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.

FILED UNDER SEAL

RESPONDENTS' POST-HEARING REPLY BRIEF

WEINER BRODSKY KIDER PC

Mitchel H. Kider, Esq.
David M. Souders, Esq.
Sandra B. Vipond, Esq.
Rosanne L. Rust, Esq.
Michael S. Trabon, Esq.
1300 19th Street, N.W., Fifth Floor
Washington, D.C. 20036
(202) 628-2000

Attorneys for Respondents PHH Corporation, PHH Mortgage Corporation, PHH Home Loans, LLC, Atrium Insurance Corporation, and Atrium Reinsurance Corporation

TABLE OF CONTENTS

Page

TABLE OF CONTENTS ... i

TABLE OF AUTHORITIES ... iii

INTRODUCTION ... 1

ARGUMENT ... 3

I. Enforcement Counsel's Attempt to Impose Civil Money Penalties on Conduct That Occurred Before July 21, 2011, Violates Due Process ... 3

II. Enforcement Counsel's Assertion That Mortgage Insurance Is Selected Based Solely on Past Payments Is Factually Unsupported ... 7

III. Respondents' Conduct Prior to July 21, 2008, Is Irrelevant to This Action ... 12

IV. Enforcement Counsel's Attempt to Punish the Receipt of Premiums Highlights Their Inconsistent Conduct ... 15

V. Atrium Provided Real Reinsurance, and Dr. Crawshaw's Novel Theory Is of No Moment ... 17

A. Reinsurance Was Provided by Atrium to the MIs ... 18

B. Dr. Crawshaw's Novel Analysis Is Insufficient to Carry Enforcement Counsel's Burden ... 23

1. Enforcement Counsel Misrepresent the HUD Letter ... 24

2. Dr. Crawshaw's Analysis Is Unusable ... 26

3. Enforcement Counsel's Assertion That the Reinsurance "Provided No Genuine Benefit to the MIs" Is Belied by the Facts Adduced at the Hearing ... 29

4. Enforcement Counsel Cannot Use Dr. Crawshaw's Analysis to Attack the Value of the Reinsurance ... 29

VI. Enforcement Counsel Manufacture Facts to Support Their Assertion of an Agreement to Refer ... 31

VII. Respondents Demonstrated That the 25% Cede Was Reasonably Related to the Value of the Services Atrium Provided ... 37

VIII. There Is No Basis for Injunctive Relief Where, as Here, The Conduct Ceased Years Before the Bureau Came Into Existence 44

IX. Enforcement Counsel's "Disgorgement" Analysis Is Flawed 45

A. Enforcement Counsel's Disgorgement of Ceded Premiums Argument Fails, as Respondents Have Not Profited on a Book-Year Basis After July 21, 2008 45

1. Atrium Experienced Losses on Loans Originated After July 21, 2008 46

2. Any Disgorgement Award Requires an Offset for Claim and Commutation Payments 46

B. Enforcement Counsel Have Failed to Show a "Causal Connection" Between Loans Closed on or After July 21, 2008 and Ceded Premiums Received Before that Date and Thus Cannot Seek Disgorgement of Such Premiums 49

C. Enforcement Counsel's Argument Seeking Disgorgement of Dividends Distributed From the Trusts Fails 53

CONCLUSION 58

TABLE OF AUTHORITIES

Page(s)

Cases

Bregman v. Perles,
747 F.3d 873 (D.C. Cir. 2014) 46, 47, 48

Commodity Futures Trading Comm'n v. Am. Metals Exch.,
991 F.2d 71 (3d Cir. 1993) 48

Edwards v. First Am. Corp.,
517 F. Supp. 2d 1199 (C.D. Cal. 2007) 50, 52

FTC v. Bronson Partners,
654 F.3d 359 (2d Cir. 2011) 48

Holland v. Florida,
560 U.S. 631 (2010) 47

Hughes Aircraft Co. v. United States ex rel. Schumer,
520 U.S. 939 (1997) 4

Humana, Inc. v. Forsyth,
525 U.S. 299 (1999) 9

Kaiser Aluminum & Chem. Corp. v. Bonjorno,
494 U.S. 827 (1990) 4

Landgraf v. USI Film Prods.,
511 U.S. 244 (1994) 4, 5, 6

SEC v. Antar,
120 F. Supp. 2d 431 (D.N.J. 2000) 57

SEC v. Banner Fund Int'l,
211 F.3d 602 (D.C. Cir. 2000) 46

SEC v. Bilzerian,
29 F.3d 689 (D.C. Cir. 1994) 45

SEC v. Bilzerian,
814 F. Supp. 116 (D.C.C. 1993) 57

SEC v. Blatt,
583 F.2d 1325 (5th Cir. 1978) 45

SEC v. First City Fin. Corp.,
890 F.2d 1215 (D.C. Cir. 1989) 46

United States v. Murphy,
937 F.2d 1032 (6th Cir. 1991) 5

Zacharias v. SEC,
569 F.3d 458 (D.C. Cir. 2009) 45, 46, 47, 48

Statutes and Regulations

12 C.F.R. § 1024.14(g)(2)...37

12 C.F.R. § 1081.303(a)...7

24 C.F.R. § 3500.14(g)(2)...37

15 U.S.C. § 1012 9

INTRODUCTION

As Respondents explained in their post-hearing brief, Enforcement Counsel failed to prove their case. Enforcement Counsel apparently agrees, which is why they needed to file a 227-page brief (with 135 footnotes), the sole purpose of which is to bring a new case against Respondents. Unfortunately for Enforcement Counsel, the record is closed, and try as they might, they cannot manufacture a case where none exists. Enforcement Counsel's difficulties are numerous. First, the Tribunal has already ruled that penalties are not available for loans that closed before July 21, 2011. That ruling fell on deaf ears, however, and Enforcement Counsel now demand more than $159 million in civil money penalties, despite the fact that not one loan with captive reinsurance was originated after July 21, 2011. Second, as Respondents predicted, under the guise of "alternative theories of recovery," Enforcement Counsel completely ignore the unrefuted testimony of every industry witness regarding the benefits of reinsurance. Indeed, Enforcement Counsel's belief that the selection of a mortgage insurer ("MI") is based solely on the receipt of reinsurance premiums is nothing more than a fanciful theory that has no testimony or evidence to support it. Third, Enforcement Counsel's attempt to punish Respondents for Atrium's continued receipt of reinsurance premiums ironically highlights Enforcement Counsel's own dilemma; that is, Enforcement Counsel seeks punitive damages for alleged "reckless behavior" because Atrium received premium payments that the Bureau specifically *permitted* the MIs to make. Fourth, reinsurance services were provided by Atrium and Atrium Re, and Dr. Crawshaw's novel risk transfer analysis – which has not been accepted by anyone other than the Bureau – cannot carry Enforcement Counsel's burden. Fifth, Enforcement Counsel's cursory request for injunctive relief fails as unsupported and unwarranted. Finally, Enforcement

Counsel's request for disgorgement under RESPA is so fundamentally flawed as to draw into question the legitimacy of the request itself.

Enforcement Counsel's 227-page "magnum opus" speaks volumes. Rather than rely on the testimony of the few witnesses they actually called to testify, Enforcement Counsel regurgitates Dr. Crawshaw's analysis and relies on the usual "snippets" of emails and documents taken out of context in a vain attempt to construct a case out of whole cloth. However, such tactics are of no moment where such "snippets" are not supported by, or are in direct contradiction with, the live testimony presented by witnesses at the hearing. The Tribunal should be leery of Enforcement Counsel's use of documents to contradict live hearing testimony, as well as their use of documents that were not actually presented to the witness for review during the hearing.

Respondents do not need 227 pages to respond to Enforcement Counsel's arguments. HUD provided guidance to the industry regarding the establishment and operation of captive mortgage reinsurance arrangements in 1997. For the 14 years that followed, when HUD was responsible for enforcement of RESPA, a statute with both criminal and civil remedies, HUD took no action against any of the ***hundreds*** of existing captive arrangements, in spite of the full disclosure of such arrangements to HUD, state regulators, and consumers.[1] Indeed, it was four

[1] HUD was fully aware of these relationships, as well as Milliman's analysis of Atrium's (and others') reinsurance agreements since at least 2008 when the Agency issued subpoenas to Milliman, UGI, and Genworth. *See* RCX 681 (HUD Office of Inspector General ("OIG") Subpoena *Duces Tecum* to Milliman, USA, Inc., dated March 28, 2008); RCX 732 (HUD OIG Subpoena *Duces Tecum* to UGI, dated March 28, 2008); RCX 391 (Genworth's response to the HUD OIG Subpoena, dated June 27, 2008). Yet, in the three years that followed, HUD – the agency with primary responsibility for RESPA – took no action against any entity with respect to any captive reinsurance arrangements. This is not a situation where Respondents, or anyone else, hid any conduct from the government. Rather, the government had all of the relevant information and did nothing for years. While Enforcement Counsel would like to assert claims back to 1994, the fact of the matter is that the Tribunal has already ruled on the issue of the

years ***after*** the last PHH loan was placed into a reinsurance book that the Bureau filed its Notice of Charges in this action. Yet, the Bureau never formally repudiated HUD's guidance and its own expert deemed it "reasonable" for Respondents to rely on Milliman's reports regarding risk transfer. Enforcement Counsel's arguments are a house of cards that cannot stand even the slightest scrutiny.

ARGUMENT

Respondents incorporate their brief filed August 8, 2014 (hereinafter "Brief"), and they need not restate the arguments made therein. In addition to explaining why they are entitled to a recommended decision in their favor, Respondents anticipated and answered the arguments raised by Enforcement Counsel. The same cannot be said of Enforcement Counsel's post-hearing brief, which 1) completely ignores the rule of lenity and its applicability to RESPA, an argument Enforcement Counsel have repeatedly refused to respond to in the past; 2) completely ignores the fundamental flaws in Dr. Crawshaw's retrospective analysis; 3) deliberately misstates the plain language of the HUD Letter; and 4) completely disregards the Tribunal's May 22 Order regarding the limits on liability. Respondents rest on their Brief and limit this Reply to demonstrating the lack of evidentiary support and, thus, lack of merit to Enforcement Counsel's last ditch effort to manufacture a Section 8 violation where none exists.

I. ENFORCEMENT COUNSEL'S ATTEMPT TO IMPOSE CIVIL MONEY PENALTIES ON CONDUCT THAT OCCURRED BEFORE JULY 21, 2011, VIOLATES DUE PROCESS

Enforcement Counsel simply ignore the Tribunal's May 22 Order which clearly states that 1) "no claims arising from loans closed before July 21, 2008, are actionable;" and 2) civil

statute of limitations and, while Respondents continue to disagree that July 21, 2008, is the earliest date, what is not in dispute is the fact that if the government wanted to go back earlier, it should have taken action long before the Bureau filed this action on January 29, 2014.

money penalties are not available for loans that were originated before July 21, 2011, the date the Bureau came into existence.[2] *See* Document 152 ("May 22 Order") at 14. Indeed, the Tribunal has already found that "Enforcement has clarified that it does not seek civil money penalties for conduct predating July 21, 2011, and it is almost certainly unavailable in any event." *Id.* at 13. Despite these rulings, which are law of the case, Enforcement Counsel seek more than $159 million in civil money penalties as well as purported "illegal payments accepted by Respondent (sic) both before and after [July 21, 2008]." Enforcement Counsel's demand ignores not only the Tribunal's prior ruling but also the due process clause of the United States Constitution.

As Respondents explained previously in connection with the briefing on their initial motion to dismiss, the "presumption against retroactive legislation" is deeply rooted in our legal system. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994) (citation omitted). Indeed, the "'principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal.'" *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 946 (1997) (quoting *Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 855 (1990) (Scalia, J., concurring)). Thus, courts "apply this time-honored presumption unless Congress has clearly manifested its intent to the contrary." *Hughes Aircraft Co.*, 520 U.S. at 946. Indeed, as the Supreme Court held in *Landgraf*, the Court has never "read a statute substantially increasing the monetary liability of a private party to apply

[2] Respondents do not believe that any civil money penalties would ever be available in this action, and they have previously argued, and preserved, their objection to the Tribunal's assertion of authority over conduct that occurred prior to July 21, 2011. *See, e.g.,* Respondents' Motion to Dismiss or, in the Alternative, for Summary Disposition, filed Jan. 31, 2014; Respondents' reply Memorandum, filed Feb. 28, 2014. However, given the fact that the Tribunal has already ruled that such penalties are not available for loans originated before July 21, 2011, and because the loans subject to reinsurance were originated before January 1, 2010, there is no reason for Respondents to waste the Tribunal's time demonstrating why their conduct does not warrant the imposition of civil money penalties.

to conduct occurring before the statute's enactment." *Landgraf*, 511 U.S. at 284. *See also, United States v. Murphy*, 937 F.2d 1032, 1038 (6th Cir. 1991) (it was "error for the district court to apply the amendments retroactively" because such amendments "were applied to increase the liability of an individual by more than $1,000,000[]") (citation omitted).

The following facts are not in dispute:

- The last time a loan was put into a Radian reinsurance book was July 2008;
- The last time a loan was put into a Genworth reinsurance book was March 2009;
- The last time a loan was put into a UGI reinsurance book was December 31, 2009;
- The last time a loan was put into a CMG reinsurance book was December 31, 2009;
- The only "conduct" that occurred after July 21, 2011, related to previously-insured loans and consisted of Atrium's receipt of premiums for reinsurance services pursuant to agreements established ***prior to January 1, 2010.***

See ECX Nos. 159; RCX 42 (Radian commutation agreement); RCX 46 (Genworth termination agreement); RCX 59 (UGI commutation agreement); RCX 39 (CMG commutation agreement). *See also* Document 67 ("March 13 Order") at 17-18; May 22 Order at 22-23; Hearing Tr. 2325.

There was no testimony at the hearing that indicated that Respondents entered into any new reinsurance arrangements after July 21, 2011, or even contemplated entering into such arrangements after that date. Enforcement Counsel simply ignore the lack of continued conduct and instead argue that the mere receipt of premiums under the existing contracts of reinsurance is sufficient to impose civil money penalties. Unfortunately for Enforcement Counsel, such an argument is merely a recast of their previously-rejected continuing violation theory.[3] *See* May 22 Order at 13 ("I conclude that the continuing violation doctrine does not apply to this

[3] Further, as explained in Section III, *infra*, the Bureau has now "blessed" the continuation of such agreements, including the payment of premiums. Enforcement Counsel cannot reject the Bureau's prior position in this administrative adjudication.

proceeding." (footnote omitted)). Thus, if, as the Tribunal held, the "statute of limitations began to run, on a loan-by-loan basis, at the time of each loan's closing," then it necessarily follows that the conduct about which the NOC is based ended on January 1, 2010, and any attempt to impose civil money penalties would constitute the imposition of "monetary liability" on a party for "conduct occurring before the statute's enactment" – something the Supreme Court has never permitted. *Landgraf*, 511 U.S. at 284.

