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.

RESPONDENTS' POST-HEARING BRIEF

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INTRODUCTION

In 1997, the U.S. Department of Housing and Urban Development ("HUD") specifically reviewed the subject of captive mortgage reinsurance arrangements and concluded that such arrangements were permissible under Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607, provided certain criteria were met.[1] Now, seventeen years later, the Consumer Financial Protection Bureau ("CFPB" or the "Bureau") is challenging these very same arrangements under its new-found RESPA enforcement authority. But as the testimony – or lack thereof – has now revealed, Enforcement Counsel's case against Respondents is nothing more than an empty shell. Enforcement Counsel did not present any evidence that Respondents failed to comply with HUD's guidance regarding their captive mortgage reinsurance arrangements; rather, Enforcement Counsel embarked on an attempt to repudiate *sub silentio* HUD's prior guidance. Such an attempt cannot succeed, however, especially given that neither HUD nor the CFPB has publicly withdrawn HUD's prior guidance. Indeed, even today, the CFPB could seek to prohibit captive mortgage reinsurance arrangements pursuant to its authority under RESPA, but it has not done so. As a result, Enforcement Counsel's attempt to promulgate new rules through an enforcement action is inappropriate. Because Enforcement Counsel failed to demonstrate how or why Respondents failed to comply with the guidance issued by HUD in 1997, Respondents are entitled to judgment in their favor on the Notice of Charges ("NOC").

Since the filing of the NOC, Enforcement Counsel's case has shrunk considerably. On May 22, 2014, the Tribunal disposed of all claims arising out of mortgage loans originated before July 21, 2008. Order on Dispositive Motions dated May 22, 2014 ("May 22 Order"),

[1] Letter from Nicolas P. Retsinas, Assistant Secretary for Housing-Federal Housing Commissioner, to Sandor Samuels, General Counsel of Countrywide Funding Corporation (Aug. 6, 1997) ("HUD Letter") (copy attached to, *inter alia*, ECX 194).

Doc. 152, at 14. With respect to loans originated on or after July 21, 2008, the Tribunal set forth a number of elements to be proven by Enforcement Counsel in order to prevail on their allegations. Enforcement Counsel came up woefully short in proving those elements. After nine days of hearing testimony, Enforcement Counsel failed to proffer proof sufficient to support a finding that Respondents violated Section 8 of RESPA. Indeed, after identifying 30 witnesses for the hearing, Enforcement Counsel called only four individuals to testify and utilized the deposition transcript of a fifth witness. And while more than 800 exhibits were identified by Enforcement Counsel, only a small fraction were actually discussed at the hearing. As explained more fully below, none of the testimony presented by Enforcement Counsel at the hearing provides the proof the Tribunal requested as part of its May 22 Order.

Coupled with Enforcement Counsel's lack of proof is the fact that the only credible evidence presented at the hearing demonstrated that Respondents, in fact, had complied with HUD's guidance. Respondents offered proof that the premiums received were commensurate with the risk it assumed – as compared to the risk assumed by the mortgage insurers ("MIs") – which is the exact analysis HUD established back in 1997. By contrast, Enforcement Counsel's only witness on this topic, their expert, Dr. Mark Crawshaw, could not opine on the issue of commensurate compensation because he valued the reinsurance as worthless. Dr. Crawshaw's position is belied, however, by every accounting firm which reviewed Respondents' financial statements, as well as the financial statements of every MI which had a reinsurance arrangement with Atrium, and indeed, by the CFPB itself when it permitted the MIs to continue accounting for such arrangements as reinsurance as part of its settlements with the MIs pursuant to the Florida consent orders.

Further, Enforcement Counsel did not demonstrate – indeed, they made no effort to demonstrate – that injunctive relief is appropriate. Respondents have repeatedly pointed out that the NOC contains no allegation of possible future conduct. Given the fact that the last loans Respondents placed into a reinsurance book were originated in 2009, or more than 18 months before the CFPB came into existence, no such demonstration could be made. And disgorgement is not even available here because, as explained below, the Tribunal lacks inherent authority to recommend such relief. In any event, the premiums received on the two remaining books of business with Genworth and UGI were paid back in the form of compensation for future expected claims as part of the commutation of those two arrangements.

Enforcement Counsel's entire case rested simply on two facts: (1) PHH Mortgage's and PHH Home Loans' ability to select the MI if the borrower elected not to select a provider; and (2) the existence of reinsurance agreements pursuant to which the MI would cede to Atrium a portion of the borrower's premium in exchange for Atrium's providing insurance coverage for a band of losses. Such facts are inconsequential, however, in light of HUD's specific acknowledgment that a captive reinsurance arrangement 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. HUD specifically allowed lenders to enter into such arrangements "so long as the payments for reinsurance under captive reinsurance arrangements are solely 'payment for goods or facilities actually furnished or for services actually performed.'" *Id.* (citing RESPA § 8(c)(2)). Simply stated, Enforcement Counsel failed to demonstrate that a service, *i.e.*, reinsurance, was not provided – because it was – or that the ceded premium was not reasonable in light of the value of the service/facility provided.

ARGUMENT

Respondents[2] disagree with several of the Tribunal's determinations in its May 22 Order regarding whether certain "elements" of a RESPA Section 8(a) and/or 8(b) violation were established as of that date. Nonetheless, Enforcement Counsel failed to proffer any evidence to support even those few remaining elements identified by the Tribunal as necessary to support a RESPA Section 8 violation. Prior to discussing those issues, however, Respondents urge the Tribunal to recognize that its interpretation of RESPA, a statute with both criminal and civil liability, is subject to the rule of lenity. Moreover, given the potential for criminal liability under RESPA, the burden of proof falls on Enforcement Counsel, not Respondents. Further, Respondents ask that the Tribunal acknowledge the undisputed testimony regarding the reasons why MIs and lenders, including Respondents PHH Mortgage and PHH Home Loans, have an interest in entering into captive reinsurance arrangements and the benefits each of them receive. In addition to this Brief, Respondents incorporate by reference the attached Proposed Findings of Fact (attached hereto as Addendum A), which were established through testimony and exhibits at the hearing in this matter.

I. THE RULE OF LENITY APPLIES TO RESPA SECTION 8 CLAIMS

In spite of Respondents' repeated raising of the rule of lenity, neither the Tribunal, nor Enforcement Counsel have addressed – or even responded to – this argument. Now that the record is closed, and this matter is before the Tribunal for a recommended decision, the issue can no longer be ignored. Where a statute "'has both criminal and noncriminal applications' . . . 'the

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[2] The Respondents are PHH Corporation, PHH Mortgage Corporation ("PHH Mortgage"), PHH Home Loans, LLC ("PHH Home Loans"), Atrium Insurance Corporation, and Atrium Reinsurance Corporation. PHH Mortgage and PHH Home Loans are referred to herein as the "Lender Respondents." Unless otherwise specified, all references to "Atrium" mean both Atrium Insurance Corporation and Atrium Reinsurance Corporation ("Atrium Re").

rule of lenity applies,'" and requires either a court or this Tribunal to "'interpret any ambiguity in the statute in [defendant's] favor.'" *Rodriguez v. Holder*, 705 F.3d 207, 213 (5th Cir. 2013) (quoting *Leocal v. Ashcroft*, 543 U.S. 1, 11 n.8 (2004)). RESPA Section 8 carries with it potential criminal penalties, in addition to civil penalties. 12 U.S.C. § 2607(d)(1) (setting forth criminal penalties, including up to one year in prison). Thus, "'[w]hen a choice has to be made between two readings of what conduct Congress has made a crime, it is appropriate, before we choose the harsher alternative, to require that Congress should have spoken in language that is clear and definite.'" *United States v. Hilton*, 701 F.3d 959, 968 (4th Cir. 2012) (quoting *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 221-22 (1952)).

The fact that the CFPB has no authority to bring a criminal action is of no consequence. The Tribunal must still consider the application of RESPA Section 8 in the criminal context because "[a] single statute with civil and criminal [penalties] receives a single interpretation." *Carter v. Welles-Bowen Realty, Inc.,* 736 F.3d 722, 727 (6th Cir. 2013) (citing *Leocal*, 543 U.S. at 11 n.8). This "bedrock principle" of law requires fair notice of what actions might be deemed crimes. *Id.* (citing *McBoyle v. United States*, 283 U.S. 25, 27 (1931)). The principles of the rule of lenity further apply to all fact-finders, whether it be a court or an administrative agency. *Id.* at 731 ("Rules of interpretation bind *all* interpreters, administrative agencies included. That means an agency, no less than a court, must interpret a doubtful criminal statute in favor of the defendant.") (emphasis in original) (Sutton, J., concurring).

The rule of lenity requires the Tribunal to resolve any statutory ambiguity in favor of Respondents – not against them – and this is a death knell to Enforcement Counsel's case. While Enforcement Counsel contends that captive mortgage reinsurance arrangements violate RESPA Section 8, in 1997, HUD – the agency with statutory authority to investigate and enforce RESPA

– issued an interpretation that specifically permitted the establishment of such arrangements, *i.e.*, the HUD Letter. HUD permitted captive reinsurance arrangements to continue for more than 14 years, during which time HUD had full authority to investigate them. At no time did HUD withdraw its conclusion that captive mortgage reinsurance arrangements were permissible under RESPA. It was only after the CFPB came into existence – and long after the last of Atrium's arrangements were placed into runoff – that an action challenging captive mortgage reinsurance arrangements was brought. As the evidence now shows, however, the CFPB's action is premised on nothing more than the mere existence of the arrangements. Enforcement Counsel failed to show that Respondents violated the HUD Letter – an interpretation that has never been withdrawn or even modified by the CFPB. Accordingly, Respondents are entitled to a recommended decision in their favor. Otherwise, any entity that followed HUD's guidance would be potentially subject to criminal penalties without receiving fair notice of what actions may be deemed crimes. Such a result fails this bedrock principle of American jurisprudence. *United States v. Santos*, 553 U.S. 507, 514 (2008) (noting the "fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed").

II. ENFORCEMENT COUNSEL HAVE THE BURDEN OF PROOF ON ALL ELEMENTS OF A RESPA SECTION 8 CLAIM INCLUDING PROVING THAT THE SECTION 8(c)(2) SAFE HARBOR DOES NOT APPLY

The Tribunal previously concluded that the safe harbor contained in RESPA Section 8(c)(2) is "an affirmative defense" and that "Respondents bear the burden of proving it." May 22 Order at 4. Even assuming that the Section 8(c)(2) safe harbor was construed as an affirmative defense – a point Respondents do not concede – the Tribunal's conclusion that

Respondents have the burden of proof is not correct in light of RESPA's potential criminal penalties.

As discussed in the preceding section, regardless of the Bureau's pursuit of civil remedies only, RESPA is both a civil and criminal statute and, as such, it "receives a single interpretation." Further, given the potential for criminal penalties, RESPA must be interpreted in accordance with due process principles. A criminal defendant does generally bear the burden of proof for any affirmative defense that seeks to justify or excuse a violation of law; however, where the affirmative defense *negates* an element of the crime, the burden of proof stays with the government. *Smith v. United States*, 133 S. Ct. 714, 719 (2013) (stating that the government may not shift the burden of proof to the defendant "when an affirmative defense *does* negate an element of the crime") (internal quotation marks and citation omitted). *See also United States v. Leal-Cruz*, 431 F.3d 667, 671 (9th Cir. 2005) ("[W]e conclude that the Due Process Clause forbids shifting the burden of proof to the defendant on an issue only where establishing the defense would necessarily negate an element that the prosecution must prove beyond a reasonable doubt . . . ."); *United States v. Brown*, 367 F.3d 549, 556 (6th Cir. 2004) ("[I]f an affirmative defense bears a necessary relationship to an element of the charged offense, the burden of proof does not shift to defendant."); *United States v. Dodd*, 225 F.3d 340, 344 (3d Cir. 2000) ("[T]he Due Process Clause requires the government to prove all elements of the charged offense beyond a reasonable doubt, and therefore requires the government to disprove beyond a reasonable doubt any defenses that negate an element of the charged offense . . . ."); *United States v. Deleveaux*, 205 F.3d 1292, 1298 (11th Cir. 2000) ("The burden to prove or disprove an element of the offense may not be shifted to the defendant. Thus, if a defendant asserts a defense that has the effect of negating any element of the offense, the prosecution must disprove that

defense beyond a reasonable doubt." (citations omitted)); *United States v. Unser*, 165 F.3d 755, 764 (10th Cir. 1999) ("[W]hen evidence has been produced of a defense which, if accepted by the trier of fact, would negate an element of the offense, the government must bear the ultimate burden of persuasion on that element, including disproving the defense.").

In *United States v. Kloess*, 251 F.3d 941 (11th Cir. 2001), the Eleventh Circuit was faced with analyzing a statute analogous to RESPA. In *Kloess*, the attorney defendant was charged with obstruction of justice in violation of 18 U.S.C. § 1512(b)(3) in connection with his representation of a client. Like RESPA, the federal obstruction of justice statute contains a "safe harbor" which provides that: "This chapter does not prohibit or punish the providing of lawful, bona fide, legal representation services in connection with or anticipation of an official proceeding." 18 U.S.C. § 1515(c). The attorney defendant moved to dismiss the indictment, contending that the government had the burden of pleading and proving that his conduct was not protected by the safe harbor. On appeal, the Eleventh Circuit rejected the defendant's challenge and concluded that the safe harbor provision was not an element of the crime but rather an affirmative defense that needed to be raised by the defendant. The Eleventh Circuit did not stop there, however:

> The parties [] have briefed and argued this appeal as though resolution of the burden of pleading also resolves the issue of the burden of proof. We do not agree. The proper resolution of the burden of proof requires an additional inquiry into the sort of defense which is provided by Section 1515(c).

Kloess, 251 F.3d at 947 (footnote omitted). Upon examining the safe harbor defense, the court discussed the consensus among the courts that "[a]ny defense which tends to negate an *element* of the crime charged, sufficiently raised by the defendant, must be *disproved* by the government." *Id.* at 947 (citations omitted). The Eleventh Circuit went on to explain that in order to convict under the obstruction of justice statute, the government must prove the

defendant acted with an improper purpose. The court concluded, however, that the safe harbor negates this element of the offense:

> Section 1515(c) provides a complete defense to the statute because one who is performing bona fide legal representation does not have an improper purpose. His purpose -- to zealously represent his client -- is fully protected by the law. Section 1515(c), therefore, constitutes an affirmative defense which negates an element of the offense stated in Section 1512(b)(3).

Id. at 948.

