Conduct Prior to July 21, 2011" (Dkt. # 77) (Mot. in Lim.), Mar. 19, 2014.

[77] *See* "Respondents' Renewed Motion to Dismiss" (Dkt. # 101) (Resp. 2nd MTD), Apr. 18, 2014. In fact, Respondents import entire passages more or less wholesale from their earlier papers. *Compare, e.g.,* Mot. in Lim. At 2-3 ("By way of background…." and following paragraph) *and* Resp. 2nd MTD at 15-16 (same) *with* Resp. Br. at 48-49 (same).

[78] May 22 Order at 7-8; **Hrg. Tr. 32:3-25** (3/25).

and other traditional equitable remedies, including for violations of RESPA. Yet it has exactly that. *See* 12 U.S.C. § 5565(a)(1) ("The [Bureau] . . . in an . . . adjudication proceeding brought under Federal consumer financial law, shall have jurisdiction to grant any appropriate legal or equitable relief ...."), *id.* (a)(2) (specifying that relief "under this section" may include, inter alia, restitution, disgorgement, and "limits on the activities or functions of the person."); *see also* 12 U.S.C. § 5481(14) (defining "Federal Consumer Financial Law" as including "the enumerated consumer laws"), *id.* (13)(M) (RESPA is an "enumerated consumer law"). Thus, "[i]t does not matter whether the Bureau has any inherent equitable authority [for disgorgement and restitution]," as Respondents are at pains to show it does not, Resp. Br. at 48-50,[79] "because the Bureau has *statutory* authority to impose those forms of relief," May 22 Order at 14 (emphasis added). Respondents again simply ignore this clear statutory authority.

Moreover, as the Tribunal also previously noted, under the rule in *Porter v. Warner Holding Company*, prior to the transfer of RESPA enforcement authority to the Bureau on July 21, 2011, district courts, too, had broad equitable powers to remedy RESPA violations – and there is therefore no bar based on anti-retroactivity to the imposition of such remedies by the Bureau, based on its clear statutory authority, here. 328 U.S. 395, 399 (1946); *see* May 22 Order at 14. Yet again, Respondents point to no new authority to disturb this conclusion.

Contrary to Respondents' arguments, an injunction is both available, and, on these facts, necessary. As noted in Enforcement's initial brief, whether an injunction is needed is a question of whether there is some cognizable danger that a violation may

[79] *See also* Mot. in Lim. at 3, n. 1, Resp. 2nd MTD at 15-17.

recur.[80] To answer this question, one must examine the incentives facing Respondents, the history of their behavior in the face of similar incentives, and the means available to them going forward. Moreover, it is not necessary to "show that [Respondents] are likely to engage in violations involving *precisely the same conduct*. An injunction is justified if … *similar* violations are likely to occur." *FTC v. Direct Marketing Concepts, Inc.*, 648 F.Supp.2d 202, 212 (D. Mass. 2009) (emphasis added; citations omitted). In making this assessment, "[c]ourts should consider . . . several factors, including"

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.
>
> [*Id.* (citing *FTC v. Think Achievement Corp.,* 144 F. Supp. 2d 1013, 1017 (N.D. Ind. 2000).]

Finally, Respondents object to any relief in the form of an "obey-the-law" injunction. First, this objection at most addresses Enforcement's request for a provision seeking compliance with Section 8 of RESPA, and no other portions of the prayed-for injunction. But even as to that provision, the objection is not valid. First, such a proscription, while "broad, [is] not vague," and therefore is not impermissible. *FTC v. eDebitPay, LLC*, 695 F.3d 938, 944 (9th Cir. 2012). Furthermore, even if this portion of the relief sought were fairly characterized as an obey-the-law injunction, contrary to Respondents' assertions, such relief is available to this Tribunal in the proper circumstances – such as those presented here. *E.g., id.* ("we have not adopted a rule against 'obey the law' injunctions per se"); *EEOC v. AutoZone, Inc.*, 707 F.3d 824, 842 (7th Cir. 2013) (under federal employment statute, obey-the-law injunction can be