In a vain attempt to overcome the Tribunal's order limiting liability to loans originated on or after July 21, 2008, Enforcement Counsel now contend that the "thing of value" for future referrals consisted of "continued ceding, dividends from the trusts, amendments to further reduce its risk or avoid capital calls, and ultimately, commutation payments that released cash to PHH." EC Brief at 64. Enforcement Counsel's assertion is simply an end-run around a ruling with which they disagree. All of these items – continued ceding payments, dividends, and commutations – relate to the agreements entered into for the books of business put together for the years in which the loans were originated. Thus, these actions are merely the result of the previously-entered contractual agreements and cannot serve as an independent basis for liability. Certainly, no witness testified that any of these payments, dividends, or commutations had any effect on future referrals.[4] Indeed, Dr. Crawshaw specifically stated that he had no evidence that the commutations of the UGI and Genworth agreements were on any basis other than an arm's length negotiation, which negates any assertion of a "referral arrangement."

As was made plain by Enforcement Counsel's "forensic accountant," Ryan Thomas, Enforcement Counsel's calculation of "disgorgement" amounts includes premiums collected on

[4] In fact, Dr. Crawshaw testified that he did not believe that the commutation of the UGI agreement was "forced" on any party.

loans originated prior to July 21, 2008. Hearing Tr. 1211.[5] Thus, awarding the Bureau such "disgorgement" would violate due process because it would constitute a penalty not authorized by RESPA, that was imposed by an agency with no authority to do so in an administrative proceeding, for conduct that occurred outside the applicable statute of limitations and before the passage of the statute authorizing such penalties.

II. ENFORCEMENT COUNSEL'S ASSERTION THAT MORTGAGE INSURANCE IS SELECTED BASED SOLELY ON PAST PAYMENTS IS FACTUALLY UNSUPPORTED

The lynchpin of Enforcement Counsel's argument that they are entitled to penalize Respondents for conduct occurring after July 21, 2011, is their unsupported assertion that the only reason the Lender Respondents – PHH Mortgage Corp. and PHH Home Loans LLC – selected a particular MI provider was because of the receipt of reinsurance premiums.[6] Such an assertion is contrary to the unrefuted evidence adduced at the hearing. In their Brief, Respondents anticipated that Enforcement Counsel would completely ignore the testimony of the industry representatives regarding the benefits of reinsurance. Enforcement Counsel did not

[5] Under cross-examination, Mr. Thomas could not initially identify what books the 5,497 loans originated after July 21, 2008 were in, Hearing Tr. 1204-6; he indicated that he could not ascertain the amount of premium on the 5,497 loans, *id.* 1210; he admitted that monies withdrawn from Atrium's trust account could not be tied to particular loans, although he "assumed" that some of the money was from loans originated before July 21, 2008, *id.* 1221; he later provided more "concise" testimony regarding the ceded premiums that resulted in a "reduction" of $70 million in his calculation of ceded premiums for UGI for loans originated after July 21, 2008, *id.* 1225-27; and he later stated that he made no effort on Demonstrative Exhibits 1 and 2 to determine which amounts related to loans originated after July 21, 2008. *Id.* 1235, 1240. Mr. Thomas did admit, however, that based on the testimony he heard sitting in the courtroom, all of the premiums ceded to Atrium were returned in connection with the commutations of the CMG and Radian reinsurance agreements. *Id.* 1238-39.

[6] Indeed, Enforcement Counsel seeks to place the burden of demonstrating the lack of a RESPA violation on Respondents. *See* EC Brief at 64 ("There is no evidence that PHH's agreements to refer business to UGI, Genworth, Radian, or CMG ended prior to the commutation of those arrangements."). *But see* 12 C.F.R. § 1081.303(a) ("Enforcement counsel shall have the burden of proof of the ultimate issue(s) of the Bureau's claims at the hearing.").

disappoint. Indeed, while Enforcement Counsel called Messrs. Rosenthal and Culver in their case-in-chief, and notably did not call representatives from any other MIs despite listing five such witnesses on their witness list, Enforcement Counsel was forced to rely on Dr. Crawshaw, their expert witness, to disparage reinsurance. But Dr. Crawshaw never worked in the industry, never had to answer to shareholders, and never had to face the catastrophic meltdown of the real estate market.[7] As a result, Dr. Crawshaw's ivory tower opinions regarding the lack of benefits of private mortgage insurance ("pmi") reinsurance are of no weight.[8] Indeed, even Mr. Culver, whom Enforcement Counsel called in an attempt to attack "deep cede" arrangements, had no such issues with reinsurance agreements that provided for a 25% cede, which are the only agreements at issue in this adjudication. More to the point, Mr. Culver admitted on the stand that MGIC's rosy analysis of the real estate market, and its anticipated need for reinsurance, were wrong in light of the subsequent crash.[9]

[7] While having never worked in the mortgage insurance industry, Dr. Crawshaw did not hesitate to offer his advice on how to run a mortgage insurance business: "From UGI's – looking at the mortgage industry as a whole, that 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 increases their risk." Hearing Tr. 2332

[8] Dr. Crawshaw even testified that he did not look at the "incentives" for the MI to do business with PHH, offering only his "common sense" view that "MIs need to do – to do business with lenders." Hearing Tr. 1100.

[9] Enforcement Counsel's disingenuous interpretation of documents is astounding. For example, Enforcement Counsel repeatedly relies on a portion of EXC 583 (a collection of two unrelated documents), specifically, the November 24, 1997 Letter from Jo Musser and Jim Long, the Insurance Commissioners of Wisconsin and North Carolina, respectively, to Darla Lyon, South Dakota Commissioner of Insurance, to attack captive reinsurance arrangements. *See, e.g.,* EC Brief at 11-12; Crawshaw Rebuttal Rpt. at 83, & n.144, 115 & n.227. Yet, Enforcement Counsel ignores the portion of the letter that states that the concern was with agreements where the ceding commission was greater than 25%. *See* ECX 583 at UG001679. ("As the domicile for four of the country's eight mortgage guaranty insurance companies; North Carolina and Wisconsin, support Vermont's decision to limit mortgage guaranty insurers from ***ceding more than 25 percent of risk and gross premium to captives*** associated with a mortgage lender." (emphasis added)). To be clear, the only agreements at issue in this proceeding provided for a 25% cede.

As Respondents explained in their Brief, the alignment of interests between the MI and the lender – *i.e.,* skin in the game, reduced earnings volatility, surplus relief, and a critical source of capital during the recent meltdown – are both unrefuted and unacknowledged by Enforcement Counsel. *See* Brief at 11-15; Cascio Report at 1-6; Hearing Tr. 867 (Dr. Crawshaw conceding that "as a general proposition" a reduction in volatility "would be a benefit"); *id.* 1096 (Crawshaw: "On one hand, you could say that by Atrium having a piece of the business, it encourages diligent underwriting."). Enforcement Counsel's continued refrain that the only reason the Lender Respondents selected a particular MI was because of the payment of reinsurance premiums should be rejected by the Tribunal as wholly unsupported.

Further, Enforcement Counsel's focus on conduct occurring after January 1, 2010 – the date on which all reinsurance agreements ended – is disingenuous and misleading. For example, Enforcement Counsel alleges, without any factual support that:

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

See also Id. (New York Circular Letter No. 2 (1999) ("In summary, the New York State Insurance Department will permit legitimate risk sharing relationships between mortgage guaranty insurers and lenders where such relationships are in the form of arms length reinsurance agreements with properly capitalized reinsurers."); Hearing Tr. at 839 (Dr. Crawshaw admitting that New York and Vermont "have extensive regulation of insurers."). More to the point, even Enforcement Counsel concedes, as it must, that "[t]he requested limits were not enacted. . . ." EC Brief at 13. The fact of the matter is that these state regulators were fully aware of the reinsurance agreements entered into by the captive reinsurers, including Atrium, yet they did nothing to limit such arrangements, even to the 25% cede stated in the January 24, 1997 Letter. The regulation of insurance is a matter of state law and the Bureau does not have any authority in this area. *See* 15 U.S.C. § 1012 ("McCarran-Ferguson"); *Humana, Inc. v. Forsyth*, 525 U.S. 299, 310 (1999) (A state law is "impair[ed]" under McCarran-Ferguson if application of a federal law would "frustrate any declared state policy or interfere with a State's administrative regime."). The Tribunal should not ignore such facts when reaching its recommended decision.

> provider list, which dictated the MI's ability to obtain additional, subsequent referrals from PHH.

EC Brief at 19-20. Enforcement Counsel's fanciful conclusions cannot stand the slightest scrutiny. Not one witness testified that past premiums, which were made pursuant to separate reinsurance book year arrangements, had any impact on future selections of MI by the Lender Respondents. Nor is Enforcement Counsel able to cobble together an argument based on the dialer settings themselves. For example, RMIC was included in the dialer from June 23, 2009, until July 29, 2011. *See* RCX 848. RMIC never had a reinsurance agreement with Atrium, however, so it never "ceded premiums" to Atrium. Nonetheless, RMIC received business from the Lender Respondents for more than two years.[10] The Lender Respondents stopped sending business to RMIC only because it announced its decision to no longer write new business effective August 31, 2011; thereafter, RMIC went into conservatorship.

Similarly, MGIC never had a reinsurance agreement with Atrium, and it never ceded any premiums to Atrium. Yet, starting in November 2008, MGIC began providing mortgage insurance on loans originated by the Lender Respondents. MGIC continued to provide such insurance through January 24, 2013, the last date on which Enforcement Counsel provided evidence; and, for a period of time, between January 28, 2009, and April 6, 2009, MGIC was receiving 60% of the "controllable" mortgage insurance; that is, in those situations where the

[10] Enforcement Counsel never called a witness from RMIC, yet that did not stop Enforcement Counsel from "testifying" on the missing witnesses' behalf. *See, e.g.,* EC Brief at 61-64 (RMIC was "clamoring for PHH's business and willingly offered up captive reinsurance in exchange for referrals;" "RMIC understood that captive reinsurance was the price of admission, and it was keen to pay-to-play;" "Kennedy pleaded . . ."). Such categorical statements would certainly be helpful to the Tribunal if, in fact, the witnesses with knowledge had actually testified to such statements, and subjected themselves to cross-examination. However, despite identifying such witnesses, Enforcement Counsel did not bother to call any of them to testify. The only possible inference to be drawn is that these witnesses would not have supported Enforcement Counsel's case.

borrower did not choose to select a specific provider, and the Lender Respondents were originating the loan. Also unexplained is the Lender Respondents':

- lack of using Genworth for the period from January 28, 2009, to March 4, 2010;
- use of Essent starting in February 2012;[11]
- use of Radian, which was not put in the dialer until ***after*** the reinsurance agreement between Radian and Atrium was in runoff, and the use of Radian continued long after the reinsurance agreement was commuted on July 22, 2009;[12] and
- limited use of UGI, specifically reducing its percentage in the dialer from a high of 100% in April 2009, to 20% in March 2010, and 5% in August 2011, despite the fact that UGI was continuing to cede reinsurance premiums to Atrium in connection with books of business originated prior to January 1, 2010.

Enforcement Counsel's theory that the amount of business was based on Atrium's receipt of prior premiums fails if one simply examines UGI, which continued to cede premiums until the agreements were commuted in May 2013. Yet, of all the entities in the dialer, the last time UGI had the highest setting was prior to March 3, 2010. Enforcement Counsel "explains" this fact on page 48 in a footnote: "UGI's share of PHH's MI referrals declined steadily after that time, suggesting that the influence of their captive reinsurance arrangement in garnering future referrals had waned – and demonstrating that without captive, UGI had a hard time competing for PHH's business." EC Brief at 48, n.16. Critically, this statement eviscerates Enforcement Counsel's "ongoing and future referral" theory and, thus, their attempt to force "disgorgement" of premiums in connection with loans originated before July 21, 2008, but received after that date.

[11] Because the Lender Respondents' use of Essent undercuts Enforcement Counsel's case, they simply state "[t]he terms of Essent's addition to the dialer are not known to Enforcement."

[12] *See* Hearing Tr. 843 (Dr. Crawshaw agreed that "runoff" means "no new business," "no new books" and that "prior books still have a ceding commission and the reinsurer is still liable for its obligation.").

These are inconvenient facts that appear nowhere in Enforcement Counsel's selective rendition of the facts. Rather, Enforcement Counsel spends considerable time stringing together snippets of email discussions which have no relevance to what actually happened. For example, Enforcement Counsel attempt to make much of various discussions regarding dialer settings, *see, e.g.,* ECX 409, 407, 220, and then concludes that the "existence of a captive arrangement was a significant, and possibly dispositive, factor in setting the dialer in November 2008." EC Brief at 47.[13] That conclusion makes no sense, since in November 2008, there was only one dialer change that reduced UGI from 75% to 40%. Yet, Enforcement Counsel's argument is that the discussions to create a new captive arrangement in conformance with Freddie Mac's temporary policy change caused the Lender Respondents to send more business to UGI. That did not happen until April 2009, after the captive arrangement was put in place. In other words, Enforcement Counsel's purported factual chronology is inconsistent with their argument.

At bottom, Enforcement Counsel adduced ***no testimony*** that such a "quid pro quo" arrangement existed; therefore, Enforcement Counsel's theory is based, at best, on circumstantial evidence and makes no sense in light of the other MIs that were utilized by the Lender Respondents.

III. RESPONDENTS' CONDUCT PRIOR TO JULY 21, 2008, IS IRRELEVANT TO THIS ACTION

"[N]o claims arising from loans closed before July 21, 2008," so ruled the Tribunal on May 22, 2014. Critically, this ruling was issued before Respondents put on their case-in-chief. In reliance on that ruling, Respondents' case-in-chief focused on the two agreements that were in

[13] This assertion by Enforcement Counsel is demonstrative as it represents their unadorned speculation as to why things happened. Enforcement Counsel could have simply asked Mr. Rosenthal why the dialer setting was changed in November 2008, but they choose not to ask him that question, presumably because they did not want to hear the answer.

place after July 21, 2008.[14] Those two agreements, Genworth 2008B and UGI 2009, were different than the prior agreements with those two MIs in that the prior agreements provided for a 40%, or "deep cede," structure.[15]

The Tribunal's May 22 Order rendered Enforcement Counsel's case meaningless, as made plain by their brief. Indeed, if stripped of its pre-July 21, 2008 "discussion," Enforcement Counsel's 227-page tome would be a fraction of its current size, and more relevant to the issues remaining following the May 22 Order. For example, pages 16 through 43 of their brief consist almost entirely of pre-July 21, 2008 conduct, at which point, Enforcement Counsel summarily conclude that Respondents' illegal conduct "endured throughout 2008 and 2009, and continuously thereafter." EC Brief at 43. The pages that follow contain a hodgepodge of unsupported innuendos unworthy of credibility.