According to the Eleventh Circuit, once a defendant raises the safe harbor defense, "the government must undertake to prove its case, including the requisite improper purpose, by adducing evidence that the charged conduct did not constitute lawful, bona fide representation." *Id.* at 949.

As it relates to this matter, like *Kloess*, the Tribunal has construed RESPA's Section 8(c)(2) safe harbor as an affirmative defense. Unlike *Kloess*, however, in determining the burden of proof for the RESPA safe harbor, the Tribunal found that Respondents must "prove that the entirety of the premiums ceded to Atrium or Atrium [Re] . . . bore a reasonable relationship to the market value of any reinsurance provided – that is, the premiums in their entirety were bona fide payments for services actually performed – then they have a complete defense to the Notice's allegations under both Sections 8(a) and 8(b) of RESPA." May 22 Order at 7. The Tribunal's conclusion is incorrect and cannot be squared with fundamental notions of due process.

First, the CFPB's own regulations make clear that Enforcement Counsel bear the burden of proof. *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."). Second, the safe harbor provided in RESPA Section 8(c)(2) "constitutes an affirmative defense which negates an element of the

offense[s] stated in Section [8(a) and 8(b)]." *Kloess*, 251 F.3d 948. Specifically, 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); *see also* Regulation X, 12 C.F.R. § 1024.14(g)(1)(iv). As the Tribunal has acknowledged, if the premiums ceded to Atrium "in their entirety were bona fide payments for services actually performed – then [Respondents] have a complete defense to the Notice's allegations under both Sections 8(a) and 8(b) of RESPA." May 22 Order at 7. Accordingly, because the RESPA Section 8(c)(2) safe harbor provides a complete defense to an alleged Section 8(a) or 8(b) violation, it is Enforcement Counsel – not Respondents – who have the burden of demonstrating that the 25% cede to Atrium "bears no reasonable relationship to the market value of the goods or services provided." Indeed, the Tribunal cited with approval the decision in *Edwards v. First American Corp.,* No. CV 07-3796, 2012 U.S. Dist. LEXIS 185448 (C.D. Cal. Nov. 30 2012), for this exact proposition – that under Regulation X, the "plaintiff 'must demonstrate that Defendants overpaid.'" May 22 Order at 6 (quoting *Edwards*, 2012 U.S. Dist. LEXIS 185448 at *10). *See also* HUD Letter at 3 (there is a violation of Section 8 where "reinsurance services are not actually performed or in which the payments to the reinsurer are not bona fide and exceed the value of the reinsurance"). To hold otherwise places the burden of disproving potential criminal conduct on Respondents, a conclusion that is completely inimical to our system of justice.

While Respondents vehemently disagree with the Tribunal's conclusion that they, not the Bureau, have the burden of proof on the Section 8(c)(2) safe harbor, that disagreement is of no moment given that Respondents unquestionably have met that burden.[3]

III. ENFORCEMENT COUNSEL IGNORE THE BENEFITS OF REINSURANCE

Under Enforcement Counsel's theory of RESPA, no excess-of-loss reinsurance arrangement could ever pass muster. That is so because Enforcement Counsel believes the "value" of the reinsurance was zero; accordingly, any time one of the MIs with which Atrium had a reinsurance agreement was selected to provide private mortgage insurance ("pmi"), a RESPA violation occurred. Enforcement Counsel's simplistic analysis ignores reality as well as the benefits of reinsurance to both the MI and the lender.

First, the undisputed evidence is that it was the policy and practice of the Respondent Lenders, PHH Mortgage and PHH Home Loans, to provide an affiliated business disclosure to borrowers on loans they originated. Hearing Tr. 118-19 (Rosenthal explaining that PHH "permit[s] borrowers to pick their own mortgage insurance companies."). That disclosure provided, among other things, notice to the borrowers that there may be reinsurance in connection with the pmi that was required on their loans and that they could shop around and select their own MI. Thus, the lender's selection of an MI occurred only after the borrowers elected not to select their own provider.

Second, mortgage guaranty insurance is "a catastrophic line of business." Hearing Tr. 2142 (Walker). As Mr. Walker explained, in the "majority of years" the MI "earns a lot of

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[3] While the Tribunal's decision to place this burden of proof on Respondents is fundamentally at odds with due process, not to mention the plain language of RESPA Section 8 and the Bureau's own regulations, even if the Tribunal continues to interpret the burden of proof as belonging to Respondents, Respondents have met this burden since they were the only party to put on relevant and credible evidence of the value of the reinsurance services provided.

money. We have very high margins in our business and we make a lot of profit." *Id.* However, during the period from 2006 through 2010, "the housing market in the United States had an unprecedented collapse not see since the 1930s." *Id.* at 2143. That collapse led to significant defaults in the primary insurance industry and, as Mr. Walker testified, "nearly all of [UGI's reinsurers] ran on very significant losses." *Id.* The testimony adduced at trial demonstrated the substantial benefits of reinsurance to both the MI and the lender. Most significant of those benefits is the alignment of the interests of the MI and the lender, or "skin in the game." *Id.* at 342 (Mr. Culver testified that the captive arrangement incentivized "a lender to do better business, . . . because they're going to share in the losses of it."); *id.* at 2130-31 (Mr. Walker explaining that UGI believed it "was a good thing for lenders to have – I use the term 'skin in the game,' to have some portion of the mortgage guarantee risk."). By putting the lender at risk of loss – through its affiliated reinsurer – the lender had an additional incentive to originate quality loans. *See also* ECX 194 ("Milliman has also concluded that the reinsurance program provides a way of increasing the management of risk by providing the lender with an incentive for better loan originations."); Hearing Tr. 452 (Rosenthal stating: "We wanted to make sure we were doing a very good job underwriting and creating the loans, they were good loans, adherent loans that complied with all of the underwriting guidelines."); ECX 153 (Deposition Transcript of Mark Danahy ("Danahy Tr.) at 200 ("Atrium can reinsure that business, largely because they know who the originator is so you have a high degree of comfort in terms of the quality; and, again, organizationally the goals of the businesses are aligned. So it kind of made a lot of sense that way.").

Further, by purchasing reinsurance, the MIs could smooth their financial results by reducing the volatility of their earnings. *See, e.g.,* RCX 816 (captive reinsurance was

"commonly used by mortgage insurers in the past to stabilize claims experience and protect against catastrophic losses"); Hearing Tr. 802 (Crawshaw: "I think business entities like to reduce volatility."); ECX 653 at 18-20 (demonstrating how reinsurance "significantly reduces the volatility of the loss ratio"). These benefits were attested to by witnesses who worked in the industry. Specifically, Messrs. Rosenthal, Culver, and Walker all attested to the benefits of reinsurance. Mr. Culver, the Chairman and CEO of MGIC Investment Corporation, and Mr. Walker, the former Chief Risk Officer of UGI, both testified that the reinsurance arrangements saved their respective companies during the recent financial crisis – a crisis that resulted in three other MIs going into receivership. *See, e.g.*, Hearing Tr. 398-99 (Mr. Culver testifying that the $900 million in reinsurance reimbursements "was very important to saving the company."); *id.* at 419 (Mr. Culver admitting that he and his Company were "wrong on the risk outlook" and that MGIC's captive reinsurance arrangements "ended up being a blessing. They helped save the company."); *id.* at 2153-6 (Walker explaining how UGI lost "in the neighborhood of two or three billion dollars" and that the Company had "in the order of 1.2, 1.4 billion of funds in the trust accounts" which could count as "ceded reserve" which helped UGI's surplus during that time).

Reinsurance also provided relief to the MIs in terms of required capital to be held. Hearing Tr. 341. As Mr. Culver explained, MGIC had so much capital that it was buying back its own stock, so it was not interested in entering into reinsurance agreements for capital relief. Hearing Tr. 339-40.[4] The fact that MGIC was not interested in such a benefit does not mean,

[4] Mr. Culver also testified that MGIC was not interested in reinsurance arrangements in general because MGIC was of the opinion that the risks of losses were such that it was unlikely the reinsurance layers would be penetrated. Hearing Tr. 339 ("we didn't think the lender would ever get into their layer of the captive"), *id.* at 361 ("we felt we would never get into the lender's layer or tier"). That analysis ultimately proved incorrect when the financial crisis hit. *Id.* at 398 (MGIC collected $900 million in reinsurance payments). Enforcement Counsel sought to make much of Mr. Culver's testimony regarding MGIC's temporary decision not to offer "deep cede"

however, that other MIs were not interested in obtaining the capital relief that a reinsurance arrangement would provide. Mr. Walker confirmed this benefit during his testimony. *See id.* at 2132-3 (Walker explaining that reinsurance reduces the MI's capital requirement); *id.* at 2160-2 (Walker explaining how the contingency reserve in the trust account allows the primary insurer to take credit and frees up its capital for other uses).

In addition, reinsurance lessens the volatility of the primary insurer's loss ratios, as demonstrated by the Milliman Report for the Genworth 2008B book. *See* Hearing Tr. 1877-78 (Schmitz); ECX 194 at 17-18.

Third, the evidence adduced at the hearing demonstrated simply that, first and foremost, the Lender Respondents' primary interest is, and always has been, originating high quality mortgage loans for qualified borrowers. As a result, the Lender Respondents needed to ensure that there were an adequate number of MIs that covered the available array of loan products being offered. Thereafter, the Lender Respondents' interests were in working with MIs which had: a broad array of products; a history of good customer service; solid financial footing, *e.g.*, little counter-party risk; and the ability to communicate electronically in terms of ordering and placing pmi.

Enforcement Counsel did not put on a shred of evidence from anyone in the industry disputing these benefits. Rather, Enforcement Counsel's entire case was based upon the testimony of their expert witness, Dr. Crawshaw, who never worked in the mortgage industry,

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reinsurance structures for a period of time, and the resulting loss of business as a result of that decision. That testimony is irrelevant to this proceeding because, as Mr. Culver testified, the efforts to take MGIC's market share were by Radian and PMI. *Id.* at 368. MGIC did not do much business with the Lender Respondents because, according to Mr. Culver, "they were satisfied with their current providers." *Id.* at 379-80. Mr. Culver also made clear that no one ever told him that the Lender Respondents would not do business unless MGIC offered a deep cede captive arrangement. *Id.* at 387-88.

never purchased reinsurance for any company, never had to answer to shareholders, and whose only relevant experience was as an consultant/expert witness. See Hearing Tr. 597 (Crawshaw stating: "I've worked in the consulting field."); *id.* at 598 (Crawshaw stating: "I mean, my entire working life as an actuary has been in a capac – as working for a consulting firm."); *id.* at 599 ("[M]y entire professional career has been as a consultant."). In short, Enforcement Counsel could not find a single fact witness who actually worked in the mortgage industry to take issue with the positive benefits of the reinsurance arrangements.

As the HUD Letter makes clear, the determination of whether there is a "real transfer of risk" can be demonstrated for an excess-of-loss arrangement "if the band of the reinsurer's potential exposure is such that a reasonable business justification would motivate a decision to reinsure that band." HUD Letter at 6. The fact witnesses presented at the hearing universally attested to the various business justifications of obtaining excess-of-loss reinsurance in an arrangement with a lender. That testimony stands unrefuted.

Finally, while Respondents stand behind the 40% cede structures that were in place for the bulk of the period of time during which Atrium had such arrangements, pursuant to the terms of the May 22 Order, only the 25% cede arrangements are at issue in this proceeding. As a result, Enforcement Counsel's case became even weaker because, to the extent he discussed such arrangements in his testimony and expert reports, Dr. Crawshaw appears not to take issue with such structures. Specifically, in his Rebuttal Report, Dr. Crawshaw cites with approval a 1997 letter from the North Carolina and Wisconsin insurance regulators stating that it would be "imprudent" to allow captive mortgage reinsurance arrangements above the 25% cede. Crawshaw Rebuttal Report at 115-6. *See also* Hearing Tr. 855-56 (Question to Dr. Crawshaw: "Did you do any analysis of any 5/5/25 reinsurance structure?" Answer: "No." Dr. Crawshaw

then "retracted" that answer and asserted that the "same principles and analysis" of the 4/10/40 structures "would apply to the 5/5/25.").

The one industry fact witness called by Enforcement Counsel, Mr. Culver, testified that MGIC sought to limit such structures to a 25% cede. Hearing Tr. 340; *id.* at 342 [redacted]

[redacted]

[redacted]

[redacted]"). The 25% cede was, and remains, acceptable to Freddie Mac, the government-sponsored enterprise ("GSE") that purchased loans from the Lender Respondents.

Enforcement Counsel spent an inordinate amount of time at the Hearing berating Mr. Rosenthal over emails related to the 2006 request for proposals (none of which ever resulted in a captive arrangement, *see* Hearing Tr. 576) which included the term "leverage" in an apparent effort to demonstrate nefarious conduct on the part of Respondents.[5] Mr. Rosenthal's hearing testimony bears repeating: in negotiating with the sophisticated MIs, the Lender Respondents were interested in remaining "profitable," and they were seeking the "best economic deal possible" that was compliant with RESPA. Hearing Tr. 128, 271-72 (Rosenthal).[6] As the NOC makes plain, the Bureau has declared that it is illegal to have a reinsurance arrangement that results in a profit. *See* NOC ¶ 67 ("In its eighteen years of existence as a captive between 1995 and 2013, Atrium never paid claims or made any other payments to MIs that exceeded the then-

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[5] *See also* Hearing Tr. 488 (Rosenthal reading from a June 2008 email (ECX 485) "Agreed, Relatively low rates and captive eligible are likely required to play, and we want to play."). This email was in connection with MGIC's proposed captive reinsurance arrangement, which was never entered into.

[6] Similarly, the hearing testimony leaves no doubt that the MIs certainly were looking after their own self interests by, for example, offering only products that they deemed to provide "reasonable returns." Hearing Tr. 329-30 (MGIC did not offer single premium programs because it did not believe the returns were "reasonable").

available funds in the applicable captive trusts."). Enforcement Counsel's attempt to evaluate reinsurance agreements retrospectively rather than prospectively is without merit. Further, now that the case has been limited to loans originated on or after July 21, 2008, Enforcement Counsel's historical facts are of no legal significance where, as here, it is undisputed that Atrium would suffer losses on the 2008B Genworth and the 2009 UGI books.

IV. THE CMG AND RADIAN AGREEMENTS ARE NOT AT ISSUE

In its May 22 Order, the Tribunal limited Enforcement Counsel's case to mortgage loans that closed on or after July 21, 2008. It is undisputed that there were no loans originated after that date that were placed into the Radian reinsurance book. Accordingly, the Radian reinsurance arrangement is not at issue in this litigation.