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[80] *See* EC Br. at 208 & n. 130 (citing EC Opp. to Resps. 2nd MTD at 22-26).

imposed "where the evidence suggests that the proven illegal conduct may be resumed," so long as it is "tailored to the particulars of the case") (citations omitted), *see id.* at 843-44 (trial court did not abuse its discretion in imposing obey-the-law injunction where defendant's "inaction over eight years was sufficient to convince [it] that compliance with the law would not be forthcoming" without such relief). The Supreme Court has acknowledged as much, noting that injunctive provisions enjoining "any practices" constituting violations of the statute at issue – in effect, obey-the-law injunctions – "are often necessary to prevent further violations where a proclivity for unlawful conduct has been shown." *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 191-92 (1949) (citations omitted).

The evidence shows that Respondents put a scheme in place to milk the MIs' profits for eighteen years without interruption. It shows that Respondents today have the same leverage over the MIs that they had in 1995, when they began their captive scheme, in 2006, when (at the latest) they became aware of government investigations of captive, and in 2013, when – at least, for the time being – they stopped participating in captive.[81] It shows that Respondents are wholly unrepentant. And, in sum, it shows that they have demonstrated "a proclivity for unlawful conduct" justifying the broad injunctive relief Enforcement has requested. *Id.* at 192.

[81] In fact, Atrium Re's management company represented to its Vermont regulators on June 21, 2013, at the time of the UGI commutation, that "[g]oing forward [Atrium Re] will continue business in dormancy due to an ongoing class action suit," **ECX 0016** at 1, suggesting that the only – temporary – impediment Respondents see to the resumption of their captive business is the threat of claims against them.

B. For violating RESPA 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.

Because the final book years under the Genworth, Radian and CMG arrangements included some loans that closed outside of the limitations period, the proposed disgorgement award for Enforcement's Section 8(b) claim in its initial brief included estimates of the premiums ceded by Genworth, Radian and CMG on loans that closed on or after July 21, 2008. Enforcement's estimation methodology assumed that the total ceded premiums for those book years were evenly distributed throughout the period of time covered by the book year. But ECX 0159, a spreadsheet produced by Respondents during Enforcement's investigation, shows the number of loans placed into each captive arrangement during each month of that period. The data in ECX 0159 allows Enforcement to make a more accurate estimate of the premiums ceded by Genworth, Radian and CMG on loans that closed on or after July 21, 2008. Enforcement hereby submits a revised calculation of its Section 8(b) disgorgement calculation that reflects this more accurate estimation methodology. This subsection replaces Section III.C.2 (pages 187-89) of Enforcement's initial brief in its entirety.[82]

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.**

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[82] This methodology results in the withdrawal of Enforcement's Section 8(b) disgorgement request based on ceding under the Radian arrangement.

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 must be estimated. According to data provided by Respondents, there were 5,383 loans placed into the Genworth captive arrangement that closed between June 1, 2008 and March 31, 2009. **ECX 0159** at tab "2008" and "2009," column D, rows 19-30. Approximately 3,317 loans – or 61.6% of those 5,383 loans – closed between July 21, 2008 and March

31, 2009.[83] Multiplying the $5,523,827.97 total ceded premiums for the Genworth 2008.B book year by 61.6% results in $3,404,557.96 of premiums. This is a reasonable estimate of the premiums ceded by Genworth to Respondents on loans that closed between July 21, 2008 and March 31, 2009.[84]

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 must be estimated. According to data provided by Respondents, there were 328 loans placed into the CMG captive arrangement that closed between January 1, 2008 and December 31, 2008. **ECX 0159** at tab "2008," cell D4. Approximately 98 loans – or 30% of those 328 loans – closed between July 21, 2008 and December 31, 2008.[85] Multiplying the $226,672.26 total ceded premiums for the CMG 2008 book year by 30% results in $67,891.11 of premiums. This is a reasonable estimate of the premiums ceded by CMG to Respondents on loans that closed between July 21, 2008 and December 31, 2008.

