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.	))))))))))))))

BRIEF IN OPPOSITION TO
ENFORCEMENT COUNSEL'S APPEAL OF THE ADMINISTRATIVE
LAW JUDGE'S RECOMMENDED DECISION DATED NOVEMBER 25, 2014

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ABBREVIATIONS USED IN RESPONDENTS' BRIEFS

1. ALJ: Administrative Law Judge Cameron Elliot.
2. Atrium: All references to "Atrium" mean both Atrium Insurance Corporation and Atrium Reinsurance Corporation ("Atrium Re") unless otherwise specifically noted.
3. Bureau: Consumer Financial Protection Bureau.
4. CFPA: Consumer Financial Protection Act of 2010.
5. CMG: CMG Mortgage Insurance Company.
6. Document __: refers to specific documents filed with the CFPB's Office of Administrative Adjudication.
7. EC: Enforcement Counsel.
8. ERD: Expected Reinsurance Deficit Test. RD 44.
9. Feb. 14 Tr.: Transcript of the February 14, 2014 scheduling conference.
10. Genworth: Genworth Mortgage Insurance Corporation.
11. Genworth 2008-B Book: Contained loans originated between June 1, 2008, and March 31, 2009. RD 48.
12. HUD: United States Department of Housing and Urban Development.
13. HUD Letter: Letter from Nicolas P. Retsinas, Assistant Secretary for Housing-Federal Housing Commissioner, to Sandor Samuels, General Counsel of Countrywide Funding Corporation, dated August 6, 1997.
14. Lender Respondents: refers specifically to PHH Mortgage Corporation and PHH Home Loans, LLC.
15. Mar. 5 Tr.: Transcript of the March 5, 2014 hearing on Respondents' initial dispositive motion.
16. May 22 Order: The ALJ's decision issued after commencement of the administrative hearing but before Respondents' case-in-chief.
17. MGIC: Mortgage Guaranty Insurance Corporation.
18. MIs: refers generally to entities providing private mortgage insurance.
19. Pmi: private mortgage insurance, a credit enhancement. Tr. 412, 1849.
20. NOC: Notice of Charges dated January 28, 2014.

21. OCC: Office of the Comptroller of the Currency.

22. OTS: Office of Thrift Supervision.

23. Radian: Radian Guaranty, Inc.

24. RD: Recommended Decision.

25. Rules: CFPB Rules of Practice for Adjudication Proceedings.

26. Tr.: Administrative Hearing Transcript.

27. UGI: United Guaranty Residential Insurance Company.

28. UGI 2009 Book: Contained loans originated between January 1, 2009 and December 31, 2009.

INTRODUCTION

In order to accept EC's arguments in this appeal, the Director must decide: to violate the constitutional rights of Respondents; to ignore the more than 130 decisions of federal and state court judges; and to completely reject the ALJ's RD. While to be sure the RD is fundamentally flawed in numerous respects, both legally and factually, the ALJ correctly rejected the novel theory of EC's expert witness that risk transfer must be evaluated over the entire length of the agreement, and the ALJ properly concluded that the reinsurance had "value." EC's attempt to recover from the ALJ's rejection of their "no value" theory is unavailing, and EC proffer no legitimate basis to overturn that aspect of the RD. Further, while the ALJ failed to apply RESPA's three-year statute of limitations properly, he did recognize that allowing EC to include conduct prior to July 21, 2008, would violate Respondents' rights. EC's appeal cannot overcome this unassailable conclusion.

EC's appeal brief is disturbing in a number of respects. EC claim not to be bound by rulings issued by United States courts of appeals, a startling proposition to say the least. Moreover, while conceding that current law does not provide the relief they are seeking, EC nonetheless contend that the Director can "fix" this shortcoming by coming up with a different interpretation of RESPA as part of this appeal. Further, EC now assert that "PHH continuously violated RESPA from 1995 through 2013." EC Brief at 2. While EC purport to rely on the RD at 95-96, that is not what is contained in the RD, nor could it be, because before Respondents even put on their case, the ALJ limited the case to loans closed on or after July 21, 2008. The ALJ's ruling mid-hearing eliminated Respondents' need, and ability, to defend conduct occurring before July 21, 2008. EC cannot now simply manufacture allegations and categorical statements about conduct that the ALJ decided was no longer at issue.