With respect to the CMG agreement, there were approximately 106 loans originated on or after July 21, 2008 that were placed into the CMG reinsurance book. RCX 849.[7] The CMG arrangement was placed into runoff as of December 31, 2008. As the May 22 Order makes plain, the only relief "presumptively" available for loans originated between July 21, 2008 and July 21, 2011 is "disgorgement, restitution, and an injunction." May 22 Order at 14. However, in no event would such equitable relief be appropriate in connection with either the CMG or Radian agreements because Atrium returned all of the premiums it received long before the CFPB came into existence and long before the Bureau filed this enforcement action. Further, the record is completely barren of any evidence that an injunction is warranted with respect to any reinsurance arrangement, and even more so with respect to the Radian and CMG arrangements, as they were terminated through a complete return of all premiums.

[7] Respondents included 36% of the loans listed on RCX 849 for the month of July 2008, which accounts for the 11 days in that month on or after July 21, 2008. In addition, one loan was added to the CMG book in January 2009.

Enforcement Counsel failed to meet their burden of demonstrating the appropriateness of granting any relief in connection with the Radian or CMG agreements. Enforcement Counsel did not call a single witness from either Radian or CMG, despite including three such witnesses on their witness list. Having failed to carry their required burden of proof, the Tribunal should recommend a decision in favor of Respondents on the Radian and CMG reinsurance arrangements. *See* 12 C.F.R. § 1081.303(a) (stating that Enforcement counsel bears "the burden of proof of the ultimate issue(s) of the Bureau's claims at the hearing.").

V. THE CFPB FAILED TO DEMONSTRATE A RESPA SECTION 8(a) VIOLATION

RESPA Sections 8(a) provides as follows:

> (a) Business referrals
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> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

12 U.S.C. § 2607(a). Thus, a violation of Section 8(a) involves three elements: (1) a payment or thing of value; (2) given and received pursuant to an agreement to refer settlement business; and (3) an actual referral. *Galiano v. Fid. Nat'l Title Ins. Co*., 684 F.3d 309, 314 (2d Cir. 2012); *see also Egerer v. Woodland Realty, Inc*., 556 F.3d 415, 427 (6th Cir. 2009).[8]

In its May 22 Order, the Tribunal found that the first element was undisputed, that there was a genuine issue of material fact with respect to the second element, and that the third element had been proven. May 22 Order at 15-16. The Tribunal's conclusion regarding the third element – an actual referral – is incorrect and unsupported by the evidence. As to the second

[8] The Tribunal identified a fourth element, that the underlying loan be a "federally related mortgage loan" as defined by RESPA. May 22 Order at 15. For purposes of this adjudication, Respondents do not contest the Tribunal's conclusion that "at least some loans were federally related mortgage loans." *Id.* at n.7.

element – the existence of an agreement to refer business – Enforcement Counsel failed to prove its case.

A. The Evidence Does Not Support the Conclusion That There Was an Actual Referral

With respect to the third element, the existence of an actual "referral," the Tribunal's conclusion that there was "evidence . . . that Respondents exercised veto power over the selection of an MI," was based upon the testimony of Curt Culver, MGIC Investment's Chairman and CEO. May 22 Order at 15. Respondents disagree that such a statement – from the CEO of an entity that did not have a reinsurance arrangement with Atrium and admittedly did very little business with the Lender Respondents – is evidence of anything. Indeed, Mr. Culver undercut his own statement by noting that his supposition was "probably" true. Further, when directly asked by Respondents' counsel, Mr. Culver stated that he was not aware if PHH ever actually rejected a borrower's request for a particular MI provider. Hearing Tr. 385-86.[9]

Indeed, the hearing record is barren of any evidence that the Lender Respondents denied anyone's request for a different MI provider. Enforcement Counsel never bothered to ask Mr. Rosenthal that particular question, despite his being on the stand on three different days. Nor did Enforcement Counsel bother to call any other witness or employee of Respondents to ascertain whether, in fact, a borrower's request for a different MI provider was "vetoed." Given the dearth of evidence from anyone who was actually in a position to know whether the Lender Respondents exercised such a "veto" power, the undisputed evidence is that the affiliated

[9] The Tribunal's rejection of Mr. Culver's denial of any specific knowledge of Respondents' operations, and more specifically how the Lender Respondents would have handled a request by a borrower to select MGIC as his or her MI in favor of Mr. Culver's statement of what was "probably" true is disheartening. There was no basis to credit the statement once Mr. Culver stated he had no specific knowledge. Further, Enforcement Counsel never asked Mr. Rosenthal this question, nor did they elicit testimony from any other witnesses that appeared at the hearing or call any other witnesses on this particular issue.

business disclosure was provided to borrowers and they had the opportunity to select a different MI.

The Tribunal further states that "the existence of the dialer alone is sufficient" to "prove" the existence of a referral.[10] Again, this finding is clearly erroneous and reflects a fundamental misunderstanding of the purpose of the dialer, which is simply an automated system to allocate business among the MIs with which the Lender Respondents wished to conduct business, regardless of whether a reinsurance agreement existed. *See, e.g.*, Hearing Tr. 106-09 (Rosenthal: the purpose of the dialer is to ensure that the retail loan "adheres to all the eligibility criteria that exists and is checked against all those rules and you have good processes that are efficient to order those mortgage insurance certificates to make sure you don't damage the loan"); *id.* at 475-6 (Rosenthal explaining how "each different MI provider started changing their opinion of where they saw the highest risk" and "everybody had their own list . . . we had to get our machine to take all these different lists"). Before the dialer was utilized, the Lender Respondents provided borrowers the opportunity to select a different MI. Under the Tribunal's analysis, any selection of an MI by the Lender Respondents was a "referral" within the meaning of Section 8(a), including the selection of an MI without a reinsurance arrangement with Atrium. As the Tribunal notes, "starting around August 2008" the Lender Respondents made "referrals to MIs lacking captive arrangements." The Tribunal's characterization of every selection of an MI

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[10] Enforcement Counsel did not call a single witness to testify regarding the basis for the dialer settings. As Mr. Rosenthal testified, those decisions were made by the "MI summit group" at PHH based on the MI relationships, but Mr. Rosenthal was not part of that group. Hearing Tr. 552-3. Enforcement Counsel questioned Mr. Rosenthal repeatedly about the dialer settings. For example, Enforcement Counsel asked for Mr. Rosenthal's interpretation of Mr. Bradfield's statement that he would "prefer to max ugi b/c of captive." While Mr. Rosenthal agreed with Enforcement Counsel's reading of the email, it is of no consequence when taken in context. At the time the email was written, May 19, 2009, UGI was at 100% in the dialer. After the email, UGI was reduced to 90%, and within a month, it was down to 70%, and three months later it was down to 40%. *See* RCX 848.

provider as a "referral" within the meaning of Section 8(a) cannot be squared with the HUD Letter's specific recognition that the existence of a captive reinsurance arrangement 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 (emphasis added). Clearly HUD, the agency responsible for RESPA during the relevant time period, did not characterize the "selection" of the MI under such circumstances as a Section 8(a) "referral," and neither should the Tribunal.

The Tribunal's finding that the Lender Respondents' decision not to do business with certain MIs "bolsters" the conclusion that a "referral" under Section 8(a) occurred is curious. May 22 Order at 16. Both Mr. Rosenthal and Mr. Danahy testified that the financial strength of the MI was a significant factor for the Lender Respondents. *See, e.g.,* Hearing Tr. 108-9 (Rosenthal); Deposition of M. Danahy (ECX 153) at 197. Thus, it makes sense that the Lender Respondents did little, if any, business with three particular MIs: The PMI Group ("PMI"), Republic Mortgage Insurance Company ("RMIC")[11] and Triad Guaranty Insurance Corporation ("Triad"). *See* NOC ¶¶ 52-54. The Lender Respondents' decisions were justified as each of these three MIs went into some form of conservatorship as a result of the financial crisis. *See* Hearing Tr. 327 (Mr. Culver noting that PMI, RMIC and Triad no longer write business). Specifically, on December 11, 2012, the Illinois Department of Insurance placed Triad in rehabilitation under which insured parties were to receive only a portion of the claim payment.[12] On October 20, 2011, the Director of the Arizona Department of Insurance took control of PMI

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[11] The Lender Respondents did utilize RMIC on their retail loans for pmi starting around July 2009. RCX 849. Atrium never had a captive arrangement with RMIC. *See* Hearing Tr. 118.

[12] *See* Triad Home Page, available at: http://www.tgic.com/ (last visited July 29, 2014).

and again the result was the institution of a partial claim payment process.[13] On January 19, 2012, the North Carolina Commissioner of Insurance placed RMIC under regulatory supervision "because the Commissioner has reasonable cause to believe that RMIC is in such a condition as to render the continuation of its business hazardous to the public or to holders of its policies or certificates of insurance."[14] Pursuant to its Corrective Plan, RMIC was paying 50% of claim payments, which amount was subsequently increased to 60% retroactive to January 19, 2012. The fact of the matter is that the Lender Respondents were fortunate not to have utilized any of these three MIs to a greater extent than they did because they, or their investors, would have suffered more significant losses as a result of their failure to pay claims. It is unclear how the Lender Respondents' decision not to partner with MIs that ultimately failed "bolsters" a finding that "referrals" were being made. The Lender Respondents should have the right to select MIs on the basis of their individual financially stability, *i.e.*, ability to pay.

By attempting to highlight Lender Respondents' decision not to do business with every possible MI, the Tribunal's apparent position is that RESPA limits a lender's decision to partner with specific MIs. RESPA has not been – and cannot be – interpreted to obligate a lender to conduct business with specific MIs. To hold otherwise would force a lender such as PHH Mortgage to deal with an MI that provided poor customer service or that refused to properly process claims. Neither RESPA, nor any other statute, has been interpreted to require two independent companies to enter into a business relationship under such circumstances.

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[13] *See* PMI Home Page, available at http://www.pmi-us.com/ (last visited July 29, 2014).

[14] Commissioner's Summary Order dated January 19, 2012, available at: http://www.rmic.com/ratesguides/releasenotes/Documents/NCDOI-Summary-Order.pdf (last visited July 29, 2014).

B. The Evidence Does Not Demonstrate an Agreement to Refer

In its May 22 Order, the Tribunal held that there was still a genuine issue of material fact with regard to the second element of Section 8(a) – the existence of an agreement to refer real estate settlement business. May 22 Order at 16. As detailed below, Enforcement Counsel utterly failed to adduce any evidence of such an "agreement."

As an initial matter, for the reasons discussed above, Respondents take issue with the Tribunal's characterization of every selection of an MI by the Lender Respondents as a "referral." Further, despite the unrefuted testimony of Mr. Rosenthal that the decision to partner with a particular MI is based on a panoply of factors, including customer service, claims paying ability, breadth of product eligibility and their ability to communicate electronically, such considerations were simply ignored by the Tribunal in its May 22 Order. *See* Hearing Tr. 108-109 (Rosenthal: "We took a look a[t] a broad perspective of every mortgage insurer with whom we do business" including counterparty strength, willingness to pay claims, automated systems, and "a good breadth of product eligibility."); *id.* at 569-75 (Rosenthal explaining the factors the Lender Respondents were looking for in partnering with an MI including financial strength, efficient processing of claims, economic and market expertise, technology, training products, and ancillary services). Such a blind eye to these significant factors ignores the plain reality of the lending process. First and foremost, the Lender Respondents' primary interest has always been originating high quality mortgage loans for qualified borrowers. As a result, the Lender Respondents need to ensure that there are an adequate number of MIs that cover the available array of loan products being offered. Thereafter, the Lender Respondents' interests are in working with the MIs with which they have a good relationship and which offer the products and services the lenders need to originate loans.

In its May 22 Order, the Tribunal draws unsubstantiated conclusions from documents indicating the selection of MIs at different points in time. At the outset, any evidence of such selections prior to July 21, 2008, is irrelevant, as the Tribunal has already found that only loans originated after July 21, 2008, are actionable.[15]

At no time did the Lender Respondents inhibit or otherwise curtail their lending practices for the purpose of "driving" borrowers to an MI with which Atrium had a reinsurance agreement. Rather, the facts demonstrate that, for example, the Lender Respondents included MGIC, an entity that never had a reinsurance arrangement with Atrium, as one of the MI providers it would select where the borrower did not elect to choose his or her own provider. The Lender Respondents went on to include RMIC and Radian in the dialer in 2009. RCX 848; *see also* RCX 849. The fact that Atrium never had a reinsurance relationship with MGIC or RMIC, and that Radian was not added to the dialer until *after* its reinsurance arrangement had gone into run-off, further demonstrate that the existence of a reinsurance arrangement was not a primary consideration for the Lender Respondents with respect to the selection of an MI.

In spite of Respondents' continued disagreement with the Tribunal's holding, Enforcement Counsel's RESPA Section 8(a) claim still fails. What the Tribunal did not find, and what Enforcement Counsel failed to demonstrate, was an agreement to refer settlement business to a particular MI in exchange for placing the loan in a reinsurance book. Rather, the only evidence adduced at the hearing demonstrated that, where the borrower failed to exercise his or her opportunity to select an MI, the lender, either PHH Mortgage or PHH Home Loans, selected the MI. The decision to select a particular MI for a particular loan was based on a

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[15] As the Tribunal notes, in June 2008, as a result of Freddie Mac's decision to restrict its business to MIs which limited their captive reinsurance arrangements to a 25% cede, there was a shift to structures that complied with this guideline.

number of factors, including whether the particular MI offered pmi for the particular loan program selected by the borrower. Thereafter, the Lender Respondents' use of particular MIs was based on a "broad perspective of every mortgage insurer with whom [they] do business." Hearing Tr. 108. *See also id.* at 118 (Rosenthal: "I'm referring to the entire arrangement that PHH Mortgage would have had with RMIC, which would have been pretty broad. It would have included how do you pay claims, how do you service loans, what type of services are provided and delegated between PHH and RMIC, what abilities do we have in servicing, policies, captive is definitely one of them that would have been part of it, product eligibility.").