The total of the amounts indicated above is $5,927,082.46. 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

[83] This includes 410 of the loans 1,141 loans that closed in the month of July 2008, using the same 36% factor identified in footnote 7 of Respondents' brief. Resp. Br. at 17 n.7.
[84] The $4,419,062.38 figure on page 175 of Enforcement's initial brief should be changed to $3,404,557.96.
[85] This includes 12 of the loans 34 loans that closed in the month of July 2008, using the same 36% factor identified in footnote 7 of Respondents' brief. Resp. Br. at 17 n.7.

of that amount for Respondents' violation of Section 8(a), it need not also award disgorgement of the $5,927,082.46 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 $5,927,082.46, which stands independently of the arguments supporting the Section 8(a) disgorgement figure.

Enforcement's calculation of pre-judgment interest for its Section 8(b) disgorgement claim has also been revised accordingly. Exhibit A attached to Enforcement's initial brief contained its calculation of pre-judgment interest. Enforcement is attaching to this brief a revised Exhibit A that is consistent with the figures above.[86]

C. Respondents should not be awarded an offset based on speculation regarding payment of expected claims

Respondents contend that any disgorgement claim is "moot" because the MIs were paid some amount of expected claims through the commutation of their captive arrangements. Resp. Br. at 50-51. Specifically with respect to the Genworth 2008.B book year and the UGI 2009 book year, Respondents claim that the payment of expected claims to the MIs through the commutation of those arrangements completely offsets any premiums expected to be ceded from those MIs. Resp. Br. at 51. Enforcement respectfully refers the Tribunal to the discussion of this issue on pages 191 through 196 of its initial brief. The reasons for disallowing any offset for claim payments also apply to any payment based on expected claims. Moreover, Respondents fail to cite any evidence to quantify the deduction they claim. They cite only Milliman's projections of expected claim payments for the Genworth 2008.B and UGI 2009 book years, but there is no

[86] Enforcement's revised pre-judgment interest calculation is also described in Section III.D below. *See* p. 130 *infra*.

evidence that Respondents and Genworth/UGI actually incorporated those projections in the commutation payments the parties negotiated and ultimately agreed upon. To quantify their offset claim, Respondents should have introduced as exhibits documents showing the calculation of those commutation payments, including the precise amount of expected claims incorporated therein. In the absence of such calculations (which are in their possession), the Tribunal should decline to speculate regarding the amount of expected claim payments received by Genworth and UGI through the commutations.[87]

If, however, the Tribunal concludes that the negotiated commutation payments for the Genworth and UGI arrangements incorporated Milliman's projections as is, the disgorgement amount for Respondents' violations of Section 8(b) must be increased to reflect Respondents' receipt of *expected* premiums for the Genworth 2008.B book year and the UGI 2009 book year. Enforcement's proposed Section 8(b) disgorgement amount, calculated in Section III.B above, reflects only premiums actually ceded on those book years, and does not include any expected, but not yet ceded, premiums. If Respondents were also paid *expected* premiums on those book years in the amount projected by Milliman, those expected premium payments are also illegal fee splits on loans that closed on or after July 21, 2008.

According to Milliman, the projected ultimate written premiums for the Genworth 2008.B book year was $8,800,000. **RCX 2004** at 5. Multiplying this by the 61.6% factor, identified on page 125 above, results in an estimate of $5,423,794.91 of premiums ceded by Genworth on loans that originated on or after July 21, 2008.

[87] The Tribunal should decline to award an offset based on expected claim payments for these two book years for the additional reason Respondents' ill-gotten gains causally connected to illegally referred loans that closed on or after July 21, 2008 is not be limited to premiums ceded under those two book years. EC Br. at 175.