RELEVANT FACTUAL ISSUES

EC's Brief raises certain factual issues that must be addressed. As it relates to EC's assertion of alleged harm, ECX 35, is the sole piece of purported evidence relied upon by the ALJ, and now EC (in their opening paragraph), for the proposition that "[i]f a captive arrangement lasts long enough, and accumulates enough in its trust account, that loss of insurance funds will have an adverse systemic effect on the mortgage insurance industry, and potentially on the housing market." EC Brief at 1[1]; RD at 99. As Respondents explained in their opening brief, the ALJ supported his statement with a document authored in 1998 by an insurance trade group that purportedly "presented" its theory to an Arizona insurance regulator in an attempt to convince that regulator to ***limit*** reinsurance arrangements ***to*** a 25% cede – which are the only structures at issue in this action. EC proffered no evidence of "harm," no witness testified that such harm occurred, and EC's reliance on such a baseless and unsupported assertion is a desperate attempt to hide their lack of evidence of a RESPA violation.[2] If EC intended to

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[1] EC also cite to page 82 of the RD; however, there is nothing to support the assertion on that page.

[2] To support his finding of "potential" harm to the housing market, the ALJ cites to three pages of testimony from MGIC CEO Culver. RD at 99. It bears noting that MGIC never had a reinsurance agreement with Atrium. Second, the cited testimony does not support the ALJ's conclusion. Mr. Culver simply stated the unremarkable proposition that MGIC earned more money when it was ceding 25% to the reinsurer than when it was ceding 40%. Nor does the ALJ explain, because he cannot, whether the alleged "adverse systemic effect on the mortgage insurance industry" occurred as a result of, or during periods of, deep cede (40%) arrangements, which are not at issue in this action, or the 25% cede arrangements, which are. Indeed, Freddie Mac, which imposed a 25% cede limitation on captive reinsurance arrangements on MIs with which it did business, believed that this would ensure sufficient claims paying ability by the MIs. RCX 811. Freddie Mac also specifically stated that other than its "temporary policy" of restricting the premium cede by the MIs, its policy "does not limit the mortgage industry's use of captive reinsurance." *Id.* The ALJ's attempted use of Culver's testimony regarding MGIC's profits also contradicts MGIC's written statement that "[c]aptive reinsurance was commonly used by mortgage insurers in the past to stabilize claims experienced and protect against ***catastrophic losses***," and that MGIC's reinsurance "provided much needed capital to MGIC that

rely on such a factual assertion, they should have proffered evidence to support it. Simply repeating the ALJ's unfounded statement does not make it true.

Further, the ***Bureau*** obviously does not believe that such arrangements have harmed the market. If it did, it would not have agreed to allow such arrangements to continue indefinitely as it did in connection with the Florida Consent Orders. Specifically, during the course of the litigation, EC produced reports from UGI, Radian, Genworth and MGIC, the four MIs that entered into Consent Orders in April 2013, which demonstrate the widespread nature of the continued ceding of payments by these four mortgage insurers ***after*** the entry of the Consent Orders. Based on the information provided by these four entities, there were more than ***160 arrangements*** in place as of April 2013 and ceding payments under those arrangements continued throughout 2013 and 2014 and likely continue today. *See* Respondents' Notice of Clarification dated Mar. 13, 2014 (Dkt. No. 68, and attachments thereto).[3] It is simply incomprehensible how EC can now claim that such arrangements "harmed" the housing market when the Bureau specifically did not order the MIs to cease such arrangements in connection with the Florida Consent Orders.

Like many of EC's other sensational allegations in the NOC which Respondents either refuted or EC summarily dropped, the manufactured assertion of "harm" to the mortgage market was clearly designed to disparage Respondents. The other specious allegations include: that borrowers were not "given a meaningful opportunity to select [a pmi] provider," NOC ¶ 13; that

helped MGIC survive the worst of the housing downturn." RCX 816 (Press Release, MGIC Comments on Captive Reinsurance Consent Order Settlement (Apr. 4, 2013) (emphasis added)).

[3] Respondents filed their Notice of Clarification to contest EC's representation to the tribunal that the provisions of the Florida Consent Orders permitting the ceding payments to continue were restricted to "highly limited conduct for agreements that were in run-off for a matter of weeks." Mar. 5 Tr. at 56. In fact, ceding payments to reinsurers other than Atrium appear to be expected to continue indefinitely.

"Atrium conducted no underwriting to price any reinsurance risks that it purportedly assumed," *id.* ¶ 22;[4] that Respondents "steer[ed] business to its captive 'partner' MIs even when [they] knew the prices they charged consumers were higher than competitors' prices," *id.* ¶ 85; that "the captive arrangements motivated [Respondents] to require more mortgage insurance coverage than was necessary, [and] at a higher cost to borrowers," *id.* ¶ 87; that Respondents "harmed borrowers by charging those with correspondent loans that did not have captive arrangements with [Respondents] an additional 75 basis points on their loan[s]," *id.* ¶ 88; that the ceding of premiums to Atrium "raised operating costs for MIs – costs which were passed on to all payors of mortgage insurance premiums to those MIs in the form of higher prices for mortgage insurance," *id.* ¶ 89; and that captive reinsurance somehow increased the "losses in the 2008 financial crisis." *Id.* ¶ 90. EC could not, and did not, present evidence of any one of these sensational assertions, which were clearly designed to intimidate Respondents into settling this matter.

It is noteworthy that when HUD, the agency responsible for enforcement of RESPA until July 2011, opined on the establishment of lender-captive reinsurance structures, it specifically noted that such arrangements "increased diversification of risk" in the mortgage market. HUD "welcome[d] such trends to the extent that such arrangements increase the availability of

[4] Indeed, such arrangements were specifically approved by the OCC as far back as 1996 when it issued Interpretative Letter #743. In that guidance, the OCC noted that because the reinsurer would only be reinsuring mortgage loans underwritten to the bank's underwriting standards, "[t]he national bank's own credit standards and credit underwriting experience will provide a valuable safeguard against excessive risk." Interpretative Letter #743, at 3 (RCX 821); *see also id.* at 7-8 (same); OCC Corporate Decision #99-26, at 7 (September 1999) (RCX 808) ("The Bank's own credit standards *and credit underwriting experience* will also be used to manage reinsurance risk since the Subsidiary will only accept home mortgage loan credit risks consistent with the Bank's underwriting standards.") (emphasis added).

mortgage credit." The disregard by the ALJ and EC of HUD's published view in favor of an industry position statement that quite possibly never saw the light of day is inexplicable.

ARGUMENT

I. THE BUREAU IS SUBJECT TO RESPA'S THREE-YEAR STATUTE OF LIMITATIONS, WHICH RUNS FROM THE LOAN CLOSING DATE

As explained in Respondents' opening brief, the Bureau is bound by the three-year statute of limitations in RESPA; accordingly, the Bureau's action can only go back to January 25, 2009, which is three years prior to the date on which Respondents agreed to toll the statute of limitations. The ALJ rejected Respondents' argument regarding the January 25, 2009, date and instead limited the time period from July 21, 2008, forward, a point Respondents are appealing. As part of their appeal, EC disagree with the ALJ's rejection of their continuing violation theory. At the same time, however, EC admit that their theory cannot be accepted absent *post hoc* rulemaking by the Bureau. Further, EC argue that no statute of limitations should apply to this action.