Further, since pmi rates are filed with state insurance regulators, there is little variation in the rates; accordingly, from the borrower's point of view, there is little difference among MIs. Hearing Tr. 119 (Mr. Rosenthal explaining that because the pricing is similar, he "guesses" that borrowers seldom pick their own MI); *id.* at 383 ("Generally borrowers don't care [who provides the pmi], the premiums are very, very similar, and the lender is the beneficiary if anything goes wrong."). For the lender, however, the relationship goes beyond simply the price for pmi. Rather, as Messrs. Rosenthal, Culver and Walker testified, the decision of the lender and the MI to enter into a particular relationship depended on a number of factors. Hearing Tr. 108-09 (Rosenthal); *id.* at 170-71 (Rosenthal stating that the Lender Respondents' "interface" with an MI is "much more expansive than just merely a captive reinsurance transaction."); *id.* at 292-3 (we would rate the different MIs in terms of strength of counterparty risks; product offerings; servicing and paying of claims); *id.* at 170-1 (same); *id.* at 328-9 (Mr. Culver testifying that "the bottom line is your ability to help your customer do business on a sound basis quickly, efficiently and fairly"); *id.* at 329 (Mr. Culver testifying that "pricing and underwriting guidelines are also important relative to determining which lenders do business with which mortgage insurers"); *id.*

at 332-33 (MGIC obtains business through having a local presence, along with its claims-paying ability, technology, and financial strength); *id.* at 2144-7 (Mr. Walker explaining the reasons why a lender would pick a particular MI including the range of services provided, the product offering, the support for the products offered, responsiveness, ability to order online, availability of underwriters to assist during "spikes in volume" -- "I think they're looking at all the factors together.").

The mere existence of the dialer, an electronic program that contained the rules for matching the various MI's programs with the borrower's specific needs and allowed the Lender Respondents to distribute their risks among various MI partners, cannot serve as prima facie evidence of an agreement to refer because Enforcement Counsel failed to show any correlation between an MI's placement in the dialer and the volume of loans placed into the various reinsurance books. Moreover, HUD specifically approved of the establishment of reinsurance arrangements between MIs and lender-captives despite the fact that such an arrangement would 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. Yet, HUD did not declare that all such arrangements would also constitute an illegal referral arrangement under Section 8(a). However, that is Enforcement Counsel's position in this administrative adjudication.

In sum, the record is devoid of any testimony that an agreement existed between any Respondent and any MI to refer business to a particular MI. Thus, the Tribunal should reject Enforcement Counsel's position that the mere fact that a captive reinsurance arrangement existed and that loans were originated and placed into reinsurance books are sufficient to demonstrate a RESPA Section 8(a) violation. Enforcement Counsel have not carried their burden. Indeed, the

HUD Letter recognized the incentive to place loans with MIs involved in captive reinsurance arrangements, and it specifically permitted such arrangements.

VI. THE TRIBUNAL'S CONCLUSION THAT A PRIMA FACIE VIOLATION OF RESPA SECTION 8(b) HAS BEEN ESTABLISHED MISCONSTRUES RESPA

RESPA Section 8(b) provides as follows:

> (b) Splitting charges
>
> No person shall give and no person shall accept 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.

12 U.S.C. § 2607(b).

Respondents disagree with the Tribunal's conclusion that the provision of "services" under 8(b) is limited to "settlement services." *See* May 22 Order at 18-20. The Tribunal's conclusion ignores the fact that HUD, and now the Bureau, defines real estate settlement services broadly to include the "[p]rovision of services ***involving*** mortgage insurance." 12 C.F.R. § 1024.2 (emphasis added); *see also Wooten v. Quicken Loans, Inc.*, 626 F.3d 1187, 1193 (11th Cir. 2010). Moreover, through the affiliated business disclosures, borrowers were advised that reinsurance may be obtained in connection with their pmi. ECX 653.

Further, it was incorrect for the Tribunal to find a "prima facie" violation of Section 8(b) without considering application of the 8(c)(2) safe harbor.[16] In any event, Respondents' disagreement with the Tribunal's conclusion is of no moment since HUD already declared that such arrangements were permissible under RESPA when it issued the HUD Letter.

[16] The Tribunal's determination of a RESPA violation without considering Section 8(c) leads to the anomalous result of being inconsistent with the HUD Letter. By way of example, HUD stated that the requirements of RESPA are "clearly satisfied" under a quota share arrangement. HUD Letter at 6. That is so, according to HUD, because "the reinsurer is bound to participate pro rata in every claim." Yet, under the Tribunal's analysis, a quota share arrangement would constitute a prima facie Section 8 violation.

VII. THE EVIDENCE SHOWS THAT RESPONDENTS SATISFIED THE RESPA SECTION 8(c)(2) SAFE HARBOR BECAUSE ATRIUM PROVIDED A SERVICE AND THE 25% CEDE WAS REASONABLY RELATED TO THE MARKET VALUE OF THE SERVICE PROVIDED

The prohibitions set forth in RESPA Sections 8(a) and 8(b) are subject to the following safe harbor in RESPA Section 8(c)(2):

> Nothing in this section shall be construed as prohibiting . . . (2) 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); *see also* Regulation X, 12 C.F.R. § 1024.14(g)(1)(iv) (same); *Cedeno v. IndyMac Bancorp, Inc.*, No. 06-Civ-6438, 2008 U.S. Dist. LEXIS 65337, at *13 (S.D.N.Y. Aug. 25, 2008) (stating that RESPA Section 8 "specifically does not prohibit payments for services actually rendered").[17]

As the Tribunal has acknowledged, both HUD and the Bureau have issued regulations that define the ultimate issue here – whether "the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided." According to the Tribunal:

> In both HUD's and the Bureau's versions of Regulation X, "[a] charge by a person for which no or nominal services are performed . . . is an unearned fee and violates" RESPA Section 8(b). 12 C.F.R. § 1024.14(c); 24 C.F.R. § 3500.14(c). Both versions also state

[17] Respondents continue to disagree with the Tribunal's finding that that the term "bona fide" in RESPA Section 8(c)(2) modifies "other payment for goods or facilities actually furnished or for services actually performed." March 13 Order, at 8. The language of RESPA Section 8(c)(2) is unambiguous and is cited by HUD on the first page of the 1997 Letter. In drafting this section, Congress clearly delineated between "bona fide salary or compensation," on the one hand, and "other payment," on the other hand. The term "bona fide" modifies "salary or compensation" only; it does not modify "other payment." Indeed, the word "other" would be rendered superfluous if the word "bona fide" was read in conjunction therewith, *i.e.*, "bona fide other payment." Thus, to the extent the Tribunal is attaching the term "bona fide" to impose a more exacting standard on the analysis of the ceding payment, such a rewriting of the statute cannot be justified. In the May 22 Order, the Tribunal finds that Respondents' construction "leads to absurd results." May 22 Order at 4. Not so, as Section 8(c) still requires that the payment be "for goods or facilities actually furnished or for services actually performed," which is sufficient to ensure that payments are made for services rendered.

> 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).

May 22 Order at 6.

As discussed in Section II, *infra*, it is Enforcement Counsel, not Respondents, who bear the burden of proof on this issue; that is, Enforcement Counsel must demonstrate that the payment, which in this case was the 25% cede, "bears no reasonable relationship to the market value of the goods or services provided." *Id.*

It is undisputed that Atrium provided reinsurance services to UGI and Genworth. Further, the Tribunal should now find that Atrium's provision of reinsurance services to these two MIs fully complied with the requirements established by the HUD Letter. The evidence demonstrates that Respondents were careful to ensure that there was risk transfer and that the 25% cede was commensurate with the risk assumed as set forth in the HUD Letter.

More specifically, as detailed below, Atrium's reinsurance agreements satisfied all of the "factors" identified in the HUD Letter for analyzing captive reinsurance arrangements. The analysis set forth in the HUD Letter is two-fold. First, the agency lists those factors which would invite further scrutiny of a particular captive reinsurance arrangement. Second, HUD sets forth the test to be applied for determining whether an arrangement violates RESPA Section 8.

A. Atrium's Reinsurance Arrangements Did Not Run Afoul of the Factors Set Forth in the HUD Letter

With respect to the first part of the HUD Letter – the factors that would cause HUD to further scrutinize a captive reinsurance arrangement – the evidence presented at the hearing clearly shows that Atrium's agreements did not raise any "red flags."

1. ***The amount charged*:** There is no dispute in this case that the pmi rates charged by the MIs were filed with and subject to the jurisdiction of each state department of insurance.[18] Further, Enforcement Counsel did not put on any evidence that borrowers who obtained mortgage loans from the Lender Respondents were charged a higher pmi premium due to the use of an MI that had a captive reinsurance arrangement with Atrium.

2. ***The cost of the captive reinsurance vs. non-captive reinsurance available in the market*:** The only testimony on this issue was presented by Mr. Walker, who stated that UGI sought out reinsurance from non-captive entities but that such reinsurance was not available in the marketplace. Hearing Tr. 2126-27 (UGI was "always seeking, especially in the 1990s, to get external reinsurance, particularly for catastrophe situations for cat cover."); *id.* at 2127 (there was "a prejudice against mortgage guaranty insurance" in the 1990s); *id.* at 2129-30 (Walker went to Europe in the mid to late 1990s looking for reinsurance and was advised that "the MI line of business in the United States was virtually uninsurable"); *id.* at 2140-1 (Walker discussing UGI's inability to get significant excess of loss coverage). Lenders were willing to provide such reinsurance through captive reinsurers, which only makes sense since, unlike other reinsurance arrangements, the lenders could increase the likelihood of earning a profit if they originated high quality loans.

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[18] While Dr. Crawshaw repeatedly disparaged the role of state insurance regulators, *see, e.g.*, Rebuttal Report at 82-110, he never took issue with the fact that the rates for pmi are filed and that all of the borrowers who obtained loans from the Lender Respondents were charged the filed rates. Further, Dr. Crawshaw's assertion that the mere fact that Atrium was regulated by New York, and Atrium Re by Vermont does not mean that there was risk transfer is questionable, but beside the point. The fact of the matter is that the reinsurance agreements at issue were fully disclosed to the appropriate state regulators who had every opportunity to investigate any aspect of those arrangements. That Dr. Crawshaw believes the regulators should have declared the arrangements not to be insurance is of no moment.

3. ***Restriction of the mortgage insurance business*:** The Lender Respondents' primary business was to originate mortgage loans. The Lender Respondents never restricted a borrower's choice of an MI and they provided a disclosure advising the borrower of the captive reinsurance arrangement and that he/she could select a different MI. Further, the Lender Respondents allowed brokers and loan correspondents to select the MI. The primary question regarding the selection of the MI was whether the MI offered to insure the loan program sought by the borrower. After that, the Lender Respondents certainly took into account a number of factors including counterparty risk, the MI's willingness to pay pmi claims, business relationship factors, and the existence of a reinsurance arrangement. *See* Hearing Tr. 532-34 (Rosenthal explaining that Lender Respondents wanted "multiple MIs willing to approve a loan" to make sure there would be a backup to offer the loan); *id*. at 547-50 (Rosenthal testifying about ECX 495 which details some of the considerations/factors in selecting Genworth for pmi including, *inter alia*, Genworth covering "PHH's pipeline" when another MI provider stopped insuring 100% LTV loans, Genworth's "great support to PHH with providing exception approvals on product and underwriting expansions and/or extensions" and Genworth's request for "reduced production" while it "managed through financial difficulties" in early 2009); *id.* at 2144-7 (Walker); *see also* Danahy Tr. at 197-200 (Over time, the number of MIs expanded because the Lender Respondents wanted to expand the number of products they could offer and CMG was added "to try to attract some of the business in the credit union space.").

4. ***The Secondary Market*:** The Lender Respondents sold the bulk of their loans to the GSEs, Fannie Mae and Freddie Mac. The Lender Respondents were keenly aware of the GSEs' requirements, and at no time did any of Atrium's reinsurance arrangements cause any secondary market investor to refuse to purchase their loans. When Freddie Mac issued its

guidance in June 2008, Respondents complied with the 25% cede limitation on a going-forward basis.

5. ***Credit Rating Agencies and State Insurance Regulators*****:** Enforcement Counsel proffered no evidence that any of the MIs suffered any reduction in their credit ratings as a result of any agreements with any captive reinsurers. To the contrary, when the housing market and mortgage insurance industry were collapsing in 2008, the MIs relied upon their reinsurance agreements to save their companies. *See, e.g.,* RCX 816 (MGIC received "nearly $900 million in loss reimbursements from its captive reinsurers" which "provided much needed capital to MGIC that helped MGIC survive the worst of the housing downturn"); Hearing Tr. 398-99 (Culver); *id.* at 2153-6 (Walker). As it relates to Respondents, Atrium's reinsurance agreements were reviewed by the New York Department of Insurance, as well as by credit rating agencies and its own outside accountants. The agreements were also available for review by any other state or federal regulator that reviewed the operations of Respondents. There was never any adverse rating attributable to the operations of Atrium.

6. ***Adequacy of reserves*****:** The New York Department of Insurance found Atrium's reserves to be adequate. In addition, Atrium obtained an annual statement of actuarial opinion and every year it was determined that Atrium: met the requirements of the insurance laws of the State of New York; maintained sufficient reserves in accordance with the Standards of Practice issued by the Actuarial Standards Board; and made "reasonable provision for all unpaid losses and loss expense obligations of the Company under the terms of its contracts and agreements." Statement of Actuarial Opinion, RCX 32-35 (Milliman Statements of Actuarial Opinions for years 2007-2010); Hearing Tr. 1924-25 (Schmitz); *id.* at 767, 776 (Crawshaw). Enforcement Counsel did not present any evidence that Atrium failed to have sufficient reserves for the only

two reinsurance agreements that are at issue, nor could it, given the substantial funds held by Atrium as of July 21, 2008.[19]

7. ***Referral of all or a predetermined volume of business*:** The Lender Respondents never agreed to refer all or a predetermined volume of business to any MI, nor did any of the agreements provide for a fluctuation of the premium based on the volume of business referred. Further, Enforcement Counsel produced no evidence that any such referral volume agreement existed at any point after July 21, 2008. The Lender Respondents' primary focus was to originate loans and, where the borrower was unable to put down 20% and thus pmi was required, the first criteria was whether the MI offered to insure the loan program sought by the borrower. *See* Danahy Tr. at 86-7 ("First of all, they have to offer the MI that meets the borrower's needs, so it fits their criteria."). Secondary considerations included each MI's ability to pay claims.

8. ***Adequate consumer disclosure*:** It was the Lender Respondents' policy and practice to provide borrowers with affiliated business disclosures with respect to all loans they originated. Samples of the types of affiliated business disclosures used by the Lender Respondents are included in the Record as part of EXC 653. These affiliated business disclosures identify Atrium as an affiliated entity of the Lender Respondents that is in the business of issuing reinsurance on pmi and each disclosure included the following, or substantially similar, language:

> You will not pay any fees directly to Atrium. If you decide to select United [Guaranty Residential Insurance Company], Genworth or Radian, for mortgage guaranty insurance, United, Genworth or Radian will pay a reinsurance fee to Atrium for its assumption of United's, Genworth's or Radian's risk.