According to Milliman, the projected ultimate written premiums for the UGI 2009 book year was $3,227,000. **RCX 0838** at 4. Therefore, if the Tribunal conclude that the negotiated commutation payments incorporated Milliman's projections, the total Section 8(b) disgorgement amount using the Milliman projections would be $8,718,686.02.[88] No offset to this amount for any expected claim payments would be appropriate for all of the reasons discussed in Enforcement's initial brief.

D. Summary of relief requested

Enforcement summarizes the relief requested as follows:

1. For Respondents' violations of RESPA Section 8(a), the Tribunal should require Respondents to disgorge all ill-gotten gains causally connected to illegally referred loans that closed on or after July 21, 2008, in the amount of either: (a) $187,385,428.85 of premiums ceded to Respondents in and after October 2006, or (b) $205,183,304 of payments removed by Respondents from the trust accounts in and after October 2006.
2. For Respondents' violations of RESPA Section 8(b), the Tribunal should require Respondents to disgorge all premiums ceded to Respondents on loans that closed on or after July 21, 2008, in the amount of $5,927,082.46.
3. Respondents should be required to pay pre-judgment interest on any disgorgement award.
    a. Pre-judgment interest on Enforcement's first measure of disgorgement for Respondents' violations of Section 8(a) amounts to $34,244,282.69.

[88] This includes the $67,891.11 figure for the CMG 2008 book year.

b. Pre-judgment interest on Enforcement's second measure of disgorgement for Respondents' violations of Section 8(a) amounts to $34,441,725.30.

c. Pre-judgment interest on Enforcement's measure of disgorgement for Respondents' violations of Section 8(b) amounts to $682,649.47.[89]

4. The Tribunal should issue an injunction against Respondents with the following non-money provisions:

   a. that Respondents, and any entity controlled by Respondents, be prohibited from engaging in the business of providing reinsurance on mortgage insurance;

   b. that Respondents be prohibited 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);

   c. 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;

   d. that Respondents be prohibited from violating Section 8 of RESPA; and

[89] This figure revises the $826,734.77 figure in Table 5 on page 203 of Enforcement's initial brief. The calculation of the revised figure appears in the "Section 8(b)" tab of Exhibit A to this response brief.

   e. that other appropriate compliance reporting and monitoring requirements be imposed.

5. On or after July 21, 2011, each of the Respondents committed numerous acts and omissions that continued their violations of RESPA with respect to referred loans that closed on or after July 21, 2008. Accordingly, Respondents should be ordered to pay civil money penalties in the amount of $22.5 million for their violations of Section 8(a) and $137,425,000 for their violations of Section 8(b).

IV. CONCLUSION

Respondents' arguments against liability and for eliminating or minimizing remedies are based on faulty statements of the law, and are strikingly free of support in – or even reference to – the bevy of contemporaneous documents in the record. Many of their legal arguments have already been urged unsuccessfully before this Tribunal. All of them should be rejected. Respondents should be found jointly and severally liable for their violations of RESPA, and accordingly, we respectfully request that the relief sought herein be awarded in its entirety.

DATED: August 28, 2014

Respectfully submitted,

Lucy Morris
Deputy Enforcement Director for Litigation

Sarah J. Auchterlonie
Assistant Deputy Enforcement Director for Litigation

/s/Donald R. Gordon
Donald R. Gordon
Kimberly J. Ravener
Navid Vazire
Thomas H. Kim
Enforcement Attorneys
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552
Telephone: (202) 435-7357
Facsimile: (202) 435-7722
e-mail: donald.gordon@cfpb.gov

Enforcement Counsel

Appendix A

I. RESPONDENTS' FACTUAL ASSERTIONS LACKING CITATION TO EVIDENCE

Respondents' post-hearing brief contains many factual assertions for which Respondents have provided no citation to any evidence. Some of these assertions are identified in Table A below. Where appropriate, Enforcement has bolded the specific part of the assertion that is unsupported. These factual assertions should be disregarded because Respondents have failed to support them by citation to any evidence.