There were other significant factors that occurred in 2008 which render Enforcement Counsel's reliance on pre-July 21, 2008 conduct meaningless. First, as Enforcement Counsel concede, Freddie Mac decided on June 1, 2008, to limit the ceding commission of MIs with

[14] The CMG agreement was also in place during the period from July 21, 2008, to December 31, 2008. However, as explained by Respondents in their Brief, the CMG 2008 book contained only approximately 104 loans that were originated after July 21, 2008, and the agreement was commuted through the return of all premiums ceded to Atrium, as well as all capital contributions and earnings.

[15] Curiously, as if to suggest some significance to the fact, Enforcement Counsel repeatedly assert that Atrium was the first captive arrangement. EC Brief at 4 (citing, *inter alia*, Walker's "belief"); *id.* at 9. Such assertions conflict with the hearing testimony of Mr. Culver who explained that he, as the CEO of MGIC, became aware of captive reinsurance arrangements "in the mid '90s when Amerin introduced them in the marketplace." Hearing Tr. 342; *see also id.* 386 (Culver discussing Countrywide's role in introducing captive reinsurance into the market place). In any event, this "disputed" issue is neither relevant nor probative of any issue before the Tribunal; rather, it reflects Enforcement Counsel's attempt to imply misconduct by Respondents, in lieu of providing real evidence.

which it dealt to 25%. Hearing Tr. at 855 (Dr. Crawshaw explaining that the structure (40% cede vs. 25% cede) and different risk bands affects risk transfer). Importantly, that decision was not based on any concerns with risk transfer, but rather was based on Freddie Mac's decision "to allow mortgage insurers to retain more insurance premiums to pay current claims and rebuild their capital base." RCX 811.[16] Second, it is undisputed that the collapse of the real estate market was well underway by July 21, 2008. May 22 Order at 23 ("The housing market and mortgage insurance industry were collapsing by 2008."); Hearing Tr. at 793 (Crawshaw: by 2008, the financial crisis "was absolutely apparent"). Thus, as the witnesses testified, the relationship between a lender and an MI was based on myriad factors, including the MI's willingness to pay claims. Given the meltdown, counter-party risk was certainly more relevant to the lender at that point than the potential for earnings ten years in the future.

In sum, it is undisputed that the Freddie Mac policy change in June 2008, caused a restructuring of any reinsurance agreement that provided for a cede above 25%. *See, e.g.,* Hearing Tr. 1073-74 (Dr. Crawshaw testified that there were no reinsured loans where UGI provided the mortgage insurance between July 1, 2008, and February 28, 2009, and thereafter, until December 31, 2009, the reinsurance agreement provided for a 25% cede.). It is also undisputed that as of 2008 both the housing market and mortgage insurance industry were

[16] Demonstrating that they will say anything, Enforcement Counsel now posit that the Freddie Mac "policy change further demonstrates that Respondents' captive reinsurance arrangements were not bona fide transactions." EC Brief at 44, n.15. The problems with Enforcement Counsel's "conclusion" are numerous. First, no Freddie Mac witness testified that this was the case; in fact, Dr. Crawshaw stated that he did not "know specifically why they did it." Hearing Tr. 856. Second, Freddie Mac specifically allowed such agreements to continue at the 25% cede, and continues to allow such agreements today. Third, Enforcement Counsel's statement is not even supported by the document upon which they purport to rely. Accordingly, Enforcement Counsel's conclusion that "Freddie Mac recognized that these purported 'reinsurance' arrangements did not help protect the security of the industry" is entirely made up. EC Brief at 44, n.15

collapsing and there were direct effects on the use of MIs. For example, MIs rapidly changed their product offerings, thereby limiting the loans which could be sent to particular MIs. Second, some MIs, Genworth for example, specifically advised the Lender Respondents that they wanted to "slow[] down production" as they managed "through financial difficulties." ECX 495. As a result, Enforcement Counsel's attempt to treat conduct before 2008 the same as conduct after 2008 is misplaced. Further, once the remaining agreements were placed in runoff (CMG as of January 1, 2009, Genworth as of March 31, 2009, and UGI as of December 31, 2009), Enforcement Counsel's attempt to attribute future conduct based on the receipt of premiums pursuant to agreements entered before those dates is wishful thinking on their part and has no basis in law or fact.

IV. ENFORCEMENT COUNSEL'S ATTEMPT TO PUNISH THE RECEIPT OF PREMIUMS HIGHLIGHTS THEIR INCONSISTENT CONDUCT

Enforcement Counsel's decision to base its monetary penalties and disgorgement claims on the receipt of premium payments from loans closed some 19 months before the Bureau even existed, rather than on the alleged referral of borrowers to a particular MI provider, is disingenuous and inconsistent with the Bureau's own conduct – specifically, its decision to permit the MIs to continue ceding premiums to captive reinsurers in connection with hundreds of such agreements.

The Bureau entered into Consent Orders with five MIs, including UGI, each of which 1) did not require the MIs to adjust their past financial statements or restate their securities filings – which accounted for the agreements as reinsurance; 2) permitted the MIs to continue to account for the arrangements as reinsurance on their financial statements; and 3) permitted the MIs to continue to cede premiums and collect on their reinsurance arrangements. Yet, Enforcement Counsel's expert, Dr. Crawshaw, now states that the MIs should not have accounted for the

Atrium reinsurance agreements, or any other similar arrangements, as reinsurance. Rebuttal Report at 121.[17] Enforcement Counsel cannot have it both ways. Either Enforcement Counsel was upfront with the district courts in Florida in connection with the negotiated Consent Orders which "settled" the Bureau's complaints against those entities and did not require the cessation of any existing agreements or the restatement of any financial statements indicating that the arrangements constituted reinsurance; or Enforcement Counsel is sitting on the sidelines while the MIs presumably commit securities fraud by continuing to issue financial statements accounting for the agreements as reinsurance despite the fact that the Bureau does not believe that is a truthful statement.[18] The Tribunal should not allow Enforcement Counsel to play "fast and loose" with the facts.

The Bureau's assertions of misrepresentations by Mr. Bogansky are specious. Enforcement Counsel again challenge Mr. Bogansky's representation that "Atrium always met its contractual funding obligations with respect to the four trusts that were created in connection with its reinsurance arrangements." EC Brief at 223. Enforcement Counsel selectively quote from an email, but deliberately leave out the phrase "even though we meet the minimum requirements today." ECX 246. Further, Enforcement Counsel mischaracterize the difference between a "deficiency" and a "capital requirement" in their discussion of the Radian Trust

[17] Dr. Crawshaw's opinion on the proper accounting of the reinsurance agreements is dubious, however, since he is not an accountant. *See* Burke Report at 17 ("Responsibility for the accounting of Atrium's reinsurance contracts and their treatment on the Company's financial statements rests with Company management and not their consulting actuary."); Hearing Tr. 1059-60 (Dr. Crawshaw explaining that accountants are responsible for checking to verify that there is risk transfer.).

[18] Respondents have repeatedly raised the issue of the blatant inconsistency between permitting the MIs to treat the arrangement as reinsurance while claiming that the same agreement does not constitute reinsurance for Respondents. At bottom, the Bureau's rejection of Dr. Crawshaw's opinion on this fundamental issue is startling and reflects the simple fact that not even the Bureau believes Dr. Crawshaw. Nor should the Tribunal.

Account. *See, e.g.*, Hearing Tr. 851 (Dr. Crawshaw was unsure if a formal demand for a capital contribution, as opposed to a deficiency notice, was made in connection with the CMG agreement). Yet further, Enforcement Counsel does not explain the timeframe for Mr. Bogansky's statements. Dr. Crawshaw was repeatedly asked if there were periods when the trusts were not adequately capitalized, and he could not provide any such instances. Finally, if Enforcement Counsel wanted to cross-examine Mr. Bogansky on his statement, they should have called him to testify; they did not, however, and their attempt to manufacture claims of misconduct is based on selective quoting of documents and blind ignorance of the real facts.

V. ATRIUM PROVIDED REAL REINSURANCE, AND DR. CRAWSHAW'S NOVEL THEORY IS OF NO MOMENT

As an initial matter, Dr. Crawshaw's analysis, along with pages 77 through 105 of EC's Brief – which is a regurgitation of his analysis – are of no moment given that even Dr. Crawshaw admitted under oath that it was "reasonable" for Respondents to rely on Milliman's analysis. *See* Hearing Tr. 807 (Dr. Crawshaw: "I think it's reasonable, I mean, to – for [Atrium] to hire Milliman and rely on what Milliman said."); *id.* 960-61 (Dr. Crawshaw confirming his testimony that it was "reasonable to rely on Milliman."); *id.* 1059 (Dr. Crawshaw reconfirming that it was "reasonable" to rely on Milliman.).[19] Enforcement Counsel makes no mention of this concession! Under the rule of lenity, which must be applied to any alleged criminal or civil RESPA violation, and Regulation X's statement that, in order to violate Section 8, the payment must "bear[] no reasonable relationship to the market value of the goods or services provided," Respondents are required to proffer nothing more in order to prevail. Thus, Respondents'

[19] On this point, Dr. Crawshaw and Mr. Burke agreed: "I find the reports issued by Milliman to be well constructed, and their conclusions to be based on appropriate analysis. Thus, I can see no reason why Atrium would not have relied on Milliman's work product which concluded that the reinsurance contracts in question met the appropriate risk transfer standards issued by the NAIC for purposes of preparing their financial statements." Burke Report at 14.

reliance on the Milliman reports – which establish that there was a reasonable relationship between the reinsurance provided and the premiums received – was reasonable. However, there is more to demonstrate why Enforcement Counsel's case lacks merit. Specifically, Atrium provided the service of reinsurance. It is undisputed that Atrium paid more than $156 million in reinsurance claims out of its earnings. Even without the payment of claims, as explained by Respondents in their Brief, the reinsurance agreements provided the MIs with capital surplus relief; that is, they were not required to maintain as much capital because of the reinsurance. Second, Dr. Crawshaw's retrospective multi-year analysis, while novel, is not accepted by anyone other than Enforcement Counsel.[20] Third, Enforcement Counsel cannot dispute Milliman's analysis that the 25% premium received by Atrium pursuant to the only agreements in place after July 21, 2008, was commensurate with the risk assumed by Atrium.

A. Reinsurance Was Provided by Atrium to the MIs

The evidence adduced at the hearing demonstrates that reinsurance services were provided by Atrium. Specifically, as explained in Respondents' Brief, there were legally binding contracts for insurance, and the agreements were accounted for on the books and records of both

[20] In sum, Dr. Crawshaw's "entire arrangement" analysis is based on his belief that the UGI and Genworth agreements were "under-capitalized" from the beginning. Hearing Tr. 1085-87. While Respondents dispute Dr. Crawshaw's basic premise, he, and Enforcement Counsel, have a more fundamental problem with their reliance on conduct prior to January 1, 2004. Specifically, a number of the MIs, including UGI were subject to a lawsuit in the Southern District of Georgia alleging that the reinsurance agreements, including the agreement between UGI and Atrium, violated RESPA. That litigation was resolved through the entry of an injunction which, *inter alia*, established terms under which the MIs could continue with existing reinsurance arrangements. *See Pedraza v. United Guar. Corp., et al.*, No. CV-99-239 (S.D. Ga. June 1, 2001). That injunction was in place from June 25, 2001, through December 31, 2003. Pursuant to its terms, as long as UGI (as well as the other MIs that were part of this litigation and subject to identical injunctions), acted in conformity with the terms of the injunction, the acts of UGI were "deemed to be in compliance with RESPA." Accordingly, Dr. Crawshaw's premise that the Atrium agreements failed to comply with RESPA at any time prior to December 31, 2003, fails as a matter of law.

Atrium and the MIs as insurance. As Dr. Crawshaw explained, management relies on its accountants to "check" to ensure that there is risk transfer. Hearing Tr. 1059-60. Notably, every accountant who reviewed those financial statements agreed with the accounting treatment of those agreements as reinsurance. *See* Cascio Rebuttal Report at 2; *see also* Hearing Tr. 1061-63 (Dr. Crawshaw noting that the Atrium reinsurance agreements were accounted for on the books and records of Atrium, UGI and Genworth as insurance.); *id.* 390 (Mr. Culver explaining that if the agreement did not pass risk transfer, MGIC could not take credit for the reinsurance on its financial statements.); *id.* 390 (same); *id*, at 391 (MGIC's auditors, PwC, reviewed MCIC's reinsurance agreements and found them to be reinsurance).

Moreover, as Respondents demonstrated in their Brief, Milliman projected losses on both the Genworth 2008B and UGI 2009 books, losses which were paid to the MIs through the commutations that both sides agree were arms-length, negotiated agreements providing for the net present value of premiums and losses on the remaining agreements.

The losses suffered by Atrium were not just for the two arrangements at issue in this action. As the Milliman Reports (RCX 838 and 2004) and cession statements (RCX 868 at Written Premium Tab; UGI cession statement dated July 31, 2012, showing losses paid on the UGI 2004 book; RCX 859 at Aggregate Loss Tab; Genworth cession statement dated December 31, 2010 showing losses paid on the Genworth 2005 book) demonstrate, Atrium paid losses on books starting in 2004.[21] Specifically, for UGI, Atrium paid losses, and Milliman projected further losses, as follows:

[21] Enforcement Counsel's tired refrain that Atrium did not pay any losses to UGI or Genworth until 2009, EC Brief at 4, 100, 101, demonstrates their continued lack of understanding of the underlying business of mortgage insurance and reinsurance. The actual date of the claim payment is irrelevant. As demonstrated at the hearing, and undisputed by Enforcement Counsel, the losses were for book years as far back as 2004. Indeed, cross-collateralization exposes the

Book Year	Paid Losses in Layer as of 3/31/13	Unpaid Claim Estimate	Projected Ultimate Loss Ratios
2004	$18,405,000	$12,327,000	90.2%
2005	$36,541,000	$9,762,000	168.7%
2006	$21,905,000	$0.00	163.5%
2007	$37,367,000	$0.00	153.5%
2008	$17,697,000	$6,232,000	167.7%
2009	$0.00	$1,693,000	52.5%

See RCX 838 at 6, 23, 24, and Tab M. Thus, as of March 31, 2013, Atrium had already paid losses of $125,683,000. *Id.* at 24; *see also* RCX 868 (as of July 31, 2012, Atrium had paid $113,408,635 in claims pursuant to the UGI books of business).[22] Further, in each instance where the ultimate loss ratio exceeds 100%, Atrium paid out more in claims to UGI than it will

reinsurer for losses for a ten-year period, and once a financial crisis strikes, as it did in the 2007 to 2008 timeframe, the losses run across books of business insured long before the crisis, as evidenced by the losses in the 2004 book years for both UGI and Genworth. *See also* Cascio Rebuttal Report at 7-8 (explaining the basis for the reasons for the long "time lag" between when the risk is "assumed" for a particular book year and the losses are paid); Hearing Tr. 792-93 (Dr. Crawshaw explaining the reasons for the "intrinsic delays" in mortgage insurance claims); *id.* 1093-94 (Dr. Crawshaw explaining "a whole bunch of factors that go into the – that delay that process."). Further, for the UGI and Genworth agreements, Atrium's exposure was not limited to the funds in the trust account. Cascio Report at 8-9. While Dr. Crawshaw may not accept that fact, his belief was not based on the actual terms of the contract. *See* Hearing Tr. 2199-2200 (Walker testified that with respect to the issue of Atrium's liability he would "go to the actual agreement, not to what Milliman said the agreement was in determining [Atrium's liability]"). More to the point, however, is the fact that whether or not Atrium's exposure was limited to the funds in the trust accounts, Atrium paid every claim presented to it. Hearing Tr. 777 (Dr. Crawshaw conceding that Atrium paid every claim presented); *id.* 900 (for UGI and Genworth, the purported limit on liability to the trust accounts "never got tested"). Finally, Milliman's assumption that the liability was limited to the funds in the trust accounts made the risk transfer analysis more conservative, a point with which Dr. Crawshaw agreed. *Id.* 918.

