UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2014-CFPB-0002

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

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I. INTRODUCTION

The evidence will show that this case involves a highly complex mechanism – captive mortgage "reinsurance" – created and operated for the simplest of purposes: to enrich Respondents by means of kickbacks and fee splits, in exchange for lucrative referrals. The Real Estate Settlement Procedures Act (RESPA) bans such practices because of the inevitable harm they cause consumers.

Atrium performed no service worthy of the name, and there was no genuine business justification for the mortgage insurance companies' (MIs) ceding of premiums to Atrium. The MIs "purchased" this "reinsurance" in order to qualify for a continuing flow of business referrals from PHH, a major lender. In short, the evidence will show that the MIs ceded to Atrium because they wanted business from PHH; and PHH referred business virtually exclusively to MIs that ceded to Atrium. Under Section 8 of RESPA, the payments were impermissible kickbacks and unearned fees.

II. STATEMENT OF FACTS

Enforcement Counsel will rely on ordinary course business documents, the majority of them drawn from Respondents' own documents, as well as witness testimony, to establish the following facts. In addition, Enforcement Counsel note the facts deemed established by the Hearing Officer's Order of March 13, 2014, No. 67 (March 13 Order), at 17-18, and incorporate all of those facts by reference here.

A. Respondents' Role in Mortgage Insurance and "Reinsurance"

Respondent PHH Corporation is among the top-ten mortgage originators in the United States.[1] At all times relevant to this matter, PHH controlled the referral of private mortgage insurance business on the residential mortgages it originated directly through the retail channel[2] –

[1] PHH Corporation, SEC Form 10-K (2006), May 24, 2007, at 6; SEC Form 10-K (2013), Feb. 26, 2014, at 3.

[2] Retail loans are those originated directly by PHH affiliates.

the great majority of its loans– and indirectly through the correspondent channel.[3] Referrals from lenders were the MIs' lifeblood, especially those from very large lenders like PHH. MGIC Board of Directors Minutes, Jan. 24, 1996 (**Enforcement Counsel Exhibit** (ECX) **0037**), at 3. In short, PHH had considerable leverage over the MIs, which it was assiduously determined to, and did, use to its advantage. S. Rosenthal, "Captive Strategy" (**ECX 0737**), at 1.

Respondent PHH Corporation's subsidiaries, Respondents Atrium Insurance Corporation and Atrium Reinsurance Corporation (together, Atrium), purported to offer "reinsurance" to MIs continually between 1995 and 2013. Atrium received a rapidly accelerating percentage of the MIs' net insurance premiums, reaching 40% in 1998 and continuing at that level until at least 2008. Amendment #1 to United Guaranty (UGI)-Atrium Reinsurance Agreement (**ECX 0584**), at 1; email thread, Walker (UGI) to Rosenthal (PHH), Feb. 14, 2008 (**ECX 0735**).

B. The HUD Letter

In 1996, the Department of Housing and Urban Development (HUD), then responsible for enforcement of RESPA, began to review then-emerging captive reinsurance arrangements. HUD sought information regarding one of the first arrangements, between Countrywide Finance Corporation and Amerin Guaranty Corporation. Pursuant to that inquiry, Countrywide sought clarification concerning RESPA compliance in connection with captive mortgage reinsurance arrangements. HUD responded with a letter to Countrywide setting forth "the facts concerning captive reinsurance programs as we understand them, relevant law, and how the Department will scrutinize these arrangements to determine whether any specific captive reinsurance program is permissible under RESPA" 1997 HUD Letter to Countrywide (HUD Letter), at 1 (**ECX 0466**, at 37). The letter to Countrywide warned that "[i]f the lender or its captive reinsurance affiliate is

[3] Correspondent loans are originated by third parties and immediately purchased by PHH affiliates.

merely given a thing of value by the primary insurer in return for this referral, in monies or the opportunity to participate in a money-making program, then section 8 would be violated; the payment would be regarded as payment for the referral of business or the split of fees for settlement services." HUD Letter, at 3 (**ECX 0466**, at 39). The letter further set forth a variety of factors that would call the arrangements into question, and basic expectations for how HUD might evaluate whether a given relationship was legitimate or a mere guise for the payment of kickbacks and unearned fees.