Table A

Page	Assertions that have no citation to evidence for support
2	Dr. Crawshaw's position is belied, however, by **every accounting firm which reviewed Respondents' financial statements, as well as the financial statements of every MI which had a reinsurance arrangement with Atrium** ....
3	In any event, the premiums received on the two remaining books of business with Genworth and UGI were paid back in the form of compensation for future expected claims as part of the commutation of those two arrangements.
14	Third, the evidence adduced at the hearing demonstrated simply that, first and foremost, the Lender Respondents' primary interest is, and always has been, originating high quality mortgage loans for qualified borrowers. As a result, the Lender Respondents needed to ensure that there were an adequate number of MIs that covered the available array of loan products being offered. Thereafter, the Lender Respondents' interests were in working with MIs which had: a broad array of products; a history of good customer service; solid financial footing, *e.g.*, little counter-party risk; and the ability to communicate electronically in terms of ordering and placing pmi.

20	**Before the dialer was utilized**, the Lender Respondents provided borrowers the opportunity to select a different MI.
23	First and foremost, the Lender Respondents' primary interest has always been originating high quality mortgage loans for qualified borrowers. As a result, the Lender Respondents need to ensure that there are an adequate number of MIs that cover the available array of loan products being offered. Thereafter, the Lender Respondents' interests are in working with the MIs with which they have a good relationship and which offer the products and services the lenders need to originate loans.
26	The mere existence of the dialer, an electronic program that **contained the rules** for matching the various MI's programs with the borrower's specific needs and allowed the Lender Respondents to distribute their risks among various MI partners ....
31	Further, the Lender Respondents allowed brokers and loan correspondents to select the MI.
31	The primary question regarding the selection of the MI was whether the MI offered to insure the loan program sought by the borrower.
31	The Lender Respondents were keenly aware of the GSEs' requirements, and at no time did any of Atrium's reinsurance arrangements cause any secondary market investor to refuse to purchase their loans.
32	As it relates to Respondents, Atrium's reinsurance agreements were reviewed by the New York Department of Insurance, as well as by credit rating agencies and its own outside accountants.
33	Secondary considerations included each MI's ability to pay claims.
33	It was the Lender Respondents' policy and practice to provide borrowers with affiliated business disclosures with respect to all loans they originated.
34	Likewise, for the last two books – Genworth 2008B and UGI 2009 – although Atrium had not yet paid a claim, the **commutations provided for the payment of all expected claims on those book years, just as if those agreements had run to completion.**
34	Atrium's contracts were legally binding and **were consistent with industry standards for reinsurance agreements.**

36	Further, as it relates to the Genworth 2008B and UGI 2009 books, Atrium paid the expected claims on those books through the commutations of those agreements.
37	Over time, however, **in order to reduce its counterparty risk**, the Lender Respondents expanded and utilized other pmi providers, a number of which did not have a reinsurance arrangement with Atrium.
41	Further, the reinsurer is required to maintain capital in the arrangements potentially for this entire period.
43	Moreover, Respondents did not rely only on **their own review of these arrangements**, but sought out the opinion of a highly-regarded third-party actuarial firm.

II. RESPONDENTS' FACTUAL ASSERTIONS BASED ON MISCHARACTERIZATION OF CITED SOURCE

Respondents' post-hearing brief contains many factual assertions that are accompanied by a citation, but which are not supported by the source cited. Some of these assertions are listed in Table B below. Where appropriate, Enforcement has bolded the specific part of the assertion that is not supported by the cited source. These factual assertions should be disregarded because they are based on a mischaracterization of the cited evidence.