[22] As the cession statements make clear, the payment of claims was made by "netting" the premium payments to Atrium.

collect in premiums over the entire book of business. For these years, Enforcement Counsel's repeated refrain that the MIs would have been better putting the premiums in a savings account rings hollow. Moreover, on this particular issue, both Mr. Culver and Mr. Walker, the only witnesses from MIs to testify at the hearing, eviscerated such a contention. According to Mr. Culver:

> Question: If instead of acquiring captive reinsurance, MGIC had self-reinsured, would it have gotten all of the money that it paid in premiums to itself back?
>
> Answer: We would have gotten all that money, right. But as I told you, the dilemma that we faced as a company is what we would have done with that money given our low risk to capital ratio and the fact that on the loss allocation, we didn't need reinsurance, so we had gone through a period, as I said, of buying $1.2 billion worth of stock back because of our low risk to capital ratio. There's intense pressure from investors. So, you know, while I was very wrong on the risk outlook and our company was of captives, it ended up being a blessing. They helped save the company.
>
> Question: Because the company might have spent the money on other things?
>
> Answer: We might have spent the money, yes.

Hearing Tr. 419; *id.* 421-22 (same). *See also Id.* 2162-63 (Walker testifying that had UGI not purchased reinsurance and kept all of the premium in a savings account it was "likely" the money would no longer be available to UGI: "I don't think we could ever keep it in a savings account.").

Further, Enforcement Counsel's assertion that Atrium had a "demonstrated ability" to "limit [its] exposure to the MIs' losses render[ing] even the slight probability of a small loss entirely illusory," EC Brief at 96, is belied by the actual losses Atrium paid, a fact that Enforcement Counsel ignores, but cannot dispute.

Similarly, Atrium paid losses, and Milliman projected future losses, in connection with the Genworth agreement as follows:

Book Year	Paid Losses in Layer as of 3/31/12	Projected Future Paid Losses	Projected Ultimate Loss Ratios
2004	$0.00	$1,957,000	25.2%
2005	$6,191,000	$8,151,000	169.8% [23]
2006	$9,335,000	$2,141,000	183.3%
2007	$6,967,000	$4,666,000	201.7%
2008A	$6,079,000	$16,398,000	190.5%
2008B	$0.00	$12,058,000	137%

RCX 2004, at Tab M, pp. 22, 44. Once again, for years 2005 to 2008 (both books), Atrium has or will pay out more in claims than it will ever collect in premiums and, as of March 31, 2012, Atrium had already paid Genworth $28,571,000 in reinsurance claims.[24]

To the extent Enforcement Counsel seeks to rely on premiums received on loans originated prior to 2005 in support of their position, such reliance is inappropriate since such transactions are far beyond the statute of limitations. In addition, such an argument completely ignores the concept of insurance, which is to provide certain benefits in the face of uncertainties. Atrium's agreements provided that benefit in the form of capital surplus relief even without payment of any claims. Once the financial meltdown occurred, Atrium made good on its contractual obligations to pay on the various books of business where the losses exceeded the

[23] *See* Hearing Tr. 932-33 (Dr. Crawshaw explaining that the ratios are the projected ultimate claims divided by the projected premium, so the 169.8% means that Atrium is projected to pay out 169.8% of the premiums it was projected to receive.).

[24] The Milliman metrics reports, RCX 838 and 2004 are undisputed. *See, e.g.,* Hearing Tr. 2319 (Crawshaw: "I got minor questions about the report, but nothing – for the purpose of what I was doing, it was – you know, wasn't too much of a concern.); *id.* 2320 (Dr. Crawshaw had no concerns with the "accuracy" of the Milliman reports).

attachment points. It is undisputed that Atrium paid every claim presented and fully complied with all of its contractual obligations.

B. Dr. Crawshaw's Novel Analysis is Insufficient to Carry Enforcement Counsel's Burden

Fundamental to Dr. Crawshaw's analysis is his assertion that the transfer of risk must be evaluated over the entire lifetime of the particular arrangement, *i.e.*, retrospectively over multiple books of business. While he repeatedly strained to cobble together some support for his novel theory, the fact of the matter is that it has never been utilized by anyone other than Dr. Crawshaw.[25] While Respondents are loath to engage on this issue since even Dr. Crawshaw admitted that Respondents were entitled to rely on Milliman, and because every accountant who reviewed either Respondents' or the MIs' financial statements over the course of many years agreed that the arrangements should be accounted for as reinsurance, rather than be viewed as conceding that there is any merit to Dr. Crawshaw's analysis, Respondents point out the following undeniable facts.

[25] It is also significant that Dr. Crawshaw's analysis only deals with his application of the 10/10 test for risk transfer. Enforcement Counsel does not, because they cannot, even state that Dr. Crawshaw's analysis is the only test for risk transfer. As the Emerging Issues Task Force noted in its paper titled "Risk transfer in Mortgage Reinsurance Captive Arrangements, RCX 809, "different parties can use decidedly different criteria in evaluating risk transfer on the same policy. Different conclusions and accounting may result when the MI is audited by one firm and the captive reinsurer by another." In fact, Milliman performed an additional alternative test in connection with its review of the Genworth 2008B book called the Expected Reinsurance Deficit ("ERD") test. *See* ECX 194 at 13. Mr. Schmitz explained this analysis on the stand during the hearing and that it was Milliman's opinion that this test was "a superior measurement of risk transfer." *See* Hearing Tr. 1867-70. The Genworth 2008B book passed the ERD test "by a significant margin" meaning that the arrangement provided for the transfer of risk. *Id.* at 1869-70. The ERD analysis of the Genworth 2008B book stands unchallenged and unrefuted by either Dr. Crawshaw or Enforcement Counsel.

1. **Enforcement Counsel Misrepresent the HUD Letter**

In a shocking representation, Enforcement Counsel state:

> The HUD Letter, as a "straightforward application of Regulation X to captive reinsurance," *id.* at 6, speaks only of the permissibility of an "arrangement" or "agreement," never of a "book year" or any other portion that is less than the whole of the arrangement.

EC Brief at 74. *See also id.* at n.23 (citing other portions of the HUD Letter). This is a false statement. In fact, the HUD Letter, in providing the "background" against which it applies its legal analysis, states:

> In exchange for a portion of mortgage insurance premiums (minus a ceding commission, if applicable) to be paid by the primary insurer, the reinsurer obligates itself to reimburse the primary insurer for an agreed portion of claims that may require payment under the contract. ***The first is an "excess loss" arrangement, under which the primary insurer pays, and is solely responsible for claims arising out of a given book of business up to a predetermined amount, after which the reinsurer is obligated to reimburse the primary insurer's claims up to another predetermined amount.***

HUD Letter at 2 (emphasis added).[26] Enforcement Counsel's misrepresentation of the HUD Letter is disconcerting. HUD – the agency responsible for the interpretation of RESPA until July 21, 2011 – is the agency with authority to interpret its guidance, not Enforcement Counsel through an administrative action. Enforcement Counsel is not HUD, and the fact that HUD took no action under RESPA against Respondents or any other entities with respect to captive mortgage reinsurance arrangements is an "inconvenient truth" that Enforcement Counsel refuse to acknowledge. Moreover, to the extent Enforcement Counsel seek to parse the term "book" and suggest that the phrase "a given book of business," as used in the HUD Letter, is different from "book year," such an assertion finds no support. The Milliman reports, upon which Atrium

[26] *See also* HUD Letter at 2 ("Premiums paid for the reinsurance may be net of an agreed upon ceding commission,' which represents the reinsurer's share of the costs of administering ***the book of insured business***." (emphasis added)).

could "reasonably rely," repeatedly refers to a "book year of business." *See, e.g.,* ECX 194; *see also* RCX 44 (Genworth Reinsurance Agreement, § 1.05 defining "book" to mean "each underwriting year"). Further, the industry uses the terms "book," "book year," and "book of business" interchangeably. *See, e.g.,* PMI Group Presentation titled "Analysis of Deep Cede Excess-of-Loss Captive Reinsurance Programs," ECX 653 at 13 (interchangeable use of "book of business," "book-year," and "books"); RCX 809 (Risk Transfer in Mortgage Reinsurance Captive Arrangements, at p.5, ¶ 14: "The task force has concluded the contract is a series of individual book year contracts renewable indefinitely. The basis for this conclusion is the contract may be terminated by either party at any time with minimal notice, and the number of book years that will ultimately be included in the contract is unknown."); Crawshaw Report, Ex. 26, [redacted] Even their own expert, Dr. Crawshaw, makes clear that "[f]or accounting purposes, mortgage guaranty insurance policies can be grouped into "book years" based on the date that coverage first became effective (in many cases this will be the date the loan was made). For example, in a typical contract, mortgage guaranty insurance policies effective from January 1, 2005 through December 31, 2005 would be grouped within the 2005 book year." Crawshaw Report at 5.[27]

[27] *See also* Crawshaw Report at 12 ("For each captive arrangement, premiums ceded by the MI for policies written in any book year were pooled into a single Trust Account established for that MI, so that the Trust Account held premiums from multiple book years. Because premiums associated with multiple book years were pooled in this manner, premiums ceded from one book year could be used to pay claims associated with another book year.")

In addition to taking a position flatly inconsistent with the plain language of the HUD Letter, Enforcement Counsel do not, because they cannot, explain how or why everyone in the industry interpreted this guidance to require a book-year analysis. It is only Enforcement Counsel that apply a "Humpty Dumpty" analysis.[28] Enforcement Counsel's new interpretation of the HUD Letter cannot stand as it represents the epitome of agency action without notice or due process.

2. **Dr. Crawshaw's Analysis Is Unusable**

Dr. Crawshaw's retrospective, multi-year analysis is unusable because financial institutions must report on an annual basis and cannot wait 15 years to determine if, in fact, there was risk transfer. Dr. Crawshaw never explains, nor could he, how Atrium or the MIs were to account for the reinsurance in the first year, second year, or subsequent years since, as his analysis requires, the entire arrangement must be analyzed. Thus, under Dr. Crawshaw's analysis, it is not possible to analyze risk transfer until the end of the agreement.

Further, Respondents proffered expert testimony from Messrs. Burke and Cascio, both of whom reiterated that "in evaluating whether the risk transfer requirements have been met, each year must be evaluated on its own, *i.e.*, on a single book year basis (unless it is, in fact, a multi-year, or long-duration, contract)." Burke Report at 10. *See also* Cascio Rebuttal Report at 2-3 ("Further, I do not believe Dr. Crawshaw's analysis is supported by the practice in the industry, as well as any applicable financial accounting standards or literature."). These reinsurance agreements were for single years, they were not multi-year agreements. *See* RCX 44 (Genworth Reinsurance Agreement, § 1.05 defining "book" to mean "each underwriting year;" § 1.39 defining "underwriting year" as a one-year period; § 9.02 providing that either party could

[28] *See* Lewis Carroll's *Through the Looking Glass.* ("When I use a word," Humpty Dumpty said, in a rather scornful tone, "it means just what I choose it to mean – neither more nor less.").

unilaterally terminate the agreement upon 90 days' prior written notice); RCX 53 (UGI Reinsurance Agreement, § 1.18 defining "policy year" as "the calendar year January 1 to December 31;" § 5.1 stating that the Agreement "may be renewed annually thereafter for additional one year terms commencing on January 1 and terminating on the following December 31 if both parties mutually agree to such renewal on or before September 1 [of a renewal year]"). As Mr. Burke explained, "[a]ll of Atrium's contracts fall within the definition of short-duration contracts" and each contract "must be evaluated on its own merits, i.e., on a single-year basis." Burke Report at 10; Cascio Rebuttal Report at 3 ("the proper methodology is to analyze each of the contracts on a single year, or book year, basis").

Respondents' experts also explained that risk transfer must be evaluated "at inception," and that Dr. Crawshaw's analysis, which is based on a retrospective analysis, is not consistent with industry practice. Burke Report at 11; *id*. at 15 ("Further, the use of 20/20 hindsight in assessing whether the risk transfer standards were met at contract inception is inconsistent, and in fact, prohibited under GAAP/SAP."); *see also* Hearing Tr. at 795 (Dr. Crawshaw: [I]n this case we're actually fortunate . . . we can see in practice actually how [the reinsurance arrangements] went.).

Further, Dr. Crawshaw's "methodology" requires the injection of subjective judgments into the analysis. Specifically, under Dr. Crawshaw's analysis, before one could reach a determination regarding the length of time an arrangement would remain in place, interviews would need to be conducted of every corporate representative for the reinsurer, the lender, and the MI, and probabilities assigned – a "theoretical" decision tree – for the purpose of ascertaining whether the agreement would continue to the next year. Hearing Tr. 794-96; *id.* 797-801 (Dr. Crawshaw explaining that the "interviews" were for the purpose of ascertaining each parties'

"goals" of the arrangement). Of course, Dr. Crawshaw could not anticipate changes in the future of reinsurance such as regulatory changes. Hearing Tr. 857 (Crawshaw: The parties "don't know" that there are not going to be any regulatory changes in year two.). In addition, as Mr. Cascio explained, there is simply no basis to "override the plain language of the termination provisions in the reinsurance agreements" based on "the 'intent' of the parties to have a 'long-term' relationship . . . such that a multi-year analysis would become appropriate." Cascio Rebuttal Report at 4.

Third, Enforcement Counsel continue to consistently – and perhaps intentionally – misrepresent the 10/10 risk transfer test. For example, Enforcement Counsel state that "[b]ecause the 10/10 test requires at least a 10% chance that claims will exceed premiums by at least 10%, for that test to be met, the reinsurer must have contributed capital equal to at least 10% of total ceded premiums." EC Brief at 99 n.36. As Respondents' experts repeatedly pointed out, the risk transfer test has nothing to do with the amount of capital the reinsurer is required to contribute. As Mr. Burke explained, while there is no "bright line" test as to what constitutes a "significant loss" within the meaning of FASB ASC 944, the industry has accepted the "10/10" rule which "means that in order for a contract to be properly characterized as reinsurance, the reinsurer has to have a 10% or greater chance of incurring a 10% or greater present value loss under the contract at the time the contract is entered into." Burke Report at 7. In other words, the test has nothing to do with "contributed capital" as stated by Enforcement Counsel. Once again, Enforcement Counsel makes up accounting rules to produce their preferred results.