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[19] Enforcement Counsel attempted to make much of dividends paid from Atrium's trust accounts; however, as Mr. Walker testified, before any dividend was paid from a trust account for one of its reinsurers, UGI "made sure" that it was in compliance with the requirements of the applicable reinsurance agreement. Hearing Tr. 2150-1. No witness testified to the contrary.

* * *

> You are NOT required to use United [Guaranty Residential Insurance Company], Genworth or Radian, and therefore Atrium, as a condition for the settlement of your loan on the subject property. THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES. However, these providers pride themselves on offering competitive rates while at the same time providing high quality customer service.

See ECX 653, Exhibit F, Danahy Decl. ¶ 25 and Exhibit B, thereto ("It is PHH Mortgage's policy and practice to provide borrowers with affiliated business disclosures with respect to all loans originated by PHH Mortgage.").

B. Atrium's Reinsurance Arrangements Satisfied the HUD Test

The second part of the HUD Letter sets forth the test for determining whether a captive reinsurance arrangement violates RESPA Section 8. The HUD Letter discusses the determination of whether reinsurance is actually being provided in return for the compensation. As an initial matter, it bears repeating that in those book years where Atrium paid claims, the analysis is completed – services were provided. Likewise, for the last two books – Genworth 2008B and UGI 2009 – although Atrium had not yet paid a claim, the commutations provided for the payment of all expected claims on those book years, just as if those agreements had run to completion. These attributes, which stand unrefuted, demonstrate that the Genworth 2008B and UGI 2009 reinsurance agreements fully complied with the HUD Letter:

1. ***Legally binding contract for reinsurance*:** Atrium's contracts were legally binding and were consistent with industry standards for reinsurance agreements. Dr. Crawshaw did not dispute that there were legally binding contracts; rather, he sought to demonstrate that the contracts were not for reinsurance based on his assertion that the UGI and Genworth agreements

contained trust caps. Dr. Crawshaw's opinion is entitled to no weight because it was not based on the actual wording of the agreements, which does not support his assertion that there were trust caps, but rather on statements by Milliman and others. As explained by Mr. Walker during the hearing, the trust caps were placed in reinsurance agreements for reinsurers domiciled in Vermont at the request of the Vermont regulator to avoid forcing a reinsurer into bankruptcy. Hearing Tr. 2167-68 (Walker). Atrium was domiciled in New York, which does not require trust caps. Accordingly, the "trust cap" provision is not in the UGI and Genworth reinsurance agreements. *See* EXC 653, Atrium Reinsurance Corporation, Vermont Captive Business Plan, attached hereto as Exhibit D (noting that the establishment of Atrium Re, a Vermont entity, and the transfer of the agreements from Atrium to Atrium Re will not require the insertion of trust caps "typically required of Vermont mortgage reinsurance captives," since the agreements are in runoff); *see also* Hearing Tr. 2169-70 (Walker explaining that trust caps were not really an issue for Atrium because its "trust account was enormous"); *id.* at 1859-61 (Schmitz explaining that for risk transfer, assuming that liability is limited to "funds available in the trust" is conservative); *id.* at 1987-9 (Schmitz explaining the reasons for the "standard industry practice" of assuming that the reinsurer's liability was limited to the funds in the particular trust account including the OCC approval and the Vermont regulator); *id.* at 830 (Dr. Crawshaw agreeing that limiting Atrium's liability to the trust account is a more conservative approach when evaluating risk transfer).

2. ***Adequate capital and reserves*:** There has never been any question that Atrium met all required reserves and that funds were available to pay the more than $156 million in claims. *See also* Hearing Tr. 777 (Dr. Crawshaw admitting that Atrium paid every claim presented); Crawshaw Rebuttal Report at 107 (noting that the solvency of Atrium was not an

issue). Further, as it relates to the Genworth 2008B and UGI 2009 books, Atrium paid the expected claims on those books through the commutations of those agreements. *See infra,* § VIII.B; *see also* Crawshaw Rebuttal Report at 74, n.128 ("Commutation typically refers to a termination in which the parties discharge and settle their obligations by valuing expected future cash flows, such as premiums and claims, and providing for a payment based on that valuation.").

3. ***There must be a real transfer of risk*:** Atrium's reinsurance agreements met this requirement. Hearing Tr. 1858-1870 (Schmitz explaining that there was a transfer of risk in the Genworth 2008B contract); *id.* at 1907-8 (Schmitz testifying that the UGI 25% cede arrangement passed risk transfer). As noted, where Atrium paid claims, or commuted agreements through an arms-length transaction with the MI, the risk analysis becomes moot because services were provided. In those instances where Atrium had not paid a claim on a particular book year, the Atrium agreements still met this requirement which the HUD Letter defines as "if the band of the reinsurer's potential exposure is such that a reasonable business justification would motivate a decision to reinsure that band." HUD Letter at 6. The pmi providers, all of which are sophisticated insurance entities, freely agreed to enter into the reinsurance arrangements with Atrium. There is nothing in the record to demonstrate that the Lender Respondents offered to send all or even a set portion of business to any particular pmi provider simply because there was a reinsurance agreement in place between that pmi provider and Atrium. While it is true that during the early years of Atrium's existence, the Lender Respondents sent the bulk of its business to UGI, that business decision was based on the lenders' belief that UGI was a solid business partner. *See* Danahy Tr. at 197 ("[UGI] was always a top-rated [pmi] company, they certainly had one of the highest rating standards, so we want good solid partners; and then we

want to develop that business together so we can be efficient at it, develop integrated systems and really kind of work effectively to get the most opportunity to make loans that we can.”). Over time, however, in order to reduce its counterparty risk, the Lender Respondents expanded and utilized other pmi providers, a number of which did not have a reinsurance arrangement with Atrium.

4. ***Determining That the Compensation Does Not Exceed the Value of the Reinsurance:*** The final section of the HUD Letter deals with the determination of the reasonableness of the compensation as compared to the services provided. Once again, Respondents are entitled to a recommended decision in their favor because Enforcement Counsel failed to put on a case. Milliman is the only party to have conducted an analysis of the compensation received by Atrium, and it determined that the compensation under the 25% excess-of-loss structure for the Genworth agreement was reasonable. ECX 194 (also RCX 20).[20] Specifically, Milliman performed a prospective analysis of the Genworth 2008B book, which contained loans originated between June 1, 2008 and March 31, 2009.

Milliman first determined that “the proposed reinsurance agreement likely satisfies the transfer of risk in the HUD Letter that there is a reasonable probability of a loss to the reinsurer.” ECX 194 at 10. Milliman then went on to analyze whether the premium ceded by Genworth to Atrium was reasonable in relation to the risk it was assuming. The analysis performed by Milliman is in accordance with the HUD Letter, which refers to the comparison of the “the risk borne by the captive reinsurer with the payments provided by the primary insurer” and the evaluation of “the relative risk exposure of the primary lender and the captive reinsurer.” HUD

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[20] As Mr. Schmitz testified, the Report (ECX 194) contains only the summary of the work product and there is a “tremendous amount of additional work paper files that take the form largely of spreadsheets that are not contained in this report, but the results of which are summarized in this report.” Hearing Tr. 1858.

Letter at 7; Hearing Tr. 1870-1874 (Schmitz concluding that the internal rate of return and cumulative return on capital to Atrium was reasonable relative to the returns to the primary insurer); *id.* at 2139-40 (Walker testified that be believed that the premium cede to Atrium was appropriate and met all of the requirements from UGI's accountants and HUD). That analysis led Milliman to conclude that under the rate of return comparison for the Genworth 2008B book, the "projected returns under the reinsurance structure are reasonable." ECX 194 at 15-6. *See also* Hearing Tr. 1858-59 (Schmitz testimony on the Report's conclusions).

Milliman then looked at the loss ratio comparison between Genworth and Atrium and concluded "that the reinsurance premium is reasonable in relation to the reinsured risk since the projected expected loss ratios for Atrium are reasonable in relation to the loss ratios for the primary insurer." *Id.* at 16-7. Milliman also issued a draft report in which it determined that the UGI 25% excess-of-loss structure satisfied the HUD Letter in all respects. RCX 2002.

Enforcement Counsel produced no credible evidence to dispute Milliman's findings on the reasonableness of the compensation; accordingly, Respondents are entitled to a recommended decision in their favor. The undisputed facts are that:

- UGI wanted to purchase reinsurance but it was generally not available from any non-lender affiliated reinsurers (Walker Testimony at 2129-30, 2140-1).

- Since the only reinsurance that was available was through lender-captives, the market rate was defined by the industry and the 25% cede was appropriate for the layer of risk insured. Hearing Tr. 1914-15 (Schmitz noting that the 25% cede arrangement was "squarely in the range" of agreements reviewed by Milliman).

- The only entity that performed a risk transfer analysis was Milliman, and it concluded that the premium was consistent with the requirements of the HUD Letter. Dr. Crawshaw's novel retrospective, multi-year analysis is inapposite and insufficient to carry Enforcement Counsel's burden. Further, now that this case is limited to reinsurance placed on loans originated on or after July 21, 2008, Dr. Crawshaw's analysis cannot be applied to the only two remaining books of loans because his

> analysis necessarily includes all books of business for the entire life of each of the arrangements.

Enforcement Counsel cannot rely on Dr. Crawshaw's analysis for purposes of challenging the reasonableness of the compensation received by Atrium because Dr. Crawshaw valued the reinsurance services as "worthless" to the MI.[21] Thus, any attempt to challenge the reasonableness of the premium paid based on Dr. Crawshaw's analysis would be disingenuous at best, as it would be fundamentally inconsistent with the conclusions in his two reports.

There are additional reasons why the Tribunal should not rely on Dr. Crawshaw's analysis. First, Dr. Crawshaw never performed a ***prospective*** risk transfer analysis. *See, e.g.,* Hearing Tr. 1909 (Tribunal preventing Schmitz from testifying about Dr. Crawshaw's analysis because "Dr. Crawshaw was quite clear that he was not engaging in exactly the same analysis that Milliman did and I'm not sure that Mr. Schmitz is qualified to opine on that."). Rather, all he did was to look back at the performance of the various reinsurance arrangements and conclude that over the 14-year period the UGI agreement was in place and the 12-year period the Genworth agreement was in place, that these two MIs would have been "better off" if they would have kept the entire premium. *But see* Hearing Tr. 419 (Culver explaining that had MGIC not purchased reinsurance, he was not sure what it would have "done with that money" given the "intense pressure from investors"); *id.* at 2162-3 (Walker explaining that had UGI "hypothetically" in hindsight not purchased reinsurance but kept all the premiums "AIG would have said, you have to dividend this up. Or we would have used it to buy another company and the money would no longer be available to us, which is more likely the case. I don't think the money – I don't think we could ever keep it in the savings account."). Dr. Crawshaw's analysis

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[21] Hearing Tr. 752 (Dr. Crawshaw, in responding to Enforcement Counsel's question regarding the "appropriate level of profit" for Atrium, testified that while he "[hasn't] done a specific analysis, it should be something less than zero percent underwriting profit.").

is deeply and fundamentally flawed. He provided no support for his use of a "multi-book year" analysis; the most he could muster was a 2012 Milliman report which was not even about risk transfer but about capital adequacy, a completely different concept. *See* Hearing Tr. 2312-4 (Dr. Crawshaw admitting that the 2012 Milliman report he attempts to rely on does not mention risk transfer, discuss FAS 113, SAS 62, the 10/10 rule, and only one entity is being evaluated as opposed to two for a risk ***transfer*** analysis).

Second, Dr. Crawshaw never specifically analyzed the 25% cede excess-of-loss structure in his Reports. Indeed, on the last day of trial, Enforcement Counsel sought to rectify this oversight by introducing a demonstrative exhibit and additional testimony from Dr. Crawshaw. Their efforts were unavailing, however, as the testimony was simply a recasting of Dr. Crawshaw's interpretation of Milliman's analysis. Critically, Dr. Crawshaw and Enforcement Counsel's last ditch effort to mount an attack on the 25% cede excess-of-loss arrangement stands in stark contrast to their prior reliance on that same structure to attack the "40% deep cede" arrangements that are no longer at issue in this proceeding. Specifically, in his Rebuttal Report Dr. Crawshaw cites affirmatively to ECX 583, the November 24, 1997 Letter from Messrs. Long and Musser, the Commissioners of the Wisconsin and North Carolina Departments of Insurance, to the Commissioner of the South Dakota Department of Insurance advocating the imposition of a limit on ceding to 25% of gross premiums. Crawshaw Rebuttal Report at 83, n.144; *id.* at 115, & n.227. Dr. Crawshaw also relied upon "a 1998 presentation by the Mortgage Insurance Association of America (a trade consortium consisting of the nation's major MI companies) to the Arizona Department of Insurance" proposing the same limitation, that is, that ceding premiums be limited to 25%. *Id.* at 116 (citing ECX 35). Nor did Dr. Crawshaw take issue with Freddie Mac's decision on June 1, 2008, to limit the ceding commission of MIs with which it

dealt to a 25% ceding commission. Indeed, in his Rebuttal Report, Dr. Crawshaw embraced this limitation as part of his attack on the "deep cede" arrangements. *Id.* at 114.

Dr. Crawshaw is not qualified to opine on the issue of the reasonableness of the compensation. No such analysis is contained in either of his two Reports since he repeatedly valued the reinsurance as "worthless." Further, Dr. Crawshaw's attempts to analogize pmi reinsurance to property and casualty reinsurance is misplaced because of the fundamental differences in those products. Among other things, because of the cross-collateralization of book years and the long tail period – ten years for the UGI and Genworth agreements – the potential losses to a particular book year may not occur until many years in the future. Further, the reinsurer is required to maintain capital in the arrangements potentially for this entire period. Such characteristics are not present in connection with reinsurance in property and casualty insurance where the period of time for filing claims is defined, and the reinsurer will be on notice of potential claims much more closely in time to the covered period. *See also* Hearing Tr. 794 (Crawshaw: "For a hurricane it happens on a day, whereas this mortgage insurance is much more protracted.").