Table B

Page	Assertion based on mischaracterization of cited source	Cited Source(s)	Comment
13	Reinsurance also provided relief to the MIs in terms of required capital to be held.	Hearing Tr. 341.	Culver did not testify that any of "the MIs" – namely, UGI, Genworth, Radian or CMG – obtained capital relief through their captive arrangements with Respondents (much less that they needed or even wanted capital relief).
16	As the NOC makes plain, the Bureau has declared that it is illegal to have a reinsurance arrangement that results in a profit.	NOC ¶ 67 ("In its eighteen years of existence as a captive between 1995 and 2013, Atrium never paid claims or made any other payments to MIs that exceeded the then-available funds in the applicable captive trusts.").	The cited allegation is not an assertion that it is illegal to have a reinsurance arrangement that results in a profit.

20	Again, this finding is clearly erroneous and reflects a fundamental misunderstanding of the purpose of the dialer, which is simply an automated system to allocate business among the MIs with which the Lender Respondents wished to conduct business, **regardless of whether a reinsurance agreement existed.**	Hearing Tr. 106-09 (Rosenthal: the purpose of the dialer is to ensure that the retail loan "adheres to all the eligibility criteria that exists and is checked against all those rules and you have good processes that are efficient to order those mortgage insurance certificates to make sure you don't damage the loan"); *id.* at 475-6 (Rosenthal explaining how "each different MI provider started changing their opinion of where they saw the highest risk" and "everybody had their own list . . . we had to get our machine to take all these different lists").	Rosenthal did not testify that captive arrangements had no effect on the captive dialer.
32	In addition, Atrium obtained an annual statement of actuarial opinion and **every year it was determined that Atrium: met the requirements of the insurance laws of the State of New York**	Statement of Actuarial Opinion, RCX 32-35 (Milliman Statements of Actuarial Opinions for years 2007-2010); Hearing Tr. 1924-25 (Schmitz); *id.* at 767, 776 (Crawshaw).	These actuarial opinions from Schmitz do not state that *Atrium* (including every aspect of Atrium) "met the requirements of the insurance laws of the State of New York." Clearly, Schmitz is not qualified to make conclusions about whether Atrium complied with every state insurance law, nor did he undertake such an analysis. He stated only that Atrium's *reserves* "met the requirements of the insurance laws of the State of New York." *See, e.g.*, **RCX 0032** at 1-2 (finding that "reserves listed in Exhibit A" met state requirements).

38	Since the only reinsurance that was available was through lender-captives, the **market rate was defined by the industry and the 25% cede was appropriate for the layer of risk insured**.	Hearing Tr. 1914-15 (Schmitz noting that the 25% cede arrangement was "squarely in the range" of agreements reviewed by Milliman).	Schmitz did not testify that the so-called "market" established that the 25% ceding rate was "appropriate for the layer of risk insured" under a 5/5/25 structure (that is, a risk band from 5% to 10% of aggregate risk). He simply testified that there were other captive arrangements in the market with a similar ceding rate and risk band.
41	[B]ecause of the cross-collateralization of book years and the long tail period ... the potential losses to a particular book year may not occur until many years in the future. **Further, the reinsurer is required to maintain capital in the arrangements potentially for this entire period. Such characteristics are not present in connection with reinsurance in property and casualty insurance where the period of time for filing claims is defined, and the reinsurer will be on notice of potential claims much more closely in time to the covered period.**	Hearing Tr. 794 (Crawshaw: "For a hurricane it happens on a day, whereas this mortgage insurance is much more protracted.").	The cited testimony from Crawshaw in no way indicates or suggests that reinsurers in other lines of business are not required to commit capital for the entire period of coverage. In fact, his opinion is precisely the opposite. Crawshaw Rebuttal Rep. at 23-24, 77. Nor does the cited testimony say anything about "the period of time for filing claims" being "defined" in other types of reinsurance arrangements.