In any event, there is no question that the funds in the Genworth and UGI trust accounts were more than sufficient. *See* Hearing Tr. 2328-30 (Dr. Crawhaw testifying that there were no

deficiencies in the UGI and Genworth trust accounts for the periods 2008 forward). While Enforcement Counsel think otherwise, their flawed conclusions rest on the faulty assertion that the funds in the trust accounts were not "earned" by Atrium when they were paid for the provision of reinsurance services. Enforcement Counsel have no basis for such an assertion – an assertion that not even Dr. Crawshaw agrees with. *Id.* 2298. Enforcement Counsel did not offer a single expert to counter Mr. Burke's conclusions in his Report, despite the fact that they called their own forensic accountant to the stand. The monies in the trust account belonged to Atrium, Atrium paid taxes on those funds, and they were earned when received. *See e.g.,* Cascio Report at 7 ("The premiums received by the reinsurer for that policy year become the funds or assets of the reinsurer."); Hearing Tr. 2298 (Dr. Crawshaw: "When the money is transferred over to the trust account, it's legally the property of Atrium.").

3. **Enforcement Counsel's Assertion That the Reinsurance "Provided No Genuine Benefit to the MIs" Is Belied by the Facts Adduced at the Hearing**

Enforcement Counsel repeatedly state that the reinsurance provided no genuine benefit to the MIs. Respondents anticipated this baseless assertion and respectfully refer the Tribunal to their Brief at pages 10 through16. Faced with unrefuted testimony adverse to their position, Enforcement Counsel now state that the "overwhelming documentary evidence" supports their position. EC Brief at 16. In other words, the witnesses who were called to testify did not support Enforcement Counsel's position. Further, Enforcement Counsel's decision not to call a single witness from Genworth, Radian, RMIC, CMG, PMI or any other MI, speaks volumes.

4. **Enforcement Counsel Cannot Use Dr. Crawshaw's Analysis to Attack the Value of the Reinsurance**

Enforcement Counsel's brief at pages 136 through 154 constitutes their effort to take issue with Milliman's findings regarding compliance with the HUD Letter requirement that the premiums received by Atrium were commensurate with the risk it assumed – as compared to the

risk assumed by the MI for particular book years – which is the analysis HUD established back in 1997. As Respondents pointed out in their Brief, and as reiterated in Enforcement Counsel's brief, it remains Enforcement Counsel's position that "[b]ecause there was no transfer of significant risk to Atrium under its captive arrangements, there were no 'services actually performed,' and therefore no price would have been reasonable." EC Brief at 137.
When asked by Enforcement Counsel for his view "as to what an appropriate level of profit would have been for Atrium given the level of risk you concluded [it] assumed," Dr. Crawshaw responded: "I haven't done a specific analysis, but it should be something less than zero percent underwriting profit." Hearing Tr. 751-52. *See also id.* 781 (Dr. Crawshaw: "[M]y analysis really an economic analysis to answer the question does this analysis – arrangement – do these arrangements provide transfer of risk? That's the question I'm answering.").[29]

Moreover, every time Dr. Crawshaw sought to proffer a comparison in rates, he relied upon property and casualty insurance rates, which are not comparable. *See, e.g.,* ECX 586 at 5-7 [redacted] ; Cascio Rebuttal Report at 7 (explaining the difference between "short-tailed" losses in the Property & Casualty business and the long lag between the assumption of the risk and the payment of losses with mortgage insurance/reinsurance); Hearing Tr. 784-86 (Dr. Crawshaw explaining that "in the first three years from the start of the arrangement, it's highly unlikely that Atrium could have a claim to pay."); *id.* 792 (Dr. Crawshaw: "there are lots of peculiarities on mortgage insurance and it is characteristic of a long delay in claims").

[29] *See* Hearing Tr. 1081-82 (Dr. Crawshaw explaining that his "analysis of underwriting profit" for the 25% cede agreements "is not in [his] report to the same extent" as the 40% cede arrangements and that the 25% cede arrangements were only discussed "in general.").

In sum, Dr. Crawshaw made quite clear in his reports and testimony that he thinks "the whole arrangement is a one-sided bet." Hearing Tr. 1086. He readily admits that he did not do any separate analysis of a single book year "[b]ecause it's not appropriate." *Id.* 2296 (specifically discussing the UGI 2009 book). Therefore, he never analyzed the relationship of the premium ceded by the MI to the risk assumed by Atrium on the two remaining books at issue. Further, he makes no effort to understand the benefits of reinsurance to both parties since his entire analysis is focused on the fact that because he believes that Atrium was not "properly capitalized right from the beginning," *i.e.*, pre-2000, it could never be in a "loss situation." *Id.* at 1087. While Respondents (and their experts) adamantly disagree with Dr. Crawshaw and his analysis including, for example, his belief that the premiums ceded to Atrium are not Atrium's funds, the fact of the matter is that since Dr. Crawshaw's entire focus is on the capitalization of Atrium's arrangements pre-2000 for UGI, *id.* at 2306, and 2001-2003 for Genworth, *id.,* he is not in any position to opine on the value of the reinsurance services provided by Atrium, nor did he offer any such analysis.[30] As a result, Milliman's evaluation of the cost of the reinsurance, and its conclusion that "reinsurance premium is reasonable in relation to the reinsured risk," *see, e.g.,* ECX 194 at 17, stands unrebutted by Enforcement Counsel.

VI. ENFORCEMENT COUNSEL MANUFACTURE FACTS TO SUPPORT THEIR ASSERTION OF AN AGREEMENT TO REFER

In its May 22 Order, the Tribunal held that there existed a genuine issue of fact with respect to the Bureau's Section 8(a) claim; that is, whether the payment of a thing of value was

[30] In fact, Dr. Crawshaw conceded that if a single book year is examined, then there were sufficient funds in the trust accounts to support the payment of claims and, thus, under his analysis, there would be a sufficient transfer of risk. *See* Hearing Tr. 2298-99 (Dr. Crawshaw: "In a way, the actual 2008 book worked . . . money was already in the trust fund from previous book years, which was largely premium, could support paying any claims in those years if it needed to.").

"made pursuant to an agreement to refer real estate settlement business." May 22 Order at 15-18. Enforcement Counsel failed to demonstrate such an agreement at the hearing. Now that the case has been narrowed to loans originated after July 21, 2008, and the record is closed, Enforcement Counsel's attempt to demonstrate a referral agreement consists of a 227-page brief that is replete with statements manufactured out of whole cloth. Examples previously cited include, *inter alia*, Enforcement Counsel's statement that the HUD Letter did not refer to "books" of business and their representation that the Freddie Mac policy change "demonstrated" that the "captive reinsurance arrangements were not bona fide transactions." Rather than take an equivalent 227 pages refuting every misrepresentation by Enforcement Counsel, Respondents detail here a representative "sample" of Enforcement Counsel's manufactured facts as they relate to the discussion of the purported agreements to refer. *See* EC Brief at 8-70.

In light of the limitations imposed by the Tribunal's May 22 Order, Enforcement Counsel's entire case is now premised on their assertion that "all of the premiums illegally ceded by the MIs before July 21, 2008 are causally connected to the referral of loans which closed on or after July 21, 2008." EC Brief at 163. Such a reckless assertion is demonstrative of a complete misunderstanding of the industry and a complete disregard of the evidence. At bottom, Enforcement Counsel does not even recognize that mortgage insurance is a credit enhancement that assists borrowers in obtaining loans when they have less than the minimum required 20% down payment. *See, e.g.,* RCX 821 (OCC Letter explaining how mortgage insurance "played a vital role in helping low and moderate-income families become homeowners by allowing families to buy homes with less cash."). Accordingly, the Lender Respondents needed to utilize one or more MIs in order to make loans to such borrowers. Prior to the financial crisis, there

were approximately ten MIs that wrote policies nationwide. As a result of the financial crisis, three of those entities went out of the business (Triad, PMI and RMIC).

Since at least November 2008, the Lender Respondents were using at least one MI where they never had a captive arrangement, and as of June 2009, the number of "never-had-a-captive" MIs increased to two, and shortly thereafter, the Lender Respondents put Radian in the dialer despite the fact that its captive had already been placed in runoff (as of January 1, 2009). Throughout the years that followed, the Lender Respondents "spread" their risk among a variety of MIs and, in February 2012, started using Essent, which had never participated in a captive reinsurance arrangement with Atrium, or anyone else. ECX 848.

With respect to their discussion of the purported "agreement to refer business to United Guaranty," EC Brief at 45-49, this section is full of conclusions based solely on Enforcement Counsel's self-serving interpretation of emails.[31] Given their decision not to call the witnesses such as Messrs. Bradfield and Danahy, Enforcement Counsel's "testimony" on their behalf of these witnesses is particularly egregious. Statements such as "expressed displeasure" with UGI's proposed captive arrangement, "attempt[s] to get back on track," and the captive arrangement "was a significant, and possibly dispositive, factor in setting the dialer in November 2008" are merely Enforcement Counsel's testifying. Enforcement Counsel never bothered to ask either Mr. Walker or Mr. Rosenthal these specific questions at the hearing.

[31] Enforcement Counsel repeatedly refer to the "government takeover" of AIG as if it has some significance to this proceeding. *See* EC Brief at 46, 58, 66. It does not. There was no testimony that the bailout of AIG had any effect on UGI, the subsidiary with which Respondents were dealing. This "guilt by association" without any evidence is disturbing. Similarly, Enforcement Counsel's repeated attempts to ascribe motive to the fact that Respondents "never called Rosenthal, nor any other employee of PHH or its affiliates," EC Brief at 3, 69, and 116, is disingenuous. Enforcement Counsel know that they have the burden of proof and, given their failure to present a case, there was simply no need for Respondents to call such witnesses.

The discussion of the purported Genworth agreement to refer is equally fanciful. *See* EC Brief at 49-53. In this section, Enforcement Counsel first posit that "Genworth struggled" to maintain "a significant share of PHH referrals while its competitor, UGI, seized the edge with a new captive arrangement." EC Brief at 50. That statement is completely at odds with the statements that follow wherein it is conceded that Genworth itself was requesting less business from PHH because of its own financial difficulties. Moreover, Enforcement Counsel simply ignore the fact that during that same period, the Lender Respondents were utilizing MGIC to a significant degree, even more than UGI for the period from January 28, 2009 to April 6, 2009. Further, by September 25, 2009, UGI was no longer receiving the majority of the new business and, by August 2011, approximately the date on which the Bureau came into existence, UGI was receiving only 5% of the business where the dialer was used to select the MI. In addition to misrepresenting the purported reasons for the flow of business, Enforcement Counsel shockingly state that in 2009, "Genworth took prompt steps to insulate PHH from any risk of an actual loss." Enforcement Counsel then recite irrelevant facts relating to the dialer in 2010, which have nothing to do with the "insulation" of risk to PHH because the last captive reinsurance arrangement ended in March 2009. The discussion of withdrawals from the trust accounts is equally irrelevant since it is undisputed that Atrium paid every claim presented. Hearing Tr. 2303 (Crawshaw). Culminating this series of misrepresentations is Enforcement Counsel's statement that "[a]s Genworth kept finding ways to pass things of value to Atrium to enhance PHH's captive reinsurance profits, PHH's agreement to refer business to Genworth endured."

Enforcement Counsel's assertion of an agreement to refer to Radian is likewise unpersuasive. EC Brief at 53-57. First, there were no loans originated after July 21, 2008, for

which Radian provided the pmi that went into a captive book. *See* ECX 159.[32] Thus, Enforcement Counsel is left with the baseless assertion that Radian was receiving business because it proposed "product offerings, which appear to reflect favorably on Radian." EC Brief at 55 (citing ECX 275). But Enforcement Counsel never identified the so-called "product offerings" by Radian, so the connection to offering a reinsurance arrangement is nonexistent. Further, Enforcement Counsel launches into a discussion of Radian's "Free after Five" and concludes, without any evidence, that Respondents failure to offer such a program "harmed borrowers." EC Brief at 56, n.19. Such manufactured allegations have no place in this proceeding. Certainly, Enforcement Counsel could have called a witness from Radian; indeed, they listed two such individuals (Messrs. Filipps and Young) on their witness list and all of them were located within commuting distance of the courthouse. Yet, Enforcement Counsel called none of them. Enforcement Counsel's conclusion that Radian only received business because it agreed to a commutation that provided for the complete return of all premiums, as well as Atrium's capital contributions and any earnings on the trust account, is nonsensical. EC Brief at 57. *See* Hearing Tr. 803 (Dr. Crawshaw: "[Atrium] didn't make any money [on the Radian agreement]. It lost its capital."). There was no testimony that Radian opposed the commutation of the agreement, which was specifically provided for by the terms of that agreement. Stated differently, Atrium did not require Radian's "consent" to commute in the manner it did – through the return of all premiums, capital contributions and earnings. As of July 21, 2008, the Lender Respondents were not originating loans that were subsequently placed into a reinsurance book,

[32] There were two loans listed on ECX 159 for July 2008; however, those were obviously originated earlier because as of June 1, 2008, Freddie Mac had imposed its policy change and there was no evidence that any MI operated counter to such guidance. *See also* EC Brief at 50 (noting that loans may not actually "close until a month or two later").

and yet the Lender Respondents continued to use Radian. Enforcement Counsel's evidence of a referral arrangement under such circumstances is nonexistent.

Enforcement Counsel's evidence of a purported referral arrangement in connection with CMG reflects a fundamental misunderstanding of the lending business. CMG could only be used for credit union loans. Credit union loans were eligible for pmi at a reduced rate because the risk associated with such loans is lower, which is also the reason such loans required a different reinsurance arrangement. Hearing Tr. 481-83, 485. Thus, Enforcement Counsel's statement that "once CMG's captive reinsurance arrangement was commuted, it never received more than a single-digit number of referrals from PHH in any month from July 2009-December 2011" is of no moment unless Enforcement Counsel also identifies how many credit union loans were being originated during that timeframe. *See* EC Brief at 58 ("CMG was a specialty provider, solely for credit union loans.") They do not make this showing; accordingly, their analysis is meaningless. Similarly, Enforcement Counsel's attempted reliance on the "preferred provider" list for correspondent lenders does not demonstrate the existence of a "referral." As explained by Mr. Rosenthal – the only witness to testify on this topic – the price adjustment only affected the correspondent lender, not the borrower, as Enforcement Counsel had originally alleged, and it was implemented to cover the additional cost of working with MIs with which the Lender Respondents did not have existing arrangements. Hearing Tr. 522.