A. EC's Continuing Violation Theory is Without Merit

Shockingly, EC request that "as a matter of first impression" the Bureau should "exercise its authority to recognize a continuing violation of Section 8(a)" and require Respondents to disgorge all of the ceded premiums they received since 1995. EC Brief at 2-3. Stated differently, EC has no support for their request unless and until the Director issues a new interpretation of RESPA Section 8(a) that will support EC's case. EC cite no legal support – because there is none – for the proposition that a federal agency can issue a new interpretation of a statute and then utilize that interpretation to punish past conduct. EC does not even cite any authority for the Director to issue this new "interpretation" of RESPA as part of this adjudicatory proceeding, again, because there is no such authority. That EC would even suggest such a procedure reflects a fundamental misunderstanding of constitutional rights and administrative procedure.

Nor is there any basis to hold Respondents liable for any conduct occurring prior to July 21, 2008. That is so because, prior to Respondents putting on their case-in-chief, the ALJ ruled that "no claims arising from loans closed before July 21, 2008, are actionable. . .." May 22 Order at 14. Therefore, any evidence regarding Respondents' conduct relating to loans originated "before July 21, 2008" was rendered irrelevant to the administrative proceeding. Thus, EC's repeated references to Respondents' conduct prior to July 21, 2008, cannot be relied upon for purposes of this appeal because such conduct was specifically excluded by the ALJ.

Separate and apart from the lack of any authority to "reinterpret" RESPA as part of this proceeding, EC's attempt to rely on a continuing violation theory to go back further than January 25, 2009, is untenable as a matter of law. Although EC relegate their discussion to a footnote, the Supreme Court's decision in *Ledbetter v. Goodyear Tire & Rubber Co.*, 550 U.S. 618 (2007), is dispositive on this issue and binding on the Bureau. In *Ledbetter*, an Equal Pay Act case, the Court rejected the argument that each paycheck constituted a new violation of the statute such that it would "restart" the statute of limitations. *Id.* at 625. For purposes of determining the statute of limitations, the Court "stressed the need to identify with care the specific [discriminatory] practice that is at issue." *Id*. at 624. In *Ledbetter*, the Court made clear the distinction between a continuing violation and the continual effects of the violation, the latter of which "cannot breathe life into prior, uncharged discrimination." *Id.* at 628; *see also Garcia v. Brockway*, 526 F.3d 456, 462 (9th Cir. 2008) ("Put differently, a continuing violation is occasioned by continual unlawful acts, not by continual ill effects from an original violation.") (internal quotation marks and citations omitted).

The plain language of RESPA makes clear that the three-year period runs from "the date of the occurrence of the violation," which is the date of the loan closing. The fact that a portion of borrowers' continued monthly pmi premium payments was used to obtain reinsurance was simply the "continuing effects" of the prior alleged violation, with "'no present legal consequences.'" *Ledbetter*, at 625-26 (quoting *United Air Lines, Inc. v. Evans*, 431 U.S. 553, 558 (1977)). EC's attempt to distinguish *Ledbetter* based on *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251 (D. Mass. 2008), is unavailing. EC Brief at 8, n.11. EC fail to point out that, in *Miller*, the court specifically noted that at least one of the named plaintiffs was "challenging a policy that continues into the limitations period" and that the case was "a disparate impact case, where both the challenged policy and its disparate effects likewise continue in the relevant period." 571 F. Supp. 2d at 262. *Miller's* analysis in the context of the Fair Housing Act has been rejected by at least one other court. *See Coulibaly v. J.P. Morgan Chase Bank, N.A.*, No. 10-3517, 2011 U.S. Dist. LEXIS 87495, at *24 (D. Md. Aug. 8, 2011) ("'A continuing violation is occasioned by continual unlawful acts, not continual ill effects from an original violation.'") (citing *Nat'l Adver. Co. v. City of Raleigh*, 947 F.2d 1158, 1166 (4th Cir. 1991)).

Even prior to the Court's decision in *Ledbetter*, the courts that considered the argument that each pmi payment constitutes a "continuing violation" with respect to an alleged RESPA violation flatly rejected it. Specifically, in *Mullinax v. Radian Guaranty*, 199 F. Supp. 2d 311 (M.D.N.C. 2002), the plaintiffs argued that a violation of RESPA occurs upon each monthly pmi payment that a borrower makes after closing because each payment "relates to the illegal kickback agreements." *Id.* at 325. The *Mullinax* court noted that such an interpretation would allow borrowers "to initiate their suit within one year from the date of any single primary mortgage premium payment." In addition:

> To allow such an interpretation would create disparate results among borrowers, who apparently can elect either to pay for their insurance in one lump sum or through multiple payments, as Plaintiffs have done here. . . . This would mean that a borrower who elected to make monthly payments would have a floating statute of limitations period based upon the date of his last payment. The situation would be different for a borrower who paid the full premium for his mortgage insurance on the date of the closing. Should such a borrower have the financial means to do this, he or she would be faced with a statute of limitations period for bringing a lawsuit under RESPA that is fixed at one year from the date of the closing. The Court can find no statutory support or legislative history that suggests that Congress intended to provide such an uneven benefit. At the very least it can be said that Congress did not expressly provide for such a result. If Congress had intended the statute of limitations to float in this way, it could have so provided in explicit language.

199 F. Supp. 2d at 325. The *Mullinax* court noted "RESPA's focus on the settlement transaction itself and the use of the phrase 'at the time of the violation.'" *Id.*

More recently, in *Menichino v. Citibank, N.A.*, No. 12-0058, 2013 U.S. Dist. LEXIS 101102 (W.D. Pa. July 19, 2013), the court rejected the plaintiffs' continuing violation theory as applied to RESPA in the context of a pmi reinsurance case. The court noted that "RESPA's statute of limitations speaks only of a single triggering violation, not multiple violations." *Id.* at *42 (internal quotation marks and citation omitted). The court further reasoned that "the closing of the mortgage and continuous [mortgage] premium payments are more properly conceived of as a single violation followed by continuing consequences, where the closing of the mortgage is the single actionable violation and the recurring payments towards the mortgage balance are the continuing ill effects." *Id.* Otherwise, the court concluded:

> [T]olling the statute of limitations through the application of a continuing violations theory would extend indefinitely the limitations period for private plaintiffs suing under § 2607 and create a limitations period that is longer than Congress could have contemplated. Courts have been willing to apply the continuing violations theory to time-limited claims like hostile work environment

> because, to make out a cause of action, the plaintiff must show a series of discrete events over time whose cumulative effect comprises a discriminatory practice. The plain language of RESPA does not envision such a cumulated series of events as giving rise to a cause of action. Therefore, it would be inappropriate as a matter of law to apply the continuing violations theory to RESPA's statute of limitations in light of these considerations.

Id. at *42-43 (internal quotation marks and citations omitted).

Finally, EC's assertion of a "continuing violation" must be rejected because EC have conceded in this action, and in connection with the Florida Consent Orders, that ceding payments are not "continuing violations." EC justified the Bureau's decision to allow UGI, Genworth, MGIC and Radian to continue receiving ceding payments in connection with their lender-captive reinsurance arrangements, including, as it relates to this action, the agreement between UGI and Respondent Atrium Re, after entry of the Florida Consent Orders, because the payments were "contractual" obligations of the MIs. Mar. 5 Hearing Tr. at 55. EC's concession that the ceding payments are "contractual" obligations eviscerates their attempt to take the position that such payments are "continuing violations" of RESPA. Further, if EC's position were correct, then the fact that the Bureau has authorized the MIs to continue ceding premiums to reinsurers means that it will have prospectively absolved the MIs for criminal conduct, which the Bureau is not authorized to do.[5]

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[5] EC's attempt to craft a continuing violation theory based on employment cases is unavailing. While EC claim that subsequent Third Circuit case law "eliminated" the permanency factor, EC's underlying premise is faulty. EC Brief at 6 (citing *Mandel v. M & Q Packaging Corp.,* 706 F.3d 157, 165-66 (3d Cir. 2013)). *Mandel* dealt with the issue of a hostile work environment and the Third Circuit made clear that "[t]o allege a continuing violation, the plaintiff must show that all acts which constitute the claim are part of the same unlawful employment practice and that at least one act falls within the applicable limitations period." 706 F.3d at 165-66. The selection of an MI provider occurred no later than the date of the closing of the loan. There were no other "acts" that occurred after that date, and the borrower's payment of the monthly premium to the MI was, in EC's words, simply the contractual obligation of the borrower. Thus, regardless of the issue of "permanence," the only question is whether there was more than one "act" in violation of RESPA, and there was not.

B. <u>EC's Rejection of *Snow* is Baseless</u>

EC's rejection of the Fifth Circuit's decision in *Snow v. First Am. Title Insurance Co.*, 332 F.3d 356 (5th Cir. 2003), regarding the commencement of a RESPA violation can be summed up as follows: the more than 130 decisions of federal and state court judges who have examined the issue got it wrong and, despite the fact that no court has accepted EC's theory after the *Snow* case, now would be a good time to reverse almost twelve years of settled jurisprudence.

The *Snow* Court carefully considered the issue and rejected an interpretation proffered by the plaintiffs that "would generate confusion and uncertainty about the timeliness of many RESPA claims." The Fifth Circuit explained that a rule allowing the limitations period to "beg[i]n to run anew" based on a payment to defendants after closing "would encourage tardy plaintiffs to sue and hope that discovery turns up a recent payment that restarts the limitations period." 332 F.3d at 358-61. Further, the *Snow* court's admonition to plaintiffs remains true for the Bureau: "Plaintiffs, by contrast, cannot point to a case that holds or even assumes that the limitations period can restart when the defendant pays an allegedly illegal kickback or fee." *Id.* at 361.

EC's assertion that "no other circuit courts . . . have adopted *Snow's* holding" is not correct. *Snow* was recently cited by the Tenth Circuit in *Clemmons v. Mortgage Electronic Registration Systems*, No. 13-3204, 2014 U.S. App. LEXIS 21589, at *12 (10th Cir. Nov. 12, 2014), an unpublished decision dismissing RESPA claims. *Snow* has also been cited by the Third Circuit in *Drennan v. PNC Bank, NA* (*In re Community Bank of N. Va. & Guaranty National Bank of Tallahassee Second Mortgage Loan Litigation*), 622 F.3d 275, 281 (3d Cir. Pa. 2010) (noting the "hurdle posed by RESPA's one-year statute of limitations" and citing *Snow*), and that decision was recently cited by the Fifth Circuit in the more recent opinion of *Haase v. Countrywide Home Loans, Inc.*, 748 F.3d 624, 629-30 (5th Cir. 2014).

EC's attempt to hold Respondents liable for conduct back to 1997 – or more than 15 years before the tolling date of January 25, 2012, and long before the CFPB even existed – on the apparent theory that there is no applicable statute of limitations for a Bureau-initiated administrative action – is specious and patently unreasonable. Indeed, EC face another insurmountable hurdle in seeking to go back further than 2003. A number of MIs were defendants in previous private litigation in the Southern District of Georgia alleging that the reinsurance agreements, including the agreement between UGI and Atrium, violated RESPA. *See, e.g., Pedraza v. United Guar. Corp., et al.*, No. CV199-239 (S.D. Ga.). That litigation was resolved through the entry of an Injunction which, *inter alia*, established terms under which the MIs could continue with existing reinsurance arrangements. That injunction was in place from June 25, 2001, through December 31, 2003, which encompasses a period of time that Atrium had a reinsurance