PFOF ¶ 8	Reinsurance is **intended** to lessen the volatility of the primary mortgage insurers' loss ratios.	Hearing Tr. 1878 (Schmitz).	Schmitz did not testify that *the reason* MIs enter into reinsurance arrangements is to reduce the volatility of their loss ratios. (Nor does his testimony establish that Respondents' arrangements would be more effective in achieving such a result than a savings account.)
PFOF ¶ 19	Respondents' selection of an MI occurred **only after** borrowers elected not to select their own MI.	Hearing Tr. 118-19 (Rosenthal).	Rosenthal did not testify that Respondents selected MIs only after borrowers elected not to select their own MI. The cited testimony only states that borrowers were provided an affiliated business disclosure, and that borrowers did not very often select the MI. Rosenthal said nothing about the timing of their referrals vis-à-vis any communications with borrowers.

PFOF ¶ 26	In 2008, the **New York Department of Insurance** conducted an audit of Atrium which covered the six-year period from January 1, 2002, through December 31, 2007. The New York Department of Insurance conducted the examination in accordance with "the guidelines and procedures established in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners" and **found Atrium in compliance with all substantive provisions of New York Insurance Law** …	RCX 143 at 2, 6 (2008 New York Department of Insurance Report of Examination)	Nowhere in this document did the NYID state that it found Atrium to be in compliance with all substantive provisions of New York Insurance Law. To the contrary, on page 10, the NYID stated: "The review of the minutes of the board of directors meetings indicated that securities were purchased without the formal approval of the Company's board of directors, *in violation of Section 1411(a) of New York Insurance Law."* RCX 0143 at 10.

III. RESPONDENTS' FACTUAL ASSERTIONS NOT SUPPORTED BY DOCUMENTARY EVIDENCE

Respondents' post-hearing brief contains numerous factual assertions lacking any documentary support, which are listed in Table C below. The only evidence cited by Respondents in support of these assertions are vague, general and self-serving statements from the testimony of Rosenthal, Walker, Danahy and Bogansky. Given the nature of these assertions, there should be many contemporaneous documents corroborating them, if they were true. These factual assertions should be disregarded because they are not supported by credible evidence.

Table C

Page	Assertion relies only on self-serving testimony	Cited Source(s)
13-14	The fact that MGIC was not interested in such a benefit does not mean, however, that other MIs were not interested in obtaining the capital relief that a reinsurance arrangement would provide. **Mr. Walker confirmed this benefit during his testimony.**	*See id*. at 2132-3 (Walker explaining that reinsurance reduces the MI's capital requirement); *id*. at 2160-2 (Walker explaining how the contingency reserve in the trust account allows the primary insurer to take credit and frees up its capital for other uses).
20	Again, this finding is clearly erroneous and reflects a fundamental misunderstanding of the purpose of the dialer, which is simply an automated system to allocate business among the MIs with which the Lender Respondents wished to conduct business, **regardless of whether a reinsurance agreement existed.**	Hearing Tr. 106-09 (Rosenthal: the purpose of the dialer is to ensure that the retail loan "adheres to all the eligibility criteria that exists and is checked against all those rules and you have good processes that are efficient to order those mortgage insurance certificates to make sure you don't damage the loan"); *id*. at 475-6 (Rosenthal explaining how "each different MI provider started changing their opinion of where they saw the highest risk" and "everybody had their own list . . . we had to get our machine to take all these different lists").