Finally, as the Tribunal noted in its May 22 Order, "it would be helpful for a CMG representative to testify about the License Agreement and whether and how the parties performed under it." May 22 Order at 17. Since the burden of demonstrating a Section 8(a) referral agreement falls on the Bureau, not Respondents, Enforcement Counsel's refusal to call a

witness from CMG, despite listing a CMG witness on their witness list, is telling, as such testimony obviously would not have assisted Enforcement Counsel in their case.

Enforcement Counsel failed to demonstrate an agreement to refer with respect to any of the four MIs with which Atrium had a reinsurance agreement at some point. Further, Enforcement Counsel's attempt to explain the fact that the Lender Respondents used a variety of MIs – many of which never had a reinsurance arrangement with Atrium – is based on sheer speculation and manufactured facts. There was no testimony to support any of Enforcement Counsel's allegations of a referral agreement. Again, as Respondents explained in their Brief, Enforcement Counsel failed to put on a case.

VII. RESPONDENTS DEMONSTRATED THAT THE 25% CEDE WAS REASONABLY RELATED TO THE VALUE OF THE SERVICES ATRIUM PROVIDED

As Respondents explained in their Brief, Regulation X provides that "[i]f the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided." 12 C.F.R. § 1024.14(g)(2); 24 C.F.R. § 3500.14(g)(2). Enforcement Counsel attempt to turn the Bureau's (and HUD's) regulation into an absolute requirement that Respondents must "prove that no dollar of premiums received was, even in part, a payment for referrals of business." EC Brief at 137. Setting aside Respondents' continued disagreement with the Tribunal's finding midway through the hearing that they bear the burden of proof on the applicability of the Section 8(c) safe harbor, Enforcement Counsel's casting of the "no reasonable relationship" into a test whereby Respondents must demonstrate that every dollar, or even "part" of a dollar was not for the "referral" of business is unjustified and constitutes an administrative rulemaking without any due process. Further, such an interpretation cannot stand under the rule of lenity, which must be applied when interpreting RESPA because of its criminal penalties.

Enforcement Counsel continue to ignore the plain language of the HUD Letter, which noted on the very first page that the existence of a reinsurance agreement with an affiliate of the lender will result in the lender "ha[ving] a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance." HUD Letter at 1. Despite Respondents' raising this issue numerous times, Enforcement Counsel simply ignore this statement, just as they ignore the rest of the HUD Letter. Given HUD's clear recognition of the "financial incentive" to use an MI that will also result in placing the loan into a reinsurance book, Enforcement Counsel's feigned surprise that loans ended up in reinsurance books is curious.

Enforcement Counsel's attack on Respondents' proof that the two agreements at issue complied with the HUD Letter is sated with unjustified statements and conclusions. For example:

- Enforcement Counsel posit that because there were no "competitors" for Atrium with respect to the reinsurance service it provided, then there is no ability to demonstrate a "market value" for the service, and Respondents therefore cannot satisfy their burden. EC Brief at 137-8. Enforcement Counsel fundamentally misunderstand the point of captive reinsurance arrangements. The benefit of having an affiliated captive provide the reinsurance is to, among other things, give the lender "skin in the game" in that it has a "financial interest" in ensuring that it originates high quality loans. In addition, the reinsurer can rely on the underwriting done by its affiliated lender and the reinsurer knows the types of loans that will be placed into the books of reinsurance. These reasons were acknowledged by HUD, along with other federal regulators, *e.g.*, the OCC and OTS, who also approved such structures for their regulated entities. *See* RCX 821at 3 (OCC Interpretive Letter No. 743) (OCC explaining that the state-chartered reinsurer would be a "monoline company (that is, its business will be restricted to the reinsurance

of mortgage guaranty insurance) and . . . only on loans originated or purchased by the national bank or one of its affiliates." Reinsuring only loans underwritten or purchased by the bank, "will provide a valuable safeguard against excessive risk."); RCX 822 (OTS Opinion Dated March 11, 1999). Further, as long as there was a transfer of risk, as HUD noted, it "welcomes" the "mortgage market trend toward increased diversification of risk." HUD Letter at 7.[33]

- Enforcement Counsel's statement that the "lack of competitors indicates not only that Atrium's "reinsurance" was excessively priced, but that it did not fill a genuine need in the first place," EC Brief at 138-9, is nonsensical. If the price were excessive, common sense dictates that "competitors" would enter the market place. Indeed, Mr. Walker testified that Swiss Re previously offered such insurance, but that it took such a financial hit as a result of the collapse of the market in the 1980s that it got out of the business. Hearing Tr. 422-23. Enforcement Counsel make no mention of that testimony, once again avoiding the facts they find inconvenient. Rather, Enforcement Counsel cite Mr. Culver, who stated that MGIC was not interested in such insurance, but again Enforcement Counsel make no mention of the $900 million that MGIC received on its reinsurance agreements, nor Mr. Culver's admission that MGIC's evaluation of the market proved incorrect. Hearing Tr. 398-99 (Culver explaining that MGIC did not believe its losses would ever penetrate the reinsurance layer, but "putting aside my earlier comments on the economy, I was wrong. And [MGIC's reinsurance] was very important

[33] Enforcement Counsel's repeated refrain that there was no transfer of risk stands in stark contrast to the fact that for book years starting in 2004, Atrium paid more than $156 million in reinsurance claims. Further, Enforcement Counsel simply ignore the risk inherent in mortgage insurance, as well as the catastrophic exposure such insurance presents. *But see* Hearing Tr. 775 (Dr. Crawshaw explaining that the statutory accounting rules "recognize that mortgage insurance is catastrophe prone"). Thus, while Enforcement Counsel note that the MIs were suffering through the financial crisis, *see, e.g.*, EC Brief at 46, 100, their passing references to such financial difficulty demonstrate that they are paying mere lip service to the risks. Nor does Enforcement Counsel acknowledge that, in an industry with only approximately ten national players, three of them went into conservatorship.

to saving the company."). Mr. Culver also testified that "throughout the last number of years" or since 2008, MGIC has been looking for reinsurance but that it was not available/affordable. *Id.* 423-24.

- Enforcement Counsel disingenuously state that no "party" conducted a pricing analysis, and that "[n]o one who worked on behalf of Atrium ever performed underwriting to price the reinsurance coverage that Atrium purported to provide." EC Brief at 140. Enforcement Counsel's cleverness cannot carry the day. As Respondents have explained repeatedly, Atrium engaged Milliman, a highly regarded third-party actuarial firm that specialized in such matters. Burke Report at 13 (Milliman "is a well-recognized actuarial consulting firm"). Indeed, Milliman's analysis was so detailed and complex that not even Dr. Crawshaw attempted to replicate it.[34] It bears repeating that the only prospective risk transfer analysis that was performed on books of business was done by Milliman, a fact now conceded by Enforcement Counsel since they have now stated that the Bureau – as a party to this proceeding – also did not conduct any "pricing analysis."

- Enforcement Counsel's *ad hominem* attacks on Milliman are unprofessional.

Specifically, Enforcement Counsel again assert that Milliman "manipulated the 'capital'

[34] As Mr. Burke explained:

> The risk transfer analysis for the types of reinsurance agreements entered into by Atrium are complex and require deep knowledge of the product, the industry and the ability to create reasonable scenarios consistent with the requirements of SFAS 113. Absent having in-house expertise to perform such complex calculations, it is not only prudent to utilize the services of a recognized expert such as Milliman, but failure to do so might be viewed as a deficiency in the Company's internal control framework.

Burke Report at 12. It is beyond question that Atrium acted responsibly in retaining Milliman to assist in the evaluation of risk transfer and one could certainly envision an enforcement action by the Bureau or some other regulator if Atrium had not sought out the services of a recognized expert such as Milliman – which is why Dr. Crawshaw admitted that it was "reasonable" for Atrium to rely on Milliman's reports.

associated with the book year it analyzed," EC Brief at 147, n.71; Milliman "aggressively marketed this service to lenders" including "hosting an annual conference in Las Vegas for more than a decade,"[35] *id.* at 148; "Milliman stood to gain directly by the proliferation of captive arrangements throughout the industry," *id*. at 149; "Milliman sought to entice lenders into creating captive arrangements, which Milliman could then bless as bona fide transactions through its risk transfer opinions," *id.* at 150; Milliman "concocted" the "test for demonstrating bona fide value," "the same test behind which Respondents now seek to hide," *id*. at 150-51; and that "[g]iven Milliman's financial stake in perpetuating the use of captive reinsurance arrangements, it is unremarkable that it was Milliman that devised the methodology used to analyze Respondents' (and other lenders') compliance with the requirements of the HUD Letter." *Id.* at 153-4. The problems with Enforcement Counsel's fury is that it has no substance, and certainly no support from the hearing testimony. Dr. Crawshaw was specifically asked about Milliman's work, and he specifically stated that Milliman did not violate any actuarial standards with regard to its preparation of the reports for Atrium and that it was "reasonable" for Atrium to rely on those reports. Hearing Tr. 806-07. Indeed, when pushed, Dr. Crawshaw's criticism of Milliman was that its "construction" of risk transfer was "too narrow" in that it looked at the

[35] Apparently Enforcement Counsel believe that "hosting a conference in Las Vegas" is tantamount to illicit or illegal conduct and seek to cast aspersions on Milliman, Respondents, and any other person or entity associated with the city of Las Vegas; otherwise, why would Enforcement Counsel find it necessary to spend a paragraph discussing this "issue?" Respondents respectfully direct the Tribunal to the Las Vegas Convention and Visitor Authority website (http://www.lvcva.com/), where it is noted that, since 2001, the number of conventions has averaged more than 20,000 each year. *See* http://www.lvcva.com/includes/content/images/media/docs/2013-Vegas-FAQs.pdf. Respondents are offended by this tactic.

issue on a book-year basis. *Id.* 808.[36] The following exchange between Dr. Crawshaw and Respondents' counsel demonstrates the baseless nature of Enforcement Counsel's barrage:

> Question: Do you have any reason to believe that Milliman provided the opinions that it did because it was paid to prepare those opinions?
>
> Answer: No.
>
> Question: Do you have any reason to believe that Milliman compromised in any way their professionalism with respect to preparing any of the opinions you reviewed because they were being paid to prepare those opinions?
>
> Answer: No.

Hearing Tr. 809. Moreover, upon cross-examination, Dr. Crawshaw readily admitted that he did not "do modeling like Milliman." Hearing Tr. 2295.

Further, Enforcement Counsel's diatribe against Mr. Rosenthal for "repeatedly" utilizing Milliman to analyze various reinsurance proposals is a classic "Catch 22." EC Brief at 150-54.[37] On one hand, Enforcement Counsel chastise Mr. Rosenthal for not mentioning "risk transfer"

[36] *See* Hearing Tr. 863: (Question: So you didn't see anything wrong with [Milliman's] description of their simulations? Answer by Dr. Crawshaw: No. I mean, all my disagreements with Milliman are on how they formulate the question of the risk transfer. But the actual, you know, calculations and modeling claims and the different scenarios, I don't have any dispute with.).

[37] Enforcement Counsel's histrionics regarding Milliman are appalling. According to Enforcement Counsel:

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

EC Brief at 150-51.

until the last page of a presentation. *See* Hearing Tr. 510-17.[38] On the other hand, Enforcement Counsel chastise Mr. Rosenthal for asking Milliman to assist him in evaluating reinsurance proposals – which he did ***for the specific purpose of ensuring that they passed risk transfer***. *Id.* 127 ("I know [Atrium] hired Ken Bjurstrom from Milliman to perform a lot of analytical work to make sure we pass risk transference and we passed all government regulations on the reinsurance topic."); *id.* 130; (same); *id.* 150; (same); *id.* 180; (same); *id.* 184 (Rosenthal testifying regarding the reasons he engaged Milliman – for risk transfer); *id.* 236-37, 241, 243-44 (Rosenthal discussing the requests for proposals and the need for the structures to pass risk transfer); *id.* 272 (Mr. Gordon reading into the record Mr. Rosenthal's deposition testimony regarding the importance of ensuring that there was proper risk transfer).[39] An additional problem with

[38] *See* Hearing Tr. 517 (Question: In fact, it isn't until Page 9 that Milliman sees fit to raise anything in this document that relates to risk transfer or compliance, correct? Answer: That's correct.).

[39] Make no mistake – Respondents are businesses. The Lender Respondents offer a service – the provision of mortgage loans to qualified borrowers. The Lender Respondents obtain mortgage insurance – which is a credit enhancement that allows borrowers who lack the requisite 20% down payment to obtain a loan – from various MIs where the borrowers do not exercise their opportunity to pick a specific provider. The fact that Respondents seek to earn a profit while acting in full compliance with all applicable rules and regulations should surprise no one. That philosophy was plainly stated by Mr. Rosenthal on his first day of testimony:

> Milliman would take a look at different types of transactions that Atrium was involved in or thinking about getting involved in to make sure that they were acceptable from a risk transference perspective, and that they were also profitable to PHH because you would always want to do everything within the confines of the law and all regulations, but at the same time, we're a business and we're trying to earn money, so it was a good transaction.

Hearing Tr. 128; *see also id.* 183 (Rosenthal: "we wanted to build a structure that would take just enough risk to pass risk transference"); *id.* 207 ("Yes, I was trying to optimize the transaction from a profit perspective for Atrium reinsurance so we could get the best possible deal at Atrium that still achieved risk transfers."). Even Dr. Crawshaw stated that he did "not see anything wrong" with "PHH's goal [] to assume minimum risk but enough to pass risk transfer." *Id.* at 1058. While Enforcement Counsel's hostility to that philosophy is readily apparent, the means by which they seek to impose their beliefs is inappropriate – specifically, by ignoring

Enforcement Counsel's argument is that it directly conflicts with the testimony of their expert, who "expected" to have a review done if, for example, there were "any change in the rules . . . governing the arrangement" including the decision to exclude certain FICO scores. Hearing Tr. 924.

VIII. THERE IS NO BASIS FOR INJUNCTIVE RELIEF WHERE, AS HERE, THE CONDUCT CEASED YEARS BEFORE THE BUREAU CAME INTO EXISTENCE

Enforcement Counsel's effort to justify injunctive relief cannot withstand any scrutiny. It bears repeating that not a single witness testified that Respondents had any intention of entering into any new captive reinsurance arrangements. Indeed, apparently recognizing such a hurdle to their request, Enforcement Counsel never bothered to ask any of the witnesses who appeared at the hearing whether they had any knowledge of any interest by Respondents to enter into new reinsurance agreements, nor did Enforcement Counsel call any witness to support such an assertion of potential future conduct.