There are other differences. [REDACTED]

[22] [REDACTED]

C. Respondents Were Entitled to Rely on Milliman

The 1997 HUD Letter established guidelines to be followed in connection with the establishment of a lender-captive pmi reinsurance arrangement. The undisputed facts are that Respondents established such an arrangement at various times with a total of four different MIs and adhered to the guidance set forth by HUD. Further, Atrium obtained opinions from Milliman, a well-known and reputable actuarial firm, to review the arrangements to ensure that there was a real transfer of risk and that the ceded premiums were reasonable in relation to the insured risk. The unrefuted hearing testimony demonstrated the following facts:

- Respondents sought out Milliman, a recognized actuarial expert, for the specific purpose of determining whether the reinsurance arrangements complied with the requirements of the HUD Letter. *See, e.g.,* Hearing Tr. 130 (Mr. Rosenthal explaining that "Milliman would always check to make sure that the structure being offered and analyzed passed risk transference that it was a proper exchange of risk that Atrium would be absorbing for the quantity of premiums that Atrium was receiving."); *id.* at 133 (Respondents would "check back with Milliman" in order "to make sure we're compliant with the law"); *id.* at 136 (Mr. Rosenthal explaining that one of the purposes of the Milliman opinions was to "make sure we were complaint with the RESPA laws"); *id.* at 184 (Respondents would always go to Milliman to determine whether the reinsurance arrangement "passed risk transfer"); *id.* at 482-4 (Rosenthal explaining the Lender Respondents' awareness that the addition of credit union loans would affect risk transfer and the need to ensure a "compliant arrangement"); *id.* at 508 (Milliman would evaluate captive arrangements "from time to time" and evaluate whether the agreement "passed the test of risk transference"); *id.* at 512 (same); *id.* at 568-9 (Rosenthal explaining that Milliman was hired to determine if the captive reinsurance arrangements "passed risk transference" and complied with all regulations); *id.* at 577 (same).

- Dr. Crawshaw agreed that Respondents were entitled to rely on the opinions issued by Milliman. *See, e.g.,* Hearing Tr. 807 (Dr. Crawhaw: "I think it's reasonable, I mean, to – for [Atrium] to hire Milliman and rely on what Milliman said.").

- The MIs and other lender-captives relied on Milliman. *See, e.g.,* Hearing Tr. 343 (Mr. Culver stating that the pricing was "based off actuarial opinions done by Milliman or other accounting firms . . . they were all actuarial priced"); *id.* at 388-91, 396-7 (MGIC obtained an actuarial analysis from Milliman or KPMG for every deep

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cede captive arrangement to ensure that the risk was commensurate with the premium); *id.* at 2135-6 (Mr. Walker stating that UGI utilized Milliman & Robertson on most of its reinsurance agreements); *id.* at 2138 ("HUD has given [UGI] specific instructions, it's not sufficient that we just use our own models. We felt more comfortable if we would get an outside, independent third party to opine on it, and we did that").

At bottom, Enforcement Counsel utterly failed to prove that the RESPA Section 8(c)(2) safe harbor does not apply. Atrium's captive reinsurance arrangements unquestionably complied with the detailed standards and test set forth in the HUD Letter. Moreover, Respondents did not rely only on their own review of these arrangements, but sought out the opinion of a highly-regarded third-party actuarial firm. Respondents were entitled to rely on Milliman's opinions that the arrangements complied with the HUD Letter, a point conceded by the Bureau's own expert. Further, the Bureau has never repudiated the guidance contained in the HUD Letter, despite the fact that the Bureau has had responsibility for RESPA for more than three years now. Accordingly, the Tribunal should find that Atrium's reinsurance arrangements satisfied the Section 8(c)(2) safe harbor and recommend a decision in Respondents' favor.

VIII. EVEN ASSUMING ENFORCEMENT COUNSEL DEMONSTRATED A RESPA SECTION 8 VIOLATION, NO RELIEF IS APPROPRIATE

Setting aside the fact that Enforcement Counsel failed to demonstrate a violation of RESPA Section 8, the fact remains that even if they did, no relief would be appropriate.[23] That is so because the Bureau "stepped into the shoes of HUD" with respect to conduct that occurred prior to July 21, 2011. Prior to the passage of Dodd-Frank, HUD could not enforce RESPA

[23] On the first day of the Hearing, Enforcement Counsel requested guidance from the Tribunal "on whether [they] should be presenting itself (sic) about relief remedies as part of [their] case in chief or wait." Tr. at 64. The Tribunal informed Enforcement Counsel that they "can put on [their] case however [they] want to." Tr. at 65. Enforcement Counsel did not reserve any right to put on additional evidence of relief and the administrative record is now closed. Accordingly, the only evidence presented on the issue of relief is what is already in the record and, as explained herein, that evidence is insufficient to support a claim for injunctive relief.

through an administrative proceeding such as this one. Indeed, neither RESPA, nor its implementing regulation, Regulation X, contains any provision authorizing an agency to bring an administrative action for alleged violations of Section 8. After the designated transfer date, the Bureau stands in HUD's shoes under RESPA.[24] Under RESPA Section 8, HUD could only obtain "injunctive relief" and only by filing suit in court. 12 U.S.C. § 2607(d)(4).

With respect to seeking injunctive relief, however, the Bureau is too late. Simply stated, as of July 21, 2011, there was nothing to enjoin. Indeed, the Bureau concedes in the NOC that the conduct had ceased: "PHH expanded its referrals of business to additional providers with whom it lacked a captive arrangement, . . . only after PHH, like others in the market, had virtually stopped placing captive reinsurance on new mortgages." NOC ¶ 54. *See also* Hearing Tr. 377 (Mr. Culver: "probably around 2007 and 2008, you saw lenders no longer interested in putting new business into the captives"); *id.* at 381-2 (Mr. Culver explaining why captives were no longer important after 2008). Further, the Tribunal has already taken as established that all four of the reinsurance agreements were in run-off before January 1, 2010, or more than a year prior to the creation of the Bureau. Thus, reinsurance was not being provided on any new loans and there was nothing left to enjoin. Indeed, the Tribunal touched on the issue of the viability of

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[24] *See* Transcript of February 14, 2014, Telephonic Scheduling Conference ("Feb. 14 Tr."), at 10-11 (Mr. Gordon: "We're in a slightly unusual posture in this investigation because . . . we stand in the shoes of HUD which prior to the Dodd-Frank transfer date, as we call it, which is July 21st, 2011, HUD had exclusive Federal responsibility for enforcing RESPA and now we do following the transfer date."); *see also* CFPA § 1061(b)(7) (12 U.S.C. § 5581(b)(7)). Section 1061(b)(7) of the CFPA provides, in pertinent part:

> The Bureau shall have all powers and duties that were vested in the Secretary of the Department of Housing and Urban Development relating to the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. § 2601 et seq.), the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (12 U.S.C. § 5101 et seq.), and the Interstate Land Sales Full Disclosure Act (15 U.S.C. § 1701 et seq.), on the day before the designated transfer date.

injunctive relief at the March 5 Motions Hearing since the conduct in question is not alleged to be ongoing. *See* Mar. 5 Tr. at 59 ("[W]hen I read the notice of charges, although there is an injunction requested in your prayer for relief, it seems like it's all very backward looking. There's really nothing in the notice of charges . . . that suggest that these violations are still occurring.").

Further, the testimony Enforcement Counsel elicited from Mr. Rosenthal demonstrates that, in fact, while the Respondents had explored the possibility of entering into new reinsurance arrangements back in 2006-2007, those efforts were abandoned after a few months. *See* Hearing Tr. 182; *id.* at 575-76. Curiously, Enforcement Counsel ***never asked*** Mr. Rosenthal, or any other witness, whether Respondents had any intention of entering into any similar reinsurance agreements in the future. Thus, the record on this issue is absolutely barren. While the Tribunal previously denied Respondents' attempt to dismiss the Bureau's claim for injunctive relief, now that the record is closed, there is no evidence to support Enforcement Counsel's demand for injunctive relief.[25]

As it relates to UGI and Genworth, both of those MIs have entered into consent orders with the Bureau, *i.e.*, the Florida Consent Orders, that restrict their ability to enter into captive reinsurance arrangements in the future. As a result, the Bureau's ability to demonstrate the necessity for an injunction as it relates to those two entities is impossible. While the Tribunal inquired about the possibility of restarting a reinsurance relationship with a company such as CMG – which is not subject to a consent order with the Bureau – in order to raise such a

[25] During the course of the administrative hearing, Enforcement Counsel demanded the production of documents from Respondents and their counsel regarding, *inter alia*, the Respondents "willingness" to enter into future captive reinsurance arrangements. Over Respondents' objections, the Tribunal ordered compliance with the subpoena. Yet, even with this desperate, last-minute demand, Enforcement Counsel did not produce a single additional document or witness in support of their demand for injunctive relief.

possibility beyond mere speculation, Enforcement Counsel should have presented some evidence, such as, for example, a witness from CMG. Enforcement Counsel's witness list included an individual affiliated with CMG, Alan Bahr; yet they failed to call Mr. Bahr to testify at the hearing. Indeed, there is not even any evidence in the record that CMG is in the business of offering such arrangements. Enforcement Counsel bears the burden of demonstrating that an injunction is appropriate. Because Enforcement Counsel failed to provide even a scintilla of evidence on this issue, the Tribunal is left with nothing more than a speculative possibility that *some future* violation *might* occur, which is insufficient as a matter of law.

The Supreme Court has explained that "[t]he purpose of an injunction is to prevent *future* violations." *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953) (citation omitted, emphasis added); *see also SEC v. Tourre*, No. 10 Civ. 3229, 2014 U.S. Dist. LEXIS 32817, at *48-49 (S.D.N.Y. Mar. 12, 2014) (an injunction "is appropriate where there is a likelihood that, unless enjoined, the violations will continue") (internal quotation marks and citation omitted). The Bureau's NOC requests that this Tribunal grant "[a] permanent injunction to prevent and restrain *future* violations of Section 8 of RESPA." NOC ¶ 104(A) (emphasis added). The Bureau's failure, however, to demonstrate that there is any possibility that Respondents *will* violate Section 8 of RESPA in the future renders their request for injunctive relief insufficient under Supreme Court precedent: "[T]he moving party must satisfy the court that relief is needed. The necessary determination is that there exists some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive." *W.T. Grant Co.*, 345 U.S. at 633 (affirming dismissal where defendant voluntarily terminated offending conduct after government filed suit).

"An injunction is a drastic and extraordinary remedy, which should not be granted as a matter of course." *Monsanto Co. v. Geerston Seed Farms*, 561 U.S. 139, 165 (2010) (reversing and remanding lower court's grant of broad injunctive relief). In this case, the fact that the complained-of agreements have been terminated, coupled with the inability to find MIs to act as counterparties for any future reinsurance agreements, weighs heavily against the imposition of such a drastic remedy.[26] In addition, the broadness of the Bureau's request only further supports the conclusion that an injunction is inappropriate. "[A]n injunction must be narrowly tailored . . . to remedy only the specific harms shown by the plaintiffs, rather than to enjoin all possible breaches of the law." *Price v. City of Stockton*, 390 F.3d 1105, 1117 (9th Cir. 2004) (internal quotation marks and citations omitted). Rather than tailor its request for this extraordinary relief, the Bureau has effectively called for an order that Respondents "obey-the-law." Such an injunction is improper in any proceeding. *See SEC v. Sky Way Global, LLC*, 710 F. Supp. 2d 1274, 1282 (M.D. Fla. 2010) (finding such an "obey-the-law" injunction unenforceable and ineffective; gathering cases); *see also Tourre*, 2014 U.S. Dist. LEXIS 32817, at *49-50 ("the Court is skeptical of the utility of this kind of 'obey-the-law' injunction – after all, everyone is required to obey the law, the law comes with its own penalties, and merely reciting statutory provisions gives an individual little guidance on how to conform his conduct to the terms of the injunction") (internal quotation marks and citation omitted); *Miglionico v. Birmingham News Co.*, 378 So. 2d 677, 681 (Ala. 1979) (finding that such injunctions are "repugnant to the

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[26] Such considerations also apply where administrative agencies issue cease and desist orders. *See, e.g.*, *Country Tweeds, Inc. v. FTC*, 326 F.2d 144, 149 (2d Cir. 1964) ("We think it advisable again to note that petitioners in this case have ceased to engage in the advertising practice which prompted the order, and voluntarily did so well before the Commission filed its complaint. [Cessation] of the offending activity, with the likelihood that the petitioner will not again resume it or a related activity, has been one factor which courts have considered in limiting broad Commission orders.").

American spirit and should not lightly be either administratively sought or judicially granted") (citation omitted).

While Respondents have repeatedly pointed out that the NOC is facially deficient with regard to the request for injunctive relief, in its May 22 Order, the Tribunal denied Respondents' request to dismiss the claim because "it is not clear at this point what precise injunctive relief Enforcement seeks." May 22 Order at 8; *id.* at 7 (The NOC states that the conduct continued "until 'at least May 2013,' but does not unequivocally allege that the conduct is ongoing" and prays for relief "in the form of . . . 'a permanent injunction to prevent and restrain future violations of Section 8 of RESPA.'"). Now that the hearing has concluded and the record is closed, it is clear that the request for injunctive relief must be denied because Enforcement Counsel failed to identify what "precise injunctive relief" they are seeking and offered absolutely nothing in terms of evidence of a potential of future reinsurance arrangements. To hold otherwise would deny Respondents their right to notice.

Even if this Tribunal accepts Enforcement Counsel's argument that injunctive relief is available and that the requisite showing has been made – points which Respondents dispute – Enforcement Counsel have two additional problems: (1) the only relief available from the Tribunal is an order enjoining future conduct; and (2) even if additional relief is available, the request is unavailing in light of the commutations of Atrium's reinsurance agreements.

A. The Bureau Cannot Order Other Equitable Relief Without Going to Court

In deciding to pursue Respondents through its administrative process, the Bureau has waived any right to seek forms of equitable relief other than an injunction. By way of background, the Supreme Court has held that, subject to certain qualifications, a federal court, once seized of equity jurisdiction to grant injunctive relief, can also grant certain additional

equitable relief, such as a claim for equitable accounting or for disgorgement of profits. *See Porter v. Warner Holding Co.*, 328 U.S. 395, 398-99 (1946) (holding that "a decree compelling one to disgorge profits, rents or property acquired in violation of the Emergency Price Control Act may properly be entered by a District Court *once its equity jurisdiction has been invoked* . . ." and noting that the statute explicitly gave courts the authority to enter "'a permanent or temporary injunction, restraining order, *or other order*'") (emphasis added). This general rule, however, does not apply to statutes like RESPA for which Congress has provided detailed and varied enforcement provisions for the various sections. *See Porter*, 328 U.S. at 398 (holding that a court cannot exercise broad equitable powers where "a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity"); *Edison v. Dep't of the Army*, 672 F.2d 840, 846 (11th Cir. 1982) ("Where a statute provides for certain types of relief, but not others, it is not proper to imply a broad right to injunctive relief."). Because RESPA gave HUD only the right to seek injunctive relief in court, and because Congress was very precise in the relief permitted to various persons under each provision of RESPA, other equitable remedies would not have been available to HUD under *Porter* and, therefore, are not available here. *Cf. Freeman v. Quicken Loans, Inc.*, 566 U.S. __, 132 S. Ct. 2034, 2041 (2012) (noting that RESPA Section 8 is enforceable through "actions for injunctive relief brought by federal and state regulators," with no reference to any ancillary equitable relief).