21	Both Mr. Rosenthal and Mr. Danahy testified that the financial strength of the MI was a significant factor for the Lender Respondents.	Hearing Tr. 108-9 (Rosenthal); Deposition of M. Danahy (ECX 153) at 197.
23	Further, despite the unrefuted testimony of Mr. Rosenthal that the decision to partner with a particular MI is based on a panoply of factors, including customer service, claims paying ability, breadth of product eligibility and their ability to communicate electronically, such considerations were simply ignored by the Tribunal in its May 22 Order.	Hearing Tr. 108-109 (Rosenthal: "We took a look a[t] a broad perspective of every mortgage insurer with whom we do business" including counterparty strength, willingness to pay claims, automated systems, and "a good breadth of product eligibility."); *id.* at 569-75 (Rosenthal explaining the factors the Lender Respondents were looking for in partnering with an MI including financial strength, efficient processing of claims, economic and market expertise, technology, training products, and ancillary services).
25	Thereafter, the Lender Respondents' use of particular MIs was based on a "broad perspective of every mortgage insurer with whom [they] do business."	Hearing Tr. 108. *See also id.* at 118 (Rosenthal: "I'm referring to the entire arrangement that PHH Mortgage would have had with RMIC, which would have been pretty broad. It would have included how do you pay claims, how do you service loans, what type of services are provided and delegated between PHH and RMIC, what abilities do we have in servicing, policies, captive is definitely one of them that would have been part of it, product eligibility.").
25	Further, since pmi rates are filed with state insurance regulators, there is little variation in the rates; accordingly, from the borrower's point of view, there is little difference among MIs.	Hearing Tr. 119 (Mr. Rosenthal explaining that because the pricing is similar, he "guesses" that borrowers seldom pick their own MI); *id.* at 383 ("Generally borrowers don't care [who provides the pmi], the premiums are very, very similar, and the lender is the beneficiary if anything goes wrong.").

30	The only testimony on this issue was presented by Mr. Walker, who stated that UGI sought out reinsurance from non-captive entities but that such reinsurance was not available in the marketplace.	Hearing Tr. 2126-27 (UGI was "always seeking, especially in the 1990s, to get external reinsurance, particularly for catastrophe situations for cat cover."); *id.* at 2127 (there was "a prejudice against mortgage guaranty insurance" in the 1990s); *id.* at 2129-30 (Walker went to Europe in the mid to late 1990s looking for reinsurance and was advised that "the MI line of business in the United States was virtually uninsurable"); *id.* at 2140-1 (Walker discussing UGI's inability to get significant excess of loss coverage).
33	The Lender Respondents' primary focus was to originate loans and, where the borrower was unable to put down 20% and thus pmi was required, the first criteria was whether the MI offered to insure the loan program sought by the borrower.	Danahy Tr. at 86-7 ("First of all, they have to offer the MI that meets the borrower's needs, so it fits their criteria.").
35	As explained by Mr. Walker during the hearing, the trust caps were placed in reinsurance agreements for reinsurers domiciled in Vermont at the request of the Vermont regulator to avoid forcing a reinsurer into bankruptcy.	Hearing Tr. 2167-68 (Walker).
36-37	While it is true that during the early years of Atrium's existence, the Lender Respondents sent the bulk of its business to UGI, **that business decision was based on the lenders' belief that UGI was a solid business partner.**	Danahy Tr. at 197 ("[UGI] was always a top-rated [pmi] company, they certainly had one of the highest rating standards, so we want good solid partners; and then we want to develop that business together so we can be efficient at it, develop integrated systems and really kind of work effectively to get the most opportunity to make loans that we can.").
38	UGI wanted to purchase reinsurance but it was generally not available from any non-lender affiliated reinsurers.	Walker Testimony at 2129-30, 2140-1.

PFOF ¶ 9	Atrium met every contractual funding obligation with respect to trusts that were created in connection with its reinsurance arrangements with Genworth and UGI.	Declaration of M. Bogansky ¶ 12 (ECX 653).
PFOF ¶ 19	Respondents' selection of an MI occurred only after borrowers elected not to select their own MI.	Hearing Tr. 118-19 (Rosenthal).

Certificate of Service

I hereby certify that on this 28th day of August 2014, I caused a copy of the foregoing "Enforcement Counsel's Post-Hearing Response 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:

Mitch Kider
kider@thewbkfirm.com

David Souders
souders@thewbkfirm.com

Sandra Vipond
vipond@thewbkfirm.com

Roseanne Rust
rust@thewbkfirm.com

Michael Trabon
trabon@thewbkfirm.com

Leslie Sowers
sowers@thewbkfirm.com

/s/ Donald R. Gordon
Donald R. Gordon