Further, Enforcement Counsel concede in their brief that "***[b]y 2010, no MI was engaging in captive reinsurance for new originations***." EC Brief at 49. Thus, by the time Enforcement Counsel got around to filing this action, it had been more than four years since any MI entered into a captive reinsurance arrangement. Enforcement Counsel proffered no case to support the need for injunctive relief under such circumstances; that is, where the necessary counterparty to the transaction had ceased such arrangements for more than four years, and there

HUD's prior guidance on captive mortgage arrangements and imposing a standard beyond the "not reasonably related" test set forth in the Bureau's own regulation. Indeed, most of Enforcement Counsel's 227-page brief is spent trying to demonstrate what Mr. Rosenthal readily admitted – that Respondents are out to make money in a manner that was fully compliant with the law. While Enforcement Counsel further seek to dispute that Respondents complied with RESPA, they fail because the hearing demonstrated that Respondents took all appropriate steps to comply with the law, and Dr. Crawshaw's multi-book year retrospective analysis does nothing to undercut Respondents' compliance efforts.

was no evidence that they or Respondents would enter into any such arrangements in the future. Simply stated, there is no legal justification for the entry of an injunction simply because the government wants it.

IX. ENFORCEMENT COUNSEL'S "DISGORGEMENT" ANALYSIS IS FLAWED

Respondents have not retained any profits from loans closed after July 21, 2008, for the simple reason that there were no "profits," and thus cannot be held subject to disgorgement. Enforcement Counsel propose a sizable disgorgement award both by refusing to offset virtually all capital contributions, claim payments, and commutations payments by Respondents, and thus seek to disgorge money not even retained by Respondents. Further, Enforcement Counsel seek disgorgement of ceded premiums and dividend payments as early as 2001, long before the first actionable loan was closed. As discussed below, Enforcement Counsel's disgorgement claims must fail.

A. Enforcement Counsel's Disgorgement of Ceded Premiums Argument Fails, as Respondents Have Not Profited on a Book-Year Basis after July 21, 2008[40]

"Disgorgement deprives wrongdoers of the *profits* obtained from their violation." *Zacharias v. SEC*, 569 F.3d 458, 472 (D.C. Cir. 2009) (emphasis added) (*citing SEC v. Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978)). As such, an "order to disgorge is not a punitive measure; it is intended primarily to prevent unjust

[40] The Tribunal has ruled that, so long as the district court had the authority to award to HUD disgorgement and restitution prior to July 21, 2011, there is no retroactivity issue. May 22 Order at 13-14. Respondents maintain their position that, prior to the July 21, 2011 transfer date, HUD did not have the equitable authority to award disgorgement or restitution. Thus, as the Bureau stands in HUD's shoes, the Tribunal does not have authority to disgorge premiums received by Respondents in connection with loans closed before July 21, 2011. Further, as Respondents have explained, disgorgement is an equitable remedy that is only available in a proceeding filed in a court with equitable jurisdiction. Since administrative tribunals do not possess the same inherent equitable authority, disgorgement is only available if provided by statute. Prior to July 21, 2011, there was no statutory authority for any award of disgorgement through an administrative proceeding.

enrichment." *Zacharias,* 569 F.3d at 471 (*quoting SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000); *see also SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-31 (D.C. Cir. 1989). Unjust enrichment "occurs when: (1) the plaintiff conferred a benefit on the defendant; (2) the defendant retains the benefit; and (3) under the circumstances, the defendant's retention of the benefit is unjust." *Bregman v. Perles*, 747 F.3d 873, 876 (D.C. Cir. 2014). Enforcement Counsel have failed to show that Respondents have retained any profits unjustly, and thus there are simply no "benefits" to disgorge.

1. Atrium Experienced Losses on Loans Originated After July 21, 2008

As explained in Respondents' Brief, any request for "disgorgement" with respect to loans originated on or after July 21, 2008, should be rejected. That is so because the only two books at issue, the Genworth 2008B and UGI 2009, were projected to incur losses that, combined, exceeded the premiums Atrium would receive over the life of those two agreements. *See* Respondents' Brief § VIII.B. Since the parties to each of those agreements negotiated an arm's length commutation, those expected losses were paid by Atrium. Thus, there is nothing to "disgorge" with respect to those two agreements.[41]

2. Any Disgorgement Award Requires an Offset for Claim and Commutation Payments

Enforcement Counsel, in an attempt to preserve their claim for disgorgement, advance several novel arguments as to why Respondents should not be entitled to an "offset" for claim or commutation payments. The outcome of such requests not only flies in the face of equity, but also brings to light the fact that equitable remedies must be fashioned on a case-by-case basis and

[41] There were approximately 106 loans originated by the Lender respondents after July 21, 2011, where the pmi was provided by CMG and the loan was placed into a reinsurance book. *See* ECX 159. However, as Respondents explained, there is nothing to "disgorge" since all of the ceded premiums, capital contributions, and earnings on those monies were returned as part of the commutation of that arrangement. Brief at 17-18.

cannot be applied blindly. *See Holland v. Florida*, 560 U.S. 631, 649-50 (2010). Enforcement Counsel have asked this Tribunal to award disgorgement, a remedy that serves to deprive wrongdoers of profits obtained from their violation in order to prevent unjust enrichment. *Zacharias*, 569 F.3d at 472. Unjust enrichment serves to return money *retained unjustly* by a defendant. *Bregman*, 747 F.3d at 876 (D.C. Cir. 2014).

To deny Respondents credit for claim payments received by the MIs, and to disgorge from Respondents more money than they actually received, is both illogical and conflicts with the underlying purposes of disgorgement.[42] Similarly, commutation payments, which reflect the expected net present value of future claims under the arrangements, should offset any potential disgorgement award. When money has been returned to the party having originally conferred the benefit – under the terms of an agreement negotiated by the parties – no "injustice" remains. Enforcement Counsel's attempt to use disgorgement as a punitive measure is only clearer in light of the fact that their theory would effectively require Respondents to pay claims twice – once to the MIs and once to the Bureau. Equity neither demands, nor permits, such a result.

First, Enforcement Counsel claim that under the Tribunal's May 22 Order, Respondents are entitled to an "offset only in an amount equal to the market value of any services provided" and that, because risk transfer is measured prospectively, the market value of such services must also be measured prospectively. EC Brief at 191. Enforcement Counsel, however, confuse the import of the Tribunal's Order, which attempts to determine the value of services provided for purposes of determining RESPA compliance. Surely, the Tribunal did not rule that the *profits* from such arrangements should be determined prospectively. Moreover, a disgorgement or

[42] Enforcement Counsel cannot even demonstrate that the purported profits were paid to Atrium since ceded premiums were paid out on a net basis, meaning that claim payments that were due were deducted from ceded premiums *prior to their distribution* to Respondents. *See* Cession Statements, RCX 851-868.

unjust enrichment award simply cannot be determined prospectively. *Bregman*, 747 F.3d at 879 ("The essence of a quasi-contract claim is not the expectancy of the parties, but rather the unjust enrichment of one of them."). Further, under Enforcement Counsel's theory, had Respondents *not made a single claim payment*, the disgorgement award would be the same. Given the significantly different outcome for the MIs in this hypothetical scenario, to grant the same disgorgement award in both scenarios would not produce an equitable result.

Second, Enforcement Counsel assert that disgorgement is properly measured by all "payments received by the wrongdoer" and that claim payments made by Respondents are merely "costs associated with committing their illegal acts," and thus should not be deducted from a disgorgement award. EC Brief at 192. As an initial matter, the D.C. Circuit and various other courts of appeal have squarely held that disgorgement is intended to deprive wrongdoers of the "profits" obtained from their violation. *See, e.g., Zacharias*, 569 F.3d at 472; *Commodity Futures Trading Comm'n v. Am. Metals Exch.*, 991 F.2d 71, 79 (3d Cir. 1993). Further, *FTC v. Bronson Partners,* 654 F.3d 359, 375 (2d Cir. 2011), on which Enforcement rely for the proposition that Respondents cannot deduct "expenses" from any disgorgement award, is more nuanced and, in fact, supports Respondents' offset of claim payments. In *Bronson*, the court explained that, although profits are the typical measure for disgorgement, "where the profits from fraud and the defendant's ill-gotten gains diverge, the district court may award the larger sum." *Id.* at 375. *See also Am. Metals Exch.*, 991 F.2d at 79 ("[T]he district court should keep in mind the limitation placed on its equitable powers by [the] requirement that there be a relationship between the amount of disgorgement and the amount of ill-gotten gain.") In *Bronson,* a case involving deceptive advertising practices, the defendant sought to offset expenses such as shipping, product storage, and advertising costs. *Id.* at 364. In contrast, here,

ceded premiums were used to pay claim payments and thus, *were returned to the MIs* pursuant to the individual reinsurance arrangements.[43] Such claim payments cannot be classified as "expenses" that are the "cost of committing illegal acts" – that is, the claim payments cannot be treated as "ill-gotten gains" for Respondents. As such, the Tribunal should offset claim and commutation payments from any potential disgorgement award.

B. Enforcement Counsel Have Failed to Show a "Causal Connection" Between Loans Closed on or After July 21, 2008 and Ceded Premiums Received Before that Date and Thus Cannot Seek Disgorgement of Such Premiums

The Tribunal has specifically ruled, "no claims arising from loans closed before July 21, 2008, are actionable." May 22 Order at 14. In blatant disregard for this ruling, and what is obviously a resubmission of their continuing violation theory, Enforcement Counsel assert that all payments received by Respondents from the MIs in and after October 2006[44] were "causally connected" to referrals of loans closed on or after July 21, 2008, and thus are actionable. EC Brief at 156. Enforcement Counsel theorize that all payments received from the MIs were, in effect, "kickback payments" to obtain future "referrals" for all loans closed on or after July 21, 2008. This is despite the fact that, prior to filing their post-hearing brief, Enforcement Counsel had exclusively asserted that these very ceded premiums represent "kickback payments" in

[43] Enforcement Counsel similarly claim that ceding commissions provided from Atrium to the MIs are "expenses" and thus should be offset from any disgorgement calculation. As with ceded premiums, monies returned to the MIs for the costs associated with engaging in the reinsurance arrangements – arrangements that the MIs readily engaged in – cannot be classified as "ill-gotten gains." As such, ceding commissions paid to the MIs should be offset in the calculation of any disgorgement award.

[44] Enforcement Counsel later state that they "believe[] that all ceded premiums accepted by Respondents in and after June, 2001 – the first month after the dialer was instituted – are causally connected to referrals of loans closed on or after July 21, 2008." EC Brief at 169. This one sentence appears to be Enforcement Counsels' only support for their claim that a disgorgement award could seek payments received since 2001 – more than ten years before their having brought this action.

exchange for having referred the underlying loan. *See* EC Pre-Hearing Brief at 3. Enforcement Counsel's new theory is that despite the fact that there were no captive arrangements in existence, as was the case starting January 1, 2010, the receipt of payments pursuant to existing contractual obligations represent yet another "kickback." Such a theory has no merit as Enforcement Counsel have failed to show any causal connection between payments received as early as June 2001 and all loans closed after July 21, 2008.[45]

Enforcement Counsel rely on *Edwards v. First Am. Corp.*, 517 F. Supp. 2d 1199, 1205 (C.D. Cal. 2007), for the proposition that the acceptance of a referral payment may occur at a time other than at closing. EC Brief 158. The *Edwards* court did not rule squarely on that issue, however. Rather, *Edwards* merely reiterated the ruling in *Snow* – that a violation occurs at the time the loan is closed – and is unenlightening given the overwhelming case law supporting that position. *Id*. Though the defendants in *Edwards* did receive a referral payment prior to the closing of the loan at issue, the court was presented with substantial evidence that the defendants had specifically paid for "exclusive" referral arrangements with title agencies. 517 F. Supp. 2d at 1201. Enforcement Counsel, however, cannot show such a causal nexus here, as they have failed to demonstrate that all, or even a portion, of the premiums ceded as early as June 2001 were causally connected to the referral of loans that closed on or after July 21, 2008.

In support of their argument, Enforcement Counsel assert that the only "reasonable conclusion" for Respondents' referral of business to UGI and Genworth is the MIs' participation in the captive program and ceding of premiums. Such claims, however, neglect extensive evidence showing that Respondents considered various factors in selecting an MI as a business

[45] Such a theory is also contrary to Enforcement Counsel's conscious decision to allow the MIs to continue to cede payments because they were "contractually obligated" to make those payments. *See* March 5 Hearing Tr. at 55 (Ms. Ravener explaining that "you cannot consent to a settlement agreement that would affect the contractual rights of third parties").

partner, including: "counterparty strength," ability to "pay their claims," preexisting "automated systems," and "product eligibility." Hearing Tr. 108-109 (Rosenthal); *Id.* 168-69 (Rosenthal considering "what their servicing policies were"); *Id.* 287-88 (Rosenthal explaining that "counterparty strength and product availability were the main drivers"); *see also* ECX 495 at 1 (PHH Internal Report noting that "Genworth continues to be a great partner with respect to business development, policy approval/exception flexibility, quality control support and MI claims/rescind practices"). This is only further supported by the fact that other MIs were willing to offer substantially similar captive arrangements, yet were not engaged by Respondents.

Further, Enforcement Counsel's claim that the payment of ceded premiums from June 2001 or October 2006 onwards was a prerequisite for obtaining future captive arrangements or referrals is simply not supported by the facts. Notably, MGIC, RMIC, and Essent were each added to the dialer notwithstanding their having never previously entered into a captive arrangement with Respondents. ECX 848. If the prior payment of ceded premiums were causally connected to an MI's receipt of future referrals, how did these three entities get onto the dialer without paying their alleged "dues"? Further, Enforcement Counsel, relying on the market's alleged reaction to MGIC in the early 2000's, suggest that an MI's decision to stop ceding premiums would have a negative effect on the MI's future ability to receive business. Despite having placed its captive arrangement into run-off in early 2009, Radian nonetheless was placed on the dialer later that year. ECX 848. Similarly inconsistent with Enforcement Counsel's theory, UGI received little to no business between June and November 2008, despite the fact that the company was allocated 75% of the dialer. Enforcement Counsel attribute this to Respondents' "dissatisfaction" with UGI's captive proposal at the time, though they provide no factual support for this alleged "dissatisfaction," despite having had the opportunity to question

witnesses Sam Rosenthal and Dan Walker at the hearing. EC Brief at 162 n.79. Enforcement Counsel fail to reconcile these significant gaps in their theory, gaps which serve to negate any causal connection between premiums ceded as early as 2001 and loans closed after July 21, 2008. Surely, Enforcement Counsel's theory does not compare to the causal connection between payments and referrals in *Edwards* – a $2 million payment in exchange for an "exclusive referral arrangement." 517 F. Supp. 2d at 1204.