Regardless of whether this Tribunal believes that injunctive relief includes other equitable remedies, however, the fact of the matter is that, unlike a federal court which has "inherent" equitable powers once its equitable jurisdiction is invoked, administrative tribunals have no such inherent authority, nor did the Bureau inherit any such authority from HUD. *See Ramos v. D.C. Dep't of Consumer & Regulatory Affairs*, 601 A.2d 1069, 1073 (D.C. 1992)

("[A]dministrative law tribunals . . . within agencies of the executive branch – by definition and design do not have the inherent 'equitable authority' that courts in the judicial branch have derived from common law traditions and powers."); *see also Feistman v. C.I.R.*, 587 F.2d 941, 943 (9th Cir. 1978) ("When the Tax Court was an administrative agency, it was without the ancillary equitable powers ordinarily exercised by a true court.").

B. There is No Legal or Factual Basis for the Award of Other Equitable Relief

In the May 22 Order, the Tribunal found that "disgorgement, restitution and an injunction are presumptively available as relief for claims arising from loans closed before July 21, 2011." May 22 Order at 14.[27] Respondents continue to object to the Tribunal's assertion that the Bureau has any authority to grant any equitable relief for conduct occurring prior to July 21, 2011; however, even assuming the availability of such relief, the undisputed facts demonstrate that such relief is unwarranted.

There is no dispute here that long before this administrative action was filed, Atrium had commuted its reinsurance agreements with Radian and CMG by returning all premiums, earnings, and capital contributions. Further, the other two reinsurance agreements, UGI and Genworth, were in run-off for more than 18 months before the Bureau came into existence. Those two agreements were subsequently commuted, again before this action was filed, and the undisputed facts are that in connection with both of those commutations, the agreements to commute were arms-length transactions. That is significant because the commutation of a

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[27] Respondents are aware of only one district court opinion that held that disgorgement of profits is available under RESPA Section 8. *See Jackson v. Prop. I.D. Corp.*, No. 07-CV-3372, Order Re: Defendants' Motions to Dismiss, Dkt. 52 (C.D. Cal. Mar. 24, 2008). *Jackson*, an unpublished opinion on a motion to dismiss that does not appear to have been cited by any other court, was wrongly decided, and never appealed because the case was settled after a motion to certify an interlocutory appeal was denied.

reinsurance agreement provides for the net present value of the arrangements to be "settled" as between the insured and insurer.[28] In the case of the Genworth 2008B book, the only Genworth reinsurance book that contained loans originated after July 21, 2008, and thus the only book at issue in this proceeding, Milliman's analysis expected that the losses on that book of business would far exceed the total premiums collected by Atrium. *See* Hearing Tr. 1905 (Schmitz noting that Milliman projected that the losses on the Genworth 2008B book would be $12 million and the projected premiums would be $8.8 million). With respect to the UGI 2009 book – the only UGI reinsurance book that contained loans originated after July 21, 2008, and thus the only book at issue in this proceeding – Milliman's analysis anticipated approximately 50% losses on that book of business. *Id.* at 1907 (Milliman projected losses of $1.7 million and premiums of $3.2 million). Because Genworth was the larger agreement, however, the losses suffered by Atrium in connection with that agreement were larger than what Milliman was predicting that Atrium would receive in connection with the UGI 2009 book; thus, between the two agreements, Atrium lost money, thereby rendering any claim for "disgorgement" of profits moot.

In addition to the fact that Atrium lost money on the two remaining agreements, there would be no basis to award restitution. "When, as in this case, a statute 'expressly provides' a specific set of remedies, the Supreme Court has cautioned that courts must 'be chary of reading others into it.'" *Mullinax v. Radian Guar. Inc.*, 199 F. Supp. 2d 311, 334 (M.D.N.C. 2002) (holding that RESPA does not give private parties the right to seek an injunction, and instead vests that right exclusively in the government) (quoting *Transamerica Mortg. Advisors, Inc. v.*

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[28] Dr. Crawshaw explained commutation several times in his various reports. *See, e.g.,* Initial Report at 23 n.47; 53-5; Rebuttal Report at 18, n.27, 74, n.128. Even Dr. Crawshaw stated that he had no evidence that the Genworth and UGI commutations were not "arms-length" transactions meaning that if the parties expected claims to accrue in the future, then Atrium would be expected to pay the net present value of those claims as part of the commutation.

Lewis, 444 U.S. 11, 19 (1979)). RESPA provides a detailed remedial scheme, which permits injured persons to recover triple damages, creates criminal penalties for offenders, and provides the government the right to enjoin the offending activity. 12 U.S.C. § 2607(d). Nowhere does the statute provide for restitution. "'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.'" *Transamerica*, 444 U.S. at 20 (quoting *Botany Worsted Mills v. United States*, 278 U.S. 282, 289 (1929)). In the presence of such specific remedies, a court is "'compelled to conclude that Congress provided precisely the remedies it considered appropriate' absent 'strong indicia of a contrary congressional intent.'" *Mullinax*, 199 F. Supp. 2d at 334 (quoting *Middlesex Cnty. Sewerage Auth. v. Nat'l Sea Clammers Ass'n*, 453 U.S. 1, 15 (1981)). Because Congress identified an injunction as the Bureau's sole remedy, that is the only remedy it should be able to pursue.

Further, restitution makes no sense where, as here, the rates paid by borrowers for pmi were filed rates. That is, regardless of whether a loan was placed into a reinsurance book, the borrower paid the same amount for pmi. Accordingly, no borrower was harmed by the existence of the reinsurance agreements. Further, it is undisputed that borrowers were given an opportunity to select their own MI for loans originated by the Lender Respondents and that the existence of the reinsurance arrangement was disclosed to them prior to closing. Having failed to select an MI, the small group of potentially affected borrowers – those with loans in the Genworth 2008B or 2009 UGI books – are not entitled to restitution because they elected to allow the Lender Respondents to select the MI for their loans. Finally, since Atrium lost money on the two arrangements, it would be inappropriate to award restitution.

IX. THE BUREAU LACKS JURISDICTION OVER ATRIUM; IT CANNOT REGULATE THE BUSINESS OF INSURANCE; AND IT IS JUDICIALLY ESTOPPED

Prior to the commencement of the hearing, Respondents raised three issues: 1) the lack of jurisdiction over Atrium and Atrium Re; 2) the Bureau's inappropriate attempt to regulate insurance; and 3) whether the Bureau is collaterally estopped from pursuing Respondents. Previously, the Tribunal rejected Respondents' arguments regarding jurisdiction and the regulation of insurance; however, now that the record has closed, the Tribunal should revisit these issues because the evidence presented warrants a recommended decision in Respondents' favor.

A. Enforcement Counsel Have Not Presented Evidence Sufficient to Establish Jurisdiction Over Atrium and Atrium Re

Respondents Atrium and Atrium Re are entitled to a recommended disposition in their favor on the grounds that this Tribunal lacks jurisdiction over them since neither is a "Covered Person," "Service Provider," or a "Related Person" under § 1002 of the Dodd-Frank Act. Section 1053(b) of the CFPA, entitled "Special Rules for Cease-and-Desist Proceedings," is expressly limited to "Covered Person[s] or Service Provider[s]." 12 U.S.C. §§ 5563(b)(1)(A), (b)(2).[29]

When Respondents moved to dismiss on this ground, this Tribunal held that Atrium and Atrium Re could not be dismissed as a matter of law because the NOC alleged facts that the Tribunal found "sufficient[] for purposes of the Dismiss Motion" to establish Atrium and Atrium Re as Related Persons to PHH Mortgage and/or PHH Home Loans. May 22 Order at 8-9. While

[29] Enforcement Counsel have conceded that this proceeding is brought pursuant to Section 1053(b) of the CFPA, which limits Cease and Desist proceedings to Covered Persons and Service Providers, and therefore also to Related Persons (which are treated as Covered Persons). Feb. 14 Tr. at 17-18.

Respondents disagree with that finding, now that the Hearing has been completed and the record is closed, Enforcement Counsel have not satisfied their burden to present evidence sufficient to establish jurisdiction over Atrium or Atrium Re.

First, under the plain language of the statute, neither Atrium, nor Atrium Re is a Covered Persons. Covered Person is defined as a "person that engages in offering or providing a consumer financial product or service,"[30] or an affiliate of that person that is also a Service Provider to that person. 12 U.S.C. § 5481(6). There has been no allegation, let alone any evidence, that Atrium or Atrium Re at any time provided any consumer financial product or service, so Atrium and Atrium Re are not Covered Persons as such.

Second, Atrium and Atrium Re are not Service Providers. Service Provider is defined as:

> any person that *provides a material service to a covered person* in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that—(i) participates in designing, operating, or maintaining the consumer financial product or service; or (ii) processes transactions relating to the consumer financial product or service (other than unknowingly or incidentally transmitting or processing financial data in a manner that such data is undifferentiated from other types of data of the same form as the person transmits or processes).

12 U.S.C. § 5481(26)(A) (emphasis added). The term "material service" is explained in the statute with reference to two examples: participation in "designing, operating or maintaining" the consumer financial product or service, or "process[ing] transactions relating to the consumer financial product or service." 12 U.S.C. § 5481(26)(A)(i), (ii). Here, there was no allegation and

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[30] "Consumer Financial Product or Service" is defined as "any financial product or service that is described in one or more categories under—(A) paragraph (15) *[defining Financial Product or Service]* and is offered or provided for use by consumers primarily for personal, family, or household purposes; or (B) clause (i) *[extending credit and servicing loans]*, (iii) *[providing most real estate settlement services, other than the business of insurance, or performing appraisals]*, (ix) *[provision or use of credit reports]*, or (x) *[debt collection]* of paragraph (15)(A), and is delivered, offered, or provided in connection with a consumer financial product or service referred to in subparagraph (A)." 12 U.S.C. § 5481(5) (with brief summaries of cross-referenced provisions added in bracketed italics).

no evidence that Atrium or Atrium Re ever engaged in either, and no evidence was presented that these two entities participated in any way in "designing, operating or maintaining" the loans made by the Lender Respondents, or that they "process[ed] transactions" relating to the loans. In fact, it is hard to see how providing reinsurance to independent third parties in connection with loans that were originated by the Lender Respondents could be deemed a "service" to the Lender Respondents at all, let alone a "*material* service . . . in connection with the offering or provision" of the loans, as the statute requires. Moreover, neither Atrium nor Atrium Re can be considered Service Providers to the MIs because pmi is not a "Financial Product or Service." *See* 12 U.S.C. § 5481(15)(C)(i) (excluding the business of insurance). At bottom, after nine days of testimony, Enforcement Counsel provided no evidence that Atrium or Atrium Re provided any "material service" to either of the Lender Respondents "in connection with the offering or provision by such covered person of a consumer financial product or service," and therefore Atrium and Atrium Re are not Service Providers.

Third, Atrium and Atrium Re are not Related Persons to either of the Lender Respondents. A "Related Person" is "deemed to mean" a Covered Person, and is defined as:

> (i) any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person;
>
> (ii) any shareholder, consultant, joint venture partner, or other person, as determined by the Bureau (by rule or on a case-by-case basis) who materially participates in the conduct of the affairs of such covered person; and
>
> (iii) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any—(I) violation of any provision of law or regulation; or (II) breach of a fiduciary duty.

12 U.S.C. § 5481(25)(C). Enforcement Counsel have neither alleged in the NOC, nor attempted to show at the hearing, that either Atrium or Atrium Re is a "director, officer, [] employee . . . or controlling shareholder of, or agent for" the other Respondents; nor that Atrium or Atrium Re is

a "shareholder, consultant, joint venture partner, or other person . . . who materially participates in the conduct of the affairs of such covered person;" nor that Atrium or Atrium Re is an "independent contractor" to the other Respondents.

Although Enforcement Counsel did not present any evidence to establish that Atrium or Atrium Re "materially participat[ed] in the conduct of the affairs of [a] covered person," because this Tribunal previously raised that possibility, however, Respondents will briefly address the issue. Simply put, we respectfully suggest that in denying dismissal for lack of jurisdiction, the Tribunal was considering the possibility – legally irrelevant here – that PHH Corp. participated in the affairs of its indirect subsidiaries, Atrium and Atrium Re, and not that the subsidiaries somehow participated in the affairs of their indirect parent. Indeed, while Respondents would dispute that PHH Corp. participated in the conduct of the affairs of Atrium and Atrium Re (since this impermissibly ignores the corporate form), there is simply no evidence or even any allegation that either Atrium or Atrium Re had *anything* to do with conducting the affairs of PHH Corp. (or PHH Mortgage or PHH Home Loans), let alone that either "materially participate[d]." And *that* is the relevant inquiry.[31]

Since CFPA Section 1053(b) only applies to Covered Persons and Service Providers, and Enforcement Counsel have failed to proffer any evidence that either Atrium or Atrium Re is a Covered Person or Service Provider under the CFPA, this Tribunal lacks jurisdiction over

[31] Moreover, it is clear that Atrium and Atrium Re could not properly be considered "other person[s]," since the canon of construction *ejusdem generis* requires that a general catch-all be limited by the nature of the specific items listed before it (here, "shareholder, consultant, joint venture partner"). *See Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-15 (2001). Since an indirect subsidiary is nothing like a "shareholder, consultant, [or] joint venture partner" who may have authority over the Covered Person, this provision is simply inapplicable to Atrium and Atrium Re.

Atrium and Atrium Re, and they are entitled to a recommended decision dismissing them from this action.