C. The MIs Ceded Premiums in Exchange for PHH's Referrals of Business

Respondents' pricing for "reinsurance" took the form of captive structures such as "4/10/40." UGI-Atrium Reinsurance Agreement and Amendments (**ECX 0584**). Under this type of excess-of-loss structure, Atrium received or was "ceded" 40% of the borrower's insurance premium, in exchange for purporting to assume liability on all claims between 4% and 14% of the total risk (the "risk band") on each "book year" of reinsured loans from the MI. *Id.*

The MIs treated captive reinsurance as a product that they offered to PHH. Genworth RFI Presentation to PHH Mortgage, Oct. 20, 2006 (**ECX 0529**)**;** MGIC Response to RFI, Oct. 2006 (**ECX 0531**); *see* PHH Supplemental NORA Submission to CFPB (PHH Suppl. NORA), Sept. 23, 2013 (**ECX 0654**), at 14, n. 9 ("…in 2006 PHH solicited proposals for new reinsurance agreements … these arrangements were structured by the pmi providers and not PHH."). In effect, the MIs engaged in reverse-bidding to send Atrium purported reinsurance business by offering structures with the most attractive terms possible – to Atrium, for the benefit of PHH. Email thread, PHH and UGI, Dec. 2006-Jan. 2007 (**ECX 0751**). PHH, for its part, directed this process and played the MIs off one another, urging them to sharpen their pencil in light of competing offers, and to offer the most profitable and risk-free captive structures possible to Respondents. *Id.***;** *see* Investigational Hearing Tr. of Samuel Rosenthal (Rosenthal Tr.) (**ECX 0731**), at 61, 64-65, 118-19. In 2006, PHH proposed to substantially increase the overall volume of retail business it could send to MIs, and issued a Request for Proposal (2006 RFP). PHH Request for Information to MGIC, Oct. 9, 2006 (**ECX 0024**), at 2. The purpose of initiating the 2006 RFP was to extract even more profitable captive reinsurance arrangements from the MIs to benefit PHH. Rosenthal Tr. (**ECX 0731**) at 61, 64-65.

Atrium had no competitors. Rosenthal Tr. (**ECX 0731**) at 43-44. Atrium did not offer reinsurance on books of loans originated by lenders other than PHH. New York Insurance Dep't., Report of Examination of Atrium Insurance Corp., Apr. 18, 2008 (**ECX 0199**), at 5. Atrium itself had no employees. 30(b)(6) Deposition Tr. of Mark Danahy, *Munoz v. PHH Corp.* (**ECX 0153**), at 24. And it did no independent actuarial analysis to assess the risk and to set the price of its reinsurance. Rosenthal Tr. (**ECX 0731**) at 40. Rather, Atrium engaged the actuarial firm Milliman Inc. to prepare a series of written opinions, each asserting that a particular captive "arrangement" transferred significant risk on a given book year commensurate with the premium ceded, for the express purpose of satisfying their reading of RESPA Section 8. Milliman Opinions (e.g., **ECX 0193, 0194, 0195**). The evidence will show that both PHH and the MIs sought to offer and implement captive arrangements that were as profitable and risk-free for PHH as possible, Rosenthal Tr. (**ECX 0731**) at 64-65, while obtaining Milliman's opinions as a cover.

PHH steered referrals only to those MIs who had arranged to cede premiums to Atrium until late 2008, when the mortgage crisis was already full-blown. March 13 Order, at 17 (Rule 213 Facts, ¶ 2); PHH data submission to CFPB, Mar. 2, 2012 (**ECX 0159**); PHH Supplemental NORA Submission to CFPB, Sept. 2013 (**ECX 0654**), at Exh. M. During this time, PHH made it virtually impossible for any MI lacking a captive arrangement with Atrium to receive any significant volume of referrals from PHH. *Id.***;** Rosenthal Tr. (**ECX 0731**) at 30. And none did. PHH data submission to CFPB, Mar. 2, 2012 (**ECX 0159**). PHH's automated "dialer" ensured retail business went only to

MIs with a captive arrangement – that is, those who had agreed to cede a substantial amount of their premiums to Atrium. Email thread, May-June 2008, RMIC-PHH (**ECX 0403**). Simultaneously, until August 8, 2008, PHH's "preferred provider" list was limited only to MIs with captive arrangements. PHH Supplemental NORA Submission to CFPB, Sept. 2013 (**ECX 0654**), at Exh. O. This list ensured that correspondent lenders would be penalized with a ¾ point increase on a mortgage loan if they picked a non-preferred MI, i.e., non-captive MI provider. PHH email thread, June 5-6, 2008 (**ECX 0262**). By late 2008, the mortgage crisis compelled PHH to utilize additional MIs – which PHH did, on the condition that plans were in place to create future captive reinsurance arrangements with them as well. These deals, however, did not come to fruition because the government-sponsored entities (GSEs) effectively prohibited "deep cede arrangements" by capping captive reinsurance arrangements at a maximum cede level of 25% in 2008 and never lifted that ban. Nonetheless, PHH continued to steer referrals, in large part due to the benefits it perceived it could gain from its existing captive reinsurance arrangements, until at least May 19, 2009. Email, Bradfield (PHH) to Rosenthal (PHH), May 19, 2009 (**ECX 0367**).

D. Abundant Evidence of the Parties' Behavior Under the "Reinsurance" Agreements Shows They Were Not Arms'-Length

In all key respects, the evidence shows that the MIs, PHH, and Atrium did not behave as if the captive arrangements were bona fide business deals.

The evidence shows that, in sending payments to Atrium, the MIs did not seek any of the benefits of real reinsurance such as catastrophic risk protection. Expert Report of Mark Crawshaw (MC Exp. Rpt.), at 4, 42, 56-57. Instead, the MIs sought to cede premiums in exchange for referrals that would gain or hold market share. UGI Proposal to PHH in Response to RFI, Oct. 18, 2006 (**ECX 0521**) at cover letter; *see* MGIC Board of Directors minutes, Jan. 23, 2003 (**ECX 0036**), at 4.

The two MIs with by far the largest captive arrangements with PHH repeatedly agreed to novations to their "reinsurance" agreements with Atrium, to their own detriment and Respondents' benefit, without receiving any compensation in return. In 2006, Genworth agreed to carve out certain subprime loans from inclusion from the captive, and received no consideration under the agreement. PHH internal email, Aug. 10, 2007 (**ECX 0204**); PHH-Genworth email thread, May-July, 2006 (**ECX 0502**); Third Amendment to Genworth-Atrium Reinsurance Agreement (**ECX 0503**). That same year, UGI agreed to a similar amendment, likewise without compensation. Amendment #6 to UGI-Atrium Reinsurance Agreement (**ECX 0584**).

In late 2006 and early 2007, at the same time PHH was discussing with UGI the proposed captive structures UGI had submitted in response to the 2006 RFP, Email thread, PHH-UGI, Dec. 2006-Jan. 2007 (**ECX 0751**), the same UGI and PHH executives discussed and agreed to an amendment to their captive deal that, when executed, allowed Atrium to withdraw from UGI's trust a dividend of over $52 million. Email thread, PHH-UGI, Jan. 4-8, 2007 (**ECX 0303**); PHH email thread, Feb.-May, 2008 (**ECX 0244**); Amendment #7 to UGI-Atrium Reinsurance Agreement (**ECX 0584**). UGI thus lost forever the benefit of having funds contributed by Atrium in the trust, and received no compensation under the amendment. Rosenthal Tr. (**ECX 0731**) at 42-43, 120-21, 127. Following the "dividend," none of Respondents' capital contributions remained in the trust. MC Exp. Rpt., at 38.

In 2012, Respondents and Genworth negotiated the cut-off termination of their captive deal. Eventually, the deal was terminated, with a $24.1 million commutation payment to Atrium. March 13 Order, at 18 (Rule 213 Facts, ¶ 10). At the same time those terms were being discussed, Genworth was also discussing the terms under which it might continue receiving business from PHH. PHH "Overview of Genworth and PHH Partnership – Briefing Document," Apr. 2012 (**ECX 0496**), at 2.

Documentary evidence likewise shows that Radian entered into its captive arrangement with Atrium not to obtain reinsurance through an arms'-length transaction, but to provide a steady stream of profits to PHH in the hopes of breaking into PHH's account. [redacted]

Consistent with its pitch, the captive arrangement that Radian entered into with Atrium was tremendously advantageous for PHH. For almost four years, Radian allowed PHH to receive 40% of its premiums in exchange for an exceedingly small $16,120 capital contribution. MC Exp. Rpt. at 55, 57. And Radian thereafter sought to make the deal even more beneficial to Respondents. For example, in its response to the 2006 RFP, Radian indicated that it "would consider amending PHH's agreement" to allow the "possibility of declaring dividends earlier subject to issuance of [a] risk transfer opinion." Radian, RFI Response for PHH Mortgage, 2006 (**ECX 536**), at 43.

E. The Captive Deals Were Designed to, and Did, Sharply Limit Risk and Maximize Profits for Respondents

As set forth in the Expert Report of Mark Crawshaw, all of the captive deals entered into by Atrium contained multiple features that ensured that Respondents avoided any significant risk. Many of these features were written into the agreements themselves; others are observed from the actual, real-world behavior of the parties. Among other things, these features included the segregation of risk by MI through separate trust accounts, the limitation of Atrium's liability to the funds in each trust account, a structure that made it extremely unlikely that Atrium would have to pay any claims in the first few years of the arrangement, Atrium's ability not to make required capital contributions by forcing a termination of the arrangement at the optimal time for Atrium, and Atrium's ability to obtain one-sided amendments to its contracts with the MIs that further reduced or eliminated any risk. MC Exp. Rpt. at 3. While the several agreements between Atrium and the MIs varied in form and language – for example, with respect to the formulation of the limitations on Atrium's liability, the combined effect of multiple features of these agreements was that Atrium by design received tremendous benefits from these agreements with no real risk to its capital. *Id.* at 3, 12-30.

Dr. Crawshaw conducted a detailed analysis of each of Atrium's four captive arrangements and concludes that, as a result of these risk-avoiding features, none of them reflected a genuine reinsurance service to the MIs. For example, Dr. Crawshaw explains that in the first several years of the UGI arrangement (from 1995 through mid-2000), the maximum amount that UGI could gain from that arrangement was limited to Atrium's $460,000 initial capital contribution to the UGI trust account, whereas the amount that UGI stood to lose was orders of magnitude greater – tens of millions of dollars of premiums it had already ceded, or would be required to cede, to Atrium for the first several book years covered under the arrangement. *Id.* at 34-36 & n. 84. In addition, the likelihood of UGI gaining Atrium's small capital contribution was less than the likelihood of UGI losing the substantial premiums ceded to Atrium. *Id* at 35. As a result, the arrangement from the start was a lopsided bet stacked heavily in Atrium's favor. Dr. Crawshaw concludes that from an insurance perspective, there was no reasonable business justification for UGI to enter into such an arrangement. *Id.* at 36.

By mid-2000, when Atrium had to decide whether to contribute additional capital, substantial premiums had already accumulated in the UGI trust account, providing a buffer against the risk of loss of any additional capital. *Id.* at 36. But if Atrium nonetheless believed that the risk of loss to its capital was significant, it could have avoided the need to contribute additional capital by terminating the arrangement, severely reducing any risk to Atrium. *Id.* at 37-38. Although

Respondents elected to continue with the UGI arrangement, they did so at a time when the housing boom was in full swing and with the knowledge that continuing to accept 40% of UGI's premiums was likely to be highly profitable to Atrium. *Id.* at 38. But not long after it had completed making additional capital contributions to the UGI trust account, Atrium began to take substantial dividends from the trust account, which reduced its net capital contribution to zero by early 2007. *Id.* at 33. Thus, by the time it paid its first claims to UGI as a result of the mortgage crisis, UGI's recovery was limited to a portion of the premiums it had already ceded to Atrium. *Id.* at 39.

Dr. Crawshaw's analysis of Atrium's conduct in its arrangements with Radian and CMG (which commenced in 2004 and 2006, respectively) presents a revealing contrast. As the mortgage crisis escalated, Atrium was faced with the prospect of significant claims, but unlike its experience with UGI (and Genworth), Atrium's arrangements with Radian and CMG had not been in existence for a sufficiently long period of time for the trust accounts to accumulate significant premiums to buffer against the risk of loss of Atrium's capital. *Id.* at 51-59. Atrium was therefore confronted with a choice – contribute additional capital that might actually be exposed to some non-trivial risk, or terminate the arrangement. Atrium chose the latter. *Id.* Atrium terminated the Radian arrangement to avoid "put[ting] additional capital at risk with this trust," email, Danahy to Bogansky, Feb. 15, 2009 (**ECX 0254**), at 2, and it declined to fund the CMG trust account to the level required by its contract with CMG, forcing a termination of that arrangement and shifting to CMG liabilities that substantially exceeded the commutation payment obtained by CMG (which was itself comprised mostly of CMG's own ceded premiums). MC Exp. Rpt. at 54; email, Bahr (CMG) to Rosenthal (PHH), Aug. 13, 2009 (**ECX 0372**).

In addition, because the standard net cede was fixed at 40% for about a decade (MC Exp. Rpt. at 31, 44; Genworth-Atrium Reinsurance Agreement and Amendments (**ECX 0503**); UGI-Atrium Reinsurance Agreement and Amendments (**ECX 0584**), these risk-limiting features also had the effect, along with other features, of maximizing Respondents' profits. Email thread, PHH-PMI, Oct. 26-27, 2006 (**ECX 0739**). Dr. Crawshaw concludes that the "arrangements were designed to yield large profits to Atrium." MC Exp. Rpt. at 4, 59-61, 72-76.

F. Respondents Were Enriched Through their Captive Arrangements by Accepting Ceded Premiums, Dividend Payments and Commutation Payments

Atrium accepted ceded premiums from its MI partners continuously from 1995, when it entered into its first captive agreement (with UGI) through May 2013, when it terminated the last of its captive arrangements (with UGI). Over the life of its captive arrangements, Atrium accepted approximately $304,729,028 in total net ceded premiums from UGI, $121,882,937 in total net ceded premiums from Genworth, $3,534,924 in total premiums from Radian and $2,726,736 in total premiums from CMG.[4] PHH NORA Submission to CFPB, Sept. 6, 2013 (**ECX 0653**) at Exh. C; Atrium-Genworth Statement, Mar. 31, 2012 (**ECX 0257)**; Atrium "MI Remittance Summary" (**ECX 0828**).

Atrium took dividends and obtained commutations payments from the trust accounts for Genworth and UGI. Atrium took $13,900,000 in total dividends from the Genworth trust account. (PHH NORA Submission to CFPB, Sept. 6, 2013 (**ECX 0653**) at Exh. C. Upon the termination of its agreement with Genworth in April 2012, Atrium received an additional $24.1 million payment from the Genworth trust account. March 13 Order, at 18. Atrium also withdrew $34,425,182 from

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[4] The total premium figures for UGI and Genworth identified above differ from the figures for UGI and Genworth reflected in paragraph 14 of the Hearing Officer's Rule 213 ruling in the March 13 Order because the former are "net" amounts (they account for ceding commissions paid by Atrium to the MI), whereas the latter are "gross" amounts (they do not account for ceding commissions). *See* March 13 Order at 18. The total premium figures for Radian and CMG identified above are based on a spreadsheet produced by PHH. Atrium "MI Remittance Summary" (**ECX 0828**). The agreements between Atrium and Radian and CMG, respectively, did not require payment of a ceding commission. Atrium-Radian Reinsurance Agreement, Jul. 26, 2004 (**ECX 0200**); CMG-Atrium Reinsurance Agreement, Dec. 1, 2006 (**ECX 0202**).

the Genworth trust account for the stated purpose of paying taxes and expenses. Atrium-Genworth statement, Mar. 31, 2012 (**ECX 0258**). Atrium took $104,973,654 in total dividends from the UGI trust account. Atrium-UGI statement, Sept. 30, 2012 (**ECX 0198**). Upon the termination of its agreement with UGI in May 2013, Atrium received an additional $69,169,499 payment from the UGI trust account. March 13 Order at 18. Atrium also withdrew $50,272,000 from the UGI trust account for the stated purpose of paying taxes and expenses. Atrium-UGI statement, Sept. 30, 2012 (**ECX 0198**).

III. ARGUMENT

A. The Evidence Will Show Prima Facie Violations of Sections 8(a) and 8(b) of RESPA

Section 8(a) of RESPA prohibits any person from giving or receiving "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.[5] "Regulation X" clarifies that such an agreement or understanding may be inferred from a course of conduct:

> Agreement or understanding. An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.
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> 24 C.F.R. §1024.14(e).

Here, the evidence will document a years-long course of dealing between Respondents and the MIs, in which Respondents established that the existence of an agreement by an MI to cede premiums for purported reinsurance was a necessary precondition of referral of the mortgage

[5] 12 U.S.C. § 2607(a).

insurance business on which the MIs indispensably depended. Moreover, Respondents received ceded payments repeatedly, virtually continuously, for nearly two decades. The value of these payments to Respondents was intimately connected to the volume of business they referred to the MIs, as the magnitude of the payments was based directly on the amount of business that was referred and subsequently "reinsured." The pattern or practice is demonstrated by evidence of all the circumstances, including that:

- from Atrium's inception in the mid-1990s until shortly after the onset of the mortgage crisis, PHH sent its controllable retail referrals only to MIs that had agreed to cede it premiums;
- during that period, PHH tried to deter correspondent referrals to any MI with whom it lacked a captive by charging a 75 basis point increase on correspondent loans assigned to an MI that was not one of its "preferred" MI providers, namely, the MIs who had agreed to cede; and
- during the life of its captive reinsurance arrangements, Atrium: 1) received approximately $493 million in gross ceded premiums, 2) withdrew at least $212,143,153 in dividends from its captive trusts, 3) received approximately $93 million in commutation payments from those trusts, and 4) withdrew at least $84,697,182 for purported tax and expense payments.

All of these practices are shown by many contemporaneous documents from PHH, the MIs, and others, and will be underscored by testimony at hearing. The referrals, ceding, and other elements will be thoroughly documented.

Section 8(b) of RESPA prohibits any person from giving or accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed."[6]

Both documents and hearing testimony will show that Respondents accepted a portion of borrowers' mortgage insurance premiums. The evidence will further show that Respondents did so without performing any actual service in exchange, including that:

- the MIs entered into the reinsurance agreements for the purpose of building or maintaining market share, and without seeking – or reasonably expecting –the normal benefits of reinsurance;
- the MIs "competed" to cede premiums and offer favorable terms to Atrium for the "reinsurance" they were purportedly buying, rather than, as one would expect, the opposite;
- the MIs permitted their captive arrangements with Atrium to be amended to their detriment and Respondents' benefit, without compensation; and
- Respondents offered and performed no services for mortgage loan borrowers in exchange for their split of borrower premiums.

B. Respondents Cannot Establish that They Qualify for the Section 8(c)(2) Affirmative Defense

Respondents cannot meet their burden of establishing that the captive arrangements at issue qualify for the affirmative defense provision of Section 8(c)(2) of RESPA. Section 8(c)(2) provides that "[n]othing in this section shall be construed as prohibiting … the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed …." 12 U.S.C. § 2607(c)(2) (emphasis added). Once a violation is established under Section 8(a) or 8(b), Respondents can only qualify for protection under Section

[6] 12 U.S.C. § 2607(b).

8(c)(2) if they prove that: (1) the MIs received "services actually performed" by Atrium; and (2) the premiums the MIs ceded to Atrium were bona fide payments entirely and solely "for" such services actually performed, such that those payments were not – even in part – "for" the purpose of obtaining referrals of MI business. *See* March 13, 2014 Order, at 8 (finding that "RESPA Section 8(c)(2) establishes a safe harbor for salary, compensation, or other payment for services actually performed, but only if such payment is bona fide.").

In its 1997 letter to Countrywide, discussed above, HUD explained that for the Section 8(c)(2) exemption to apply, payments to the captive reinsurer must be: (1) "for reinsurance services 'actually furnished'"; and (2) "*bona fide* compensation that does not exceed the value of such services." HUD Letter at 3; (**ECX 0466** at 39). If the MIs receive referrals from the lenders who own the captive reinsurers, any payment, or portion thereof, by the MIs to the captives that exceeds the value of reinsurance services is an "impermissible referral fee." *Id.* at 3, 4.[7] Thus, citing Section 8(c)(2), HUD "concluded that, so long as payments for reinsurance under captive reinsurance arrangements are *solely* 'payments for goods or facilities actually furnished or for services actually performed,' these arrangements are permissible under RESPA." *Id.* at 1 (emphasis added). HUD explained that "[i]f the lender or its [captive] reinsurance affiliate is merely given a thing of value by the primary insurer in return for this referral, in monies or the opportunity to participate in a money-making program, then section 8 would be violated; the payment would be regarded as payment for the referral of business or a split of fees for settlement services." *Id.* at 3; *see also id.* at 4 (explaining that captive arrangements will be subject to "particular scrutiny" when the "lender restricts its

[7] The HUD Letter notes that the compensation exceeds the value of reinsurance services when, among other things, "the lender or the firm controlling the captive reinsurer is shielded from potential losses by inadequate reserves" or the captive reinsurer has "a corporate structure that segregates risk." HUD Letter at 7 (**ECX 0466** at 43).

mortgage insurance business in whole or to a large extent to a primary mortgage insurer that has a reinsurance agreement with the lender's captive reinsurer.").

Respondents cannot meet their burden of establishing that the narrow Section 8(c)(2) defense applies. First, the evidence presented at the hearing will refute any claim that the MIs received "services actually performed" by Atrium. In his expert report, Dr. Crawshaw explains that Atrium's captive arrangements had a variety of features that enabled Atrium to avoid any significant risk of sustaining a significant loss of its capital – a generally accepted industry guideline for determining whether a contract or arrangement results in a real transfer of risk. MC Exp. Rpt. at 12-30. For each of Atrium's four captive arrangements, he describes how those features, and other risk-avoiding practices employed by Respondents throughout the course of those arrangements, resulted in a failure to transfer risk from Atrium to the MIs. *Id.* at 30-59. He concludes that there was no reasonable insurance-based business justification for the MIs to enter into captive arrangements with Atrium. *Id.* at 4, 35-36, 55-56. Moreover, Dr. Crawshaw's analysis also highlights and supports the factual observation that even after the most severe mortgage crisis in decades, Atrium did not incur any overall loss of capital as a result of the mortgage "reinsurance" service it claims to have provided; instead, it made massive profits. *Id.* at 39, 40, 49-52, Attachment 2. Dr. Crawshaw's well-supported and highly detailed analysis of Atrium's captive arrangements, as they were conceived and as the parties conducted them in practice, makes clear that these were sham arrangements that did not reflect real reinsurance services to the MIs.

Second, even if Atrium's captive arrangements could somehow be construed as providing a "reinsurance" service to the MIs, however minimal, the evidence will show that the MIs participated in those arrangements not because they actually wanted reinsurance from Atrium, but because doing so was a requirement of obtaining referrals of MI business from PHH. *See* Section II.C, *supra*. Thus, no matter how strenuously Respondents attempts to characterize Atrium's captive arrangements as providing a genuine reinsurance service to the MIs, or providing other supposed benefits like "capital smoothing," its reliance on Section 8(c)(2) is a dead end because the MIs' payments to Atrium were not "for" any such services, but rather "for" business referrals. *See* HUD Letter at 1 (**ECX 0466** at 37) (Section 8(c)(2) requires that the payments be "solely" for the actual services performed).

Indeed, even if Respondents could demonstrate that there was some incidental value to the MIs from any "reinsurance" service provided by Atrium (in addition to the value of the referrals), as Dr. Crawshaw explains in his report, the "compensation paid to Atrium in the form of premiums ceded by the MIs was extremely high relative to any risk assumed by Atrium." MC Exp. Rpt. at 4, 59-61, 72-76. Because the amount of premiums the MIs were required to cede to Atrium was vastly in excess of any risk that Atrium assumed, Respondents cannot establish that no portion of those payments were referral fees prohibited by RESPA. *See* HUD letter at 3 (**ECX 0466** at 39) (payments that "exceed the value of the reinsurance" are an "impermissible referral fee").

C. The Proposed Remedies Are Appropriate and Available

RESPA's Section 8 anti-kickback provision provides that "[t]he Bureau . . . may bring an action to enjoin violations. . . ." 12 U.S.C. § 2607(d)(4) (as amended).[8] In addition, Section 1055 of the Consumer Financial Protection Act (CFPA) explicitly provides for disgorgement and restitution, as well as non-money injunctive relief and other remedies, for violations of "Federal consumer financial law," defined to include the enumerated consumer laws such as RESPA. *See* CFPA, 12 U.S.C. § 5565(a)(2)(D)), § 5481(12)(M) (defining RESPA as an "enumerated consumer law").

[8] The Dodd-Frank Act amended this language to include "the Bureau;" beyond that change, no other changes were made to this language during the period relevant to the conduct at issue in this case.

Although the CFPA only recently codified the availability of remedies such as disgorgement and restitution for RESPA violations in any enforcement proceeding by the Bureau, these are not new forms of relief for RESPA violations because these remedies were previously available to the government (that is, HUD) under equitable principles.[9] Since the power to enjoin is an equitable one, a suit for an injunction by HUD would have invoked the full equitable powers of the court. *See Jackson v. Property I.D. Corp., et al.,* CV-07-3372-GHK (CWx) (C.D. Cal. Mar. 24, 2008) (opinion attached hereto as **Exhibit A**). In *Property I.D.*, the court held that the power to enjoin RESPA violations "calls forth the full equitable jurisdiction of this Court," "including a range of equitable relief, among which are disgorgement and accounting." *Property I.D.* at 3. Relying on the foundation of *Porter v. Warner Holding Co.*, 328 U.S. 395 (1946), the court concluded that "[u]nless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied." *Property I.D.* at 3 (quoting *Porter*, 328 U.S. at 398). In cases of public interest, "those equitable powers assume an even broader and more flexible character." *Id.* The court found that because nothing in RESPA "supports a negative inference about the availability of other equitable remedies in a suit brought by HUD," it would "not infer that Congress intended to exclude such remedies from § 2607 by failing to enumerate them." *Property I.D.* at 4. Instead, it determined that "Congress intended to invoke the full range of equitable remedies in § 2607," including disgorgement. *Property I.D.* at 4-5.

Where "federal courts had authority . . . to award [remedies] based upon equitable principles," a statute expressly providing for the same may be applied to conduct that occurred

[9] *See* March 13 Order, at 12 ("To the extent Enforcement seeks the same relief as was formerly available to HUD, Dodd Frank's expansion of the available adjudicatory forum to include the present forum affects only jurisdiction. It does not impair rights Respondents possessed when they acted, increase their liability for past conduct, or impose new duties with respect to transactions already completed.").

before the enactment of the statute. *Landgraf v. USI Film Products*, 511 U.S. 244, 277 (1994) (reviewing its decision in *Bradley v. School Bd. of Richmond,* 416 U.S. 696, 94 (1974) to authorize attorney's fees under a new statute, even for services rendered before the enactment of the law); *see also S.E.C. v. First Pacific Bancorp,* 142 F.3d 1186, 1193 n.8 (9th Cir. 1998), *cert. denied sub nom., Sands v. S.E.C.,* 525 U.S. 1121 (1999) (holding that the proposed remedy could be invoked without any impermissible retroactive effect, because the new law "merely codified the equitable authority to impose [an] officer and director bar which the courts already possessed and exercised.").

An injunction as well as ancillary equitable relief, such as in the form of disgorgement and restitution, are necessary in this case to protect the public interest and enforce Section 8 of RESPA against captive reinsurance schemes. There may well be no other available remedy to stop this conduct and deter others from repeating it in the future.

Civil money penalties are also available and appropriate in this matter. *See* 12 U.S.C. 5565(c).

IV. CONCLUSION

For all the reasons cited above, Enforcement Counsel respectfully request that this tribunal make appropriate findings of fact and order the requested relief.

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Respectfully submitted,

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Certificate of Service

I hereby certify that on this 19th day of March 2014, I caused a copy of the foregoing "Enforcement Counsel's Prehearing Brief" to be filed with the Office of Administrative Adjudication and served by electronic mail on the following persons who have consented to electronic service on behalf of Respondents:

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