Further, October 2006 – the time period of the Request for Proposal ("RFP") – and June 2001 – the formation of the dialer – are completely arbitrary dates from which to calculate disgorgement.[46] Describing the RFP, Enforcement Counsel claim that "in a normal market" it is "irrational" for buyers of a service to compete with one another. EC Brief at 163. To be clear, the MIs are mortgage insurance providers – not buyers. Moreover, the RFP makes clear that Respondents sought a broad range of information about the companies, such as "corporate strength," "products and services" provided, "captive reinsurance options," and "policy servicing" processes to determine each MI's strengths as a business partner. ECX 774 (Request for Information). Enforcement Counsel's claim that these dates represent the time from which the causal connection was clear is forced and merely attempts to circumvent the Tribunal's denial of their continuing violation theory.

[46] Indeed, Enforcement Counsel's selection of the October 2006 date based on the sending out of the requests for information on the products and services offered by various MIs by the Lender Respondents – without any regard to any purported "referral" of business – demonstrates that Enforcement Counsel was simply looking for a date in 2006 upon which to base their demand for disgorgement. The 2001 date, which is based on the creation of the dialer, is even more random since, as explained by Respondents in their opening brief, the dialer is simply the mechanism by which loans are assigned to various MIs in those situations where the borrower does not opt to select his or her own provider. The dialer settings are established by senior management of the Lender Respondents based on business reasons. Enforcement Counsel's use of 2001 is not based on any alleged RESPA violation but rather on their objective in formulating a demand for hundreds of millions of dollars. In both cases, the dates are arbitrary and capricious.

Enforcement Counsel next claim that limiting disgorgement relief to ceding payments on individual loans would not approximate Respondents' gains.[47] They claim that, because it is simply not possible to trace every dollar of ceded premium to a specific illegally referred loan that closed on or after July 21, 2008, simply everything should come in. This is not an issue here, as it was established at the hearing that the number of loans in the Genworth 2008B and UGI 2009 books was approximately 5,497, and that Enforcement Counsel's forensic accountant, admitted that he could ascertain the amount of premiums ceded on these loans. The ceded premiums on those two books totaled approximately $7,791,000. EC Brief at 210 (ceded premiums for UGI 2009 book as of March 31, 2013, was $2,250,000; Genworth ceded premiums for 2008B was $5,541,000 as of March 31, 2012). Thus, even if the Tribunal was to order the disgorgement of all premiums on loans originated on or after July 21, 2008, *i.e.,* the only loans that are "actionable," (which it should not), the maximum possible recovery is $7,791,000. But even that figure would be inappropriate given the expected losses on those two books because Atrium "paid back" those amounts as part of the commutations.

C. Enforcement Counsel's Argument Seeking Disgorgement of Dividends Distributed from the Trusts Fails

As an alternative to their claim for disgorgement of ceded premiums, Enforcement Counsel seek disgorgement of all monies Respondents received from the trust accounts. EC Brief 175-76. This argument fails for three reasons: (1) the trust dividends were permissible; (2) even if the trust dividends were impermissible (which they are not), Enforcement wholly failed to distinguish earned premiums from investment income; and (3) the monies in the trust represent ceded premiums received over a period of almost two decades virtually all of which

[47] Enforcement Counsel further claim that a loan-by-loan remedy would be inappropriate on the basis that loans referred to the MIs were not limited to loans covered by captive arrangements, despite the fact that no such evidence was put on at the hearing. EC Brief at 159-160.

was earned on loans originated before July 21, 2008, and thus are outside of the statute of limitations.

Enforcement Counsel characterize the arrangements as per se impermissible on the basis that Atrium intended to yield profits – as if such ambitions were improper for a mortgage reinsurer – or any other business. Further, Enforcement Counsel inexplicably claim that any movement of funds to Atrium in furtherance of that purpose – to yield profits – was part of an "overarching illegal purpose." EC Brief at 177. Yet further, Enforcement Counsel go on to state that these dividend payments had "no purpose" other than to "pay Respondents in exchange for referrals." *Id.* This claim, however, clearly conflicts with Dan Walker's explanation for why UGI agreed to allow for a dividend payment from the trust:

> Atrium was one of the -- was the first captive reinsurance agreement that United Guaranty had entered into back in the . . . the mid 1990s. So by -- I forget the date that this request came in . . . we had a number of books, the 1996, '7, '8 books. And I don't remember exactly which books it involved, but they had run off the exposure of the original mortgages. The borrowers had pre-paid them. In most cases there were not a lot of defaults in those years. So most all of them had been pre-paid . . . . Some of those book years ran off very fast. So the remaining exposure by 2007 on a lot of those books was very, very tiny. That was something we never anticipated in the original -- in the way we structured the reinsurance agreements, that there might be a captive where, because the business has run off so fast, there's just multiple books of business, five years or so, where . . . the remaining exposure is so small, there's no longer any chance that the losses could exceed the attachment point for the reinsurance. There's no way United Guaranty could incur a loss on those old books of business. And so in that situation, I believe we made a decision, business decision, to allow release of the reserve.

Hearing Tr. 2152-53. Walker further clarified, upon being questioned if UGI received anything for the $52 million dividend:

> I do not recall that we did. But, again, this was *their money to begin with*. It's their money in the trust. They had a right to withdraw that money sooner or later.

Id. 2221 (emphasis added); *see also id.* 260-61 (Rosenthal explaining how the risk of loss on the earlier book years was gone, so Atrium was negotiating the release of capital since there was no reason for Atrium to hold it where there was no risk of loss); *id.* 774-75 (Dr. Crawshaw admitting that under the "statutory accounting rules" it was reasonable to reduce the contingency reserve where there was no risk of a claim). In other words, there was simply no longer any risk on certain books closed during the late 1990's, and thus no need to retain the ceded premiums held back to pay any future claims in connection with those book years. Where no risk remains, there is no longer any need for such safeguards. So, it is unclear what point Enforcement Counsel intend to make by stating that "no witness called by Respondents attempted to explain what conceivable reinsurance benefits UGI obtained by allowing the dividend." EC Brief at 178. UGI's benefit was obvious – it was able to account for the reinsurance on its financial statements for all of those years, thus obtaining capital surplus relief. In addition, Atrium was on the hook for a band of losses in the event of a financial crisis which, as it turned out, did not happen until 2007-2008. Finally, Dr. Crawshaw made clear that he had no evidence that Atrium failed to comply with the statutory accounting rules with respect to the contingency reserve requirements for its trust accounts and noted that as of the date of the hearing, he had "no concern" with Atrium's reserves "***because it did pay its claims.***" Hearing Tr. 777 (emphasis added). Once again, such statements by Enforcement Counsel reflect a genuine misunderstanding of the business of insurance and reinsurance.

It is also unclear how Enforcement Counsel can claim that the $52 dividend was only allowed to "maintain or increase UGI's share of PHH's MI business on a prospective basis." EC Brief at 179. Such a claim simply ignores – if not blatantly misrepresents – Mr. Walker's testimony. In a self-serving fashion, Enforcement Counsel go on to state that it would require an

"extraordinary inference, supported by no evidence," that the $52 million dividend did not increase PHH's allocation of business to UGI. However, as clearly explained by Mr. Walker, from the MI's perspective, the money was Atrium's to begin with. That being the case, Enforcement Counsel's *quid pro quo* theory rings hollow.

Enforcement Counsel have simply failed to put on *any* evidence to support a "causal connection" between dividend payments and ongoing referrals to the MIs beyond July 21, 2008. For instance, Enforcement Counsel suggest that Respondents increased referrals to Genworth in late 2010 because "very soon after Respondents were allowed to take a $5 million dividend payment from the Genworth trust account." EC Brief at 180 (quoting ECX 495). This is despite the fact that in early 2009, "PHH considerably slowed down production to Genworth *due to their request*;" in mid 2009, Genworth was in a position to take on more new insurance written, but PHH production was "not meeting Genworth's quality rating;" and, in March 2010, "PHH received delegated authority and added Genworth back into the MI Dialer." ECX 495 at 1 (emphasis added).[48] Enforcement Counsel continue to misrepresent several select exchanges between the parties in these complex business relationships to further their very basic argument that the relationships themselves were improperly motivated. Far from being improper, however, the motivation of the parties was specifically acknowledged and addressed by HUD on the first page of its 1997 Letter – the captive reinsurance arrangement will give the lender "a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance." *See also* RCX 821 (OCC explaining that "[i]n return for accepting the limited credit risk associated with the proposed reinsurance arrangement, the Subsidiary [*i.e.,* the reinsurer] will receive reinsurance premiums, as well as investment income

[48] Notably, Enforcement Counsel failed to call any witness from Genworth, despite having included one such witness, David Tubolino, on their witness list.

from its cash flow, providing a potentially important source of revenue for the bank and its Subsidiary.").

Second, Enforcement Counsel wholly fail to distinguish earned premiums from investment income in calculating a disgorgement award. It is well established that, in determining the appropriate amount of disgorgement, it is important to distinguish between "benefits from lawful conduct and benefits from unlawful conduct." *SEC v. Bilzerian*, 814 F. Supp. 116, 121 (D.C.C. 1993). "Indeed, the amount of disgorgement ordered must always represent a reasonable approximation of the illegal profits gained and must not extend to legal profits." *SEC v. Antar*, 120 F. Supp. 2d 431, 438 (D.N.J. 2000).

As has been explained, the MI trust funds consist of: (1) initial capital contributions, (2) ceded premiums, and (3) investment income. Hearing Tr. 2150 (Walker). Enforcement Counsel, in seeking the disgorgement of *all* dividend payments, fail to distinguish ceded premiums from *investment income*, which they do not claim to be impermissible. Notably, as represented by Enforcement Counsel's forensic accountant, the portion of the trusts representing investment income earned over the life of the arrangements is readily identifiable. Hearing Tr. 1187 (Ryan Thomas noting $49 million in investment income in the UGI trust and $10 million in investment income in the Genworth trust earned over the life of the arrangements). Enforcement Counsel have not questioned the legitimacy of investment income earned by the trusts, but instead attempt to include such monies as part of their general argument that all transfers of value from the MIs to Respondents over the life of the arrangements were improper. Investment income cannot be subject to any disgorgement award, as it represents profits earned legally over the course of the arrangements.

Lastly, Enforcement Counsel fail to acknowledge the fact that significant portions of the trust accounts were funded by premiums ceded *prior to* the creation of the dialer. For example, the $52 million dividend received from UGI consisted of ceded premiums and investment income *earned as early as 1996*. Hearing Tr. 2152-53 (Walker). This surely conflicts with the Tribunal's ruling that no claims arising from loans closed before July 21, 2008, are actionable. As an additional matter, this conflicts with Enforcement Counsel's assertion that the "causal connection" between ceded premiums and the subsequent referral of loans only reaches back to June 2001 – the time of the creation of the dialer. In seeking to disgorge all dividend payments received by Respondents, Enforcement Counsel necessarily seek to collect ceded premiums, investment income, and contributed capital reaching back into the mid-1990's. Enforcement Counsel have, however, failed to advance any reasonable rationale to justify the disgorgement of premiums ceded more than 15 years prior to the Bureau's formation, and 10 years prior to the closing of the earliest actionable loan.

CONCLUSION

Enforcement Counsel's case against Respondents is without merit. Indeed, for an agency that holds itself out as a "21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules;"[49] seeking transparency in the financial marketplace; while stating that it abhors "tricks and traps,"[50] this action epitomizes a clandestine prosecution of Respondents who took repeated steps to ensure

[49] *See, e.g.* Prepared Remarks of Richard Cordray dated June 11, 2014, available at: http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-mobile-request-for-information-field-hearing/.

[50] *See, e.g.* CFPB Press Release dated July 30, 2014, available at: http://www.consumerfinance.gov/newsroom/cfpb-launches-nationwide-effort-to-provide-financial-education-and-tools-to-low-income-consumers/.

compliance with existing government guidance. In repeated instances, Enforcement Counsel draw unwarranted conclusions from documents, including, for example, even misrepresenting the HUD Letter, the only government guidance on captive mortgage reinsurance arrangements. With respect witness testimony presented at the hearing, Enforcement Counsel ignore entirely the testimony from industry witnesses regarding the benefits of reinsurance and the reasons why a lender would select one MI provider over another in those instances where the borrower decided not to select his or her own provider. Absent from Enforcement Counsel's brief is any demonstration how Atrium's agreements did not satisfy the HUD Letter, other than to rely exclusively on Dr. Crawshaw's flawed analysis. *See* May 22 Order at 6 ("The [HUD] Letter articulates both general and specific guidance regarding captive reinsurance."). But Dr. Crawshaw's analysis is, by his own admission, only one manner in which risk transfer can be evaluated. He never states that it is the only method that can be used. Further, once the Bureau entered into Consent Orders with four, and later a fifth, MI that specifically permitted the continuation of ceding payments under the stated reason that the MIs were "contractually bound" to continue with such agreements, Enforcement Counsel's effort to punish Respondents, specifically Atrium Re, for honoring its side of the contractual arrangements bespeaks bad faith. Nor should it escape the Tribunal's attention that while the Bureau found it appropriate to settle with the MIs on amounts that were less than the cost those entities would have incurred in connection with complying with the Bureau's overly-broad CID, *see, e.g.,* RCX 2001; Hearing Tr. 396 ([redacted] and those entities had hundreds of such agreements – many of which are still ongoing – Enforcement Counsel now seek more than one hundred times the amount paid by a single MI, and Respondents had only four such agreements, the last of which ended in January 2010, and the last commutation

occurred in May 2013. Enforcement Counsel's less-than-fair enforcement tactics cannot be justified.

For all of the foregoing reasons, as well as the reasons stated in Respondents' Brief, the Tribunal should recommend that Respondents are entitled to judgment in their favor on the Bureau's Notice of Charges.

Dated: August 28, 2014

Respectfully submitted,

WEINER BRODSKY KIDER PC

By: /s/ Mitchel H. Kider

Mitchel H. Kider, Esq.
David M. Souders, Esq.
Sandra B. Vipond, Esq.
Rosanne L. Rust, Esq.
Michael S. Trabon, Esq.
1300 19th Street, N.W., Fifth Floor
Washington, D.C. 20036
(202) 628-2000

Attorneys for Respondents PHH Corporation, PHH Mortgage Corporation, PHH Home Loans, LLC, Atrium Insurance Corporation, and Atrium Reinsurance Corporation

CERTIFICATION OF SERVICE

I hereby certify that on the 28th day of August, 2014, I caused a copy of the foregoing Respondents' Post-Hearing Reply Brief to be filed under seal with the Office of Administrative Adjudication and served by electronic mail on the following parties who have consented to electronic service:

Lucy Morris
Lucy.Morris@cfpb.gov

Sarah Auchterlonie
Sarah.Auchterlonie@cfpb.gov

Donald Gordon
Donald.Gordon@cfpb.gov

Kim Ravener
Kim.Ravener@cfpb.gov

Navid Vazire
Navid.Vazire@cfpb.gov

Thomas Kim
Thomas.Kim@cfpb.gov

Kimberly Barnes
Kimberly.Barnes@cfpb.gov

Fatima Mahmud
Fatima.Mahmud@cfpb.gov

/s/ Hazel Berkoh
Hazel Berkoh