B. The Bureau Is Precluded From Using These Proceedings to Regulate the Business of Insurance

The NOC makes clear that the Bureau believes that the reinsurance arrangements entered into by Atrium, and subsequently assumed by Atrium Re, do not constitute "real insurance." *See* NOC ¶¶ 60-70. In its May 22 Order, the Tribunal again denied Respondents' renewed motion by simply referring to the Tribunal's statements at the beginning of the hearing that "RESPA does not run afoul of the McCarran-Ferguson Act." May 22 Order at 3; *see also* Hearing Tr. 23 (Tribunal denying Respondents' Motion in Limine on this issue on the basis of the court's decision in *Patton v. Triad Guaranty Ins.*, 277 F.3d 1294, 1299 (11th Cir. 2002)). However, now that the hearing has concluded, Respondents renew their objection to Enforcement Counsels' theory that the reinsurance arrangements do not constitute "insurance." Enforcement Counsel relies on its expert witness, Dr. Crawshaw, to decide what is, or is not, "insurance." Specifically, Dr. Crawshaw relies upon what he deems to be the "common features" of Atrium's captive arrangements – the purported limitation of liability to funds in the applicable trust accounts, segregation of the trust accounts, purported low capital contributions, Atrium's purported "ability to force termination of its captive arrangements" and the high expected underwriting profit margins – to conclude that, in his opinion, none of the four reinsurance arrangements "provide[d] a genuine reinsurance service." *See* Crawshaw Expert Report at 12-30; Rebuttal Report at 2 ("Atrium did not provide any genuine reinsurance service to those mortgage insurance companies."); Hearing Tr. 614-40; *id.* at 763-64.

The Bureau's blatant attempt to displace the role of state insurance regulators is inappropriate. Under the McCarran-Ferguson Act, "[n]o Act of Congress shall be construed to

invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012(b) ("McCarran-Ferguson"). 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." *Humana, Inc. v. Forsyth*, 525 U.S. 299, 309-10 (1999).

Atrium Re is licensed and regulated by the Insurance Division of the Vermont Department of Financial Regulation. Atrium is licensed and regulated by the Insurance Division of the New York Department of Financial Services. Both Vermont and New York have comprehensive insurance and reinsurance regulatory regimes. Both states' regulators regularly supervised and examined their respective licensee, Atrium or Atrium Re, pursuant to a complex state regulatory scheme covering insurance, an issue essentially and exclusively reserved for state regulation under McCarran-Ferguson. Moreover, the MIs were also supervised and regulated by their respective state insurance regulators. As such, the Bureau's attempt to second-guess the state insurance regulators and appoint itself as the arbiter of whether reinsurance was "real reinsurance" is irredeemably inconsistent with McCarran-Ferguson. *See Doe v. Mut. of Omaha Ins. Co.*, 179 F.3d 557, 564 (7th Cir. 1999) (McCarran-Ferguson prevented federal courts from applying federal law to question actuarial practices: "Even if the formal criteria are the same under federal and state law, displacing their administration into federal court—requiring a federal court to decide whether an insurance policy is consistent with state law—obviously would interfere with the administration of the state law.").

Respondents do not dispute the general statement by the *Patton* court that "the McCarran-Ferguson bar does not apply where Congress explicitly reveals its intent to regulate

the business of insurance." *Patton*, 277 F.3d at 1298. However, in that case, the court went on to find that Congress's inclusion of "underwriting" as a settlement service – which the court construed to refer to "mortgage insurance" – meant that "RESPA is a Congressional Act that 'specifically relates' to mortgage insurance." *Id.* Respondents are not aware of any other court that has construed the term "underwriting" as it relates to the settlement service in connection with the origination of a loan to be "mortgage insurance." Indeed, such an assertion is nonsensical where the lender "underwrites" the loan. Under *Patton*, the lender's underwriting department would fall within the purview of the state insurance department, a position not taken by any state insurance regulator. More to the point, simply including the term "underwriting" does not mean that RESPA occupies the field of mortgage insurance such that the Bureau has the authority over all aspects of mortgage insurance including, for example, what constitutes mortgage insurance reinsurance.

Curiously, the Bureau acknowledges the authority of state insurance regulators and their role in regulating the very same captive insurers it now seeks to regulate through this enforcement action. Specifically, Enforcement Counsel have introduced into evidence, and seeks to rely upon, the fact that the MIs allegedly "expressed alarm to state insurance regulators in 1998, asking for limits on captive and other 'risk-sharing' arrangements between MIs and lenders." NOC ¶ 25. According to the Bureau, "the MIs argued[] such arrangements 'present a threat to the overall strength and claims-paying ability of the private mortgage insurance industry.'" *Id; see also id.* ¶¶ 26-27. Further, the Bureau introduced exhibits discussing the purported involvement of the Arizona Department of Insurance in the issue of captive reinsurance, and Dr. Crawshaw relied upon such materials to support his conclusions. *See* ECX

35; *infra,* at 40. Thus, the Bureau concedes that state insurance regulators regulate the very issue it is seeking to affect through this enforcement action.

Finally, in addition to the fact that McCarran-Ferguson precludes the Bureau's evidentiary theories under RESPA, the CFPA itself—which gave the Bureau the authority to enforce RESPA—precludes this type of collateral attack that would "affect[] the authority" of the state insurance regulators. 12 U.S.C. § 5552(d)(3) ("No provision of this title shall be construed as altering, limiting, or affecting the authority of a State insurance commission or State insurance regulator under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or regulator.").

Accordingly, the Bureau is precluded from using RESPA to attempt to regulate the business of insurance or collaterally attack the actions of the Vermont and New York insurance regulators which approved of the reinsurance arrangements at issue.

C. The Bureau is Judicially Estopped From Pursuing Respondents

In spite of the Enforcement Counsel's efforts to sweep the issue under the rug, the fact remains that it is the Enforcement Counsel's position in this administrative action that the reinsurance arrangement between UGI and Atrium was a "sham" and that the reinsurance was "worthless." However, the Bureau specifically permitted UGI to continue to make payments to Atrium and to account for this arrangement as reinsurance on its financial statements. In its May 22 Order, the Tribunal stated Respondents have "'failed to demonstrate that Enforcement took inconsistent positions.'" May 22 Order at 9 (citing the March 13 Order at 9, 14). Respondents continue to disagree with this finding. The fact that UGI was permitted to continue to cede premiums to Atrium after the entry of the Consent Order, and that UGI was permitted to continue to cede millions of dollars to other lender-captive reinsurers under similar arrangements demonstrates that the Florida Consent Order is a "sham."

As Respondents have pointed out, there is no question that UGI was permitted to cede premiums to Atrium after entry of the Consent Order.[32] Indeed, nowhere in any of the briefing on this issue has Enforcement Counsel ever challenged this fact. The Supreme Court has made clear that "giv[ing]" and "accept[ing]" a payment are two sides of the same RESPA coin, such that it cannot be legal for one party to pay money to another party, but illegal for the second party to receive it. *See Freeman*, 132 S. Ct. at 2041 (because a consumer's payment of an alleged overcharge for a settlement service was legal, the receipt of that charge by the service provider could not be illegal under RESPA). Respondents again reiterate their position that explicitly permitting UGI to continue to cede premiums to Atrium, while prosecuting Atrium for the receipt of those same premiums, is inconsistent on its face.

The Tribunal's explanation that one of the new emails "weakens Respondents' argument . . . because it shows that Enforcement was adamant with opposing counsel that 'the MIs have violated Section 8' of RESPA, and should be enjoined from doing so in the future," is curious. Contrary to the Tribunal's conclusion, Respondents assert that this is exactly what they have

[32] Indeed, UGI made clear in its briefing on Respondents' motion to intervene in the Florida case that the Consent Order permitted UGI to pay, and Atrium to receive, ceding payments after the entry of the Consent Order. *See CFPB v. United Guaranty Corp.*, No. 13-cv-21189 (S.D. Fla. Feb. 14, 2014), UGI's Memorandum in Opposition to Respondents' Motion to Intervene in the Florida case ("UGI Mem."), ECF No. 18. As UGI explained, the ceding payments were permitted by the Bureau:

- "Moreover, because this Court already approved the Consent Order, including the provision in it that expressly authorizes PHH's conduct in question . . . ." UGI Mem. at 2;
- "[B]ecause this Court has already approved the Consent Order, which contains an express approval of PHH's receipt of ceded payments from United Guaranty . . . ." *Id.* at 11.
- "United Guaranty negotiated a settlement that "*explicitly permitted* the continuation of the payments under the reinsurance contracts between UGI and Atrium." *Id.* at 12.
- "United Guaranty adequately represented [PHH's] interests by including a provision that declared the ceded payments from United Guaranty to be lawful." *Id.*

been arguing: the Bureau believes the reinsurance arrangements like those entered into between UGI and Atrium violated RESPA, yet the Bureau specifically allowed UGI to continue to violate RESPA and the Bureau even obtained the district court's affirmation that the conduct could continue. The Consent Order deems the conduct to be legally permitted; to hold otherwise would mean that the Bureau obtained an order that permitted illegal conduct, which is not permissible and, in fact, is inexcusable. *See, e.g., Howard v. McLucas*, 871 F.2d 1000, 1008 (11th Cir. 1989) (district court must "ensure that [consent order does] not violate federal law"); *United States v. City of Miami, Fla.*, 664 F.2d 435, 440-41 (5th Cir. 1981) (Rubin, J., concurring) (a court must ensure that a consent order "does not put the court's sanction on and power behind a decree that violates . . . [a] statute"); *Williams v. Vukovich*, 720 F.2d 909, 925 (6th Cir. 1983) (vacating consent decree as "illegal" where it "contain[ed] impermissible waivers of future" statutory violations); *Robertson v. N.B.A.*, 556 F.2d 682, 686 (2d Cir. 1977) ("*[A] settlement that authorizes the continuation of clearly illegal conduct cannot be approved*, but a court in approving a settlement should not in effect try the case by deciding unsettled legal questions.") (emphasis added).

Enforcement Counsel's attempt to explain their present position by pointing to the language in the Consent Order that there was no finding on the merits and that UGI did not admit liability for a RESPA violation is of no moment. If the Bureau believed that the reinsurance arrangement between UGI and Atrium actually violated Section 8 of RESPA, then it was obligated to ensure that such conduct ceased with the entry of the Consent Order. It did not. Rather, it took civil money penalties and then turned a "blind eye" to the continuation of the exact same conduct it said was illegal.

Enforcement Counsel's inconsistent position regarding their treatment of UGI vis-à-vis Respondents is further highlighted by Dr. Crawshaw in his Rebuttal Report wherein he states:

> [B]ecause Atrium's captive arrangements did not in fact transfer risk, **I do not believe it would have been appropriate for the MIs to reflect any reduction of risk in their financial statements as a result of entering into those arrangements**. Because the MIs in reality retained virtually all of the risk, any reduction in their risk-to-capital ratio would have been illusory and not consistent with the purpose of maximum risk-to-capital requirements.

Rebuttal Report at 121 (emphasis added). Inexplicably, the Bureau entered into a Consent Order with UGI that permitted UGI to continue to cede premiums and to account for the agreement with Atrium (and other lender-captive reinsurers) as insurance on its books while at the same time, Enforcement Counsel is advising this Tribunal that, in fact, such accounting treatment is inappropriate.

The doctrine of judicial estoppel seeks to protect the integrity of the judicial process. Enforcement Counsel's position here, that it can bring an action against Atrium for the receipt of the same payments that the Bureau allowed UGI to make, when RESPA specifically provides that "[n]o person shall give and no person shall accept" any fee for the referral of settlement service business, is repugnant to the judicial process. Stated differently, by paying a civil money penalty of $4.5 million, UGI is permitted to continue to cede premiums in connection with arrangements such as the one entered into with Atrium, for as long as it wants to. The only apparent qualification on that conduct is that the agreement had to be entered into prior to the entry of the Consent Order. Respondents are aware of no authority, and to date Enforcement Counsel have cited none, that stands for the remarkable proposition that a "person" can continue to participate in conduct that a federal agency of the United States is "adamant" is in violation of a federal law that carries criminal penalties. Respondents ask that the Tribunal reconsider its decision to permit Enforcement Counsel to take inconsistent positions in connection with this

administrative action. Because the Bureau is judicially estopped from asserting that the ceding payments violate RESPA, Respondents are entitled to a recommended decision in their favor on any claim based on the receipt of ceding payments or, in the alternative, at a minimum for conduct occurring after the entry of the Florida Consent Orders.

CONCLUSION

This action should have never been filed. RESPA was enacted to prevent kickbacks and fee splits with parties "who did nothing in return for the portions they received." *Boulware v. Crossland Mortg. Corp.*, 291 F.3d 261, 268 (4th Cir. 2002) (citation omitted). Respondents did not violate RESPA. As far back as 1997, HUD reviewed the very arrangements at issue here and concluded that they were permissible subject to certain conditions. The administrative hearing in this case proved one thing – that Respondents repeatedly took steps to ensure that they remained in compliance with HUD's guidance. Enforcement Counsel's case is not based on demonstrating that Respondents failed to comply with HUD's guidance; rather, their case is based on their belief that no captive mortgage reinsurance agreement is permissible under RESPA. That is why Enforcement Counsel made absolutely no attempt to demonstrate how or why Respondents' reinsurance agreements failed to satisfy the requirements in the 1997 HUD Letter. Indeed, Enforcement Counsel, and their expert witness, Dr. Crawshaw, paid mere lip service to that guidance, and then launched an attack based on their belief that pmi reinsurance was "worthless." But other than Dr. Crawshaw's post hoc, backward looking, "multi-year" analysis, Enforcement Counsel offered nothing to support their position. Standing in stark contrast to Enforcement Counsel's lack of evidence were the industry representatives who testified to the benefits of such reinsurance. Once this Tribunal determines that reinsurance services were provided – as it must given the dearth of evidence proffered by Enforcement Counsel – then the

Tribunal must also conclude that the amount of the cede was reasonable. That is so because Enforcement Counsel made no attempt to demonstrate that the 25% cede for the only two arrangements at issue was not reasonable, nor could they since their expert valued the services at $0.00. Therefore, the only evidence on this last point is that of the Milliman reports, which stand unrebutted. Further, given RESPA's criminal penalties, Enforcement Counsel's attempt to hold Respondents liable for conduct that was in compliance with HUD's guidance is inappropriate and contrary to the bedrock principle that clear notice of what constitutes a crime must be provided. Simply put, Enforcement Counsel cannot undermine Respondents' right to due process. Finally, even if Enforcement Counsel demonstrated a RESPA violation – which they did not – they are not entitled to any relief where, as here, there is no evidence to support the issuance of an injunction and "other" equitable relief is neither available through this administrative proceeding nor justified given the losses Atrium paid.

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

Dated: August 8, 2014

Respectfully submitted,

WEINER BRODSKY KIDER PC

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CERTIFICATION OF SERVICE

I hereby certify that on the 8th day of August, 2014, I caused a copy of the foregoing Respondents' Post-Hearing 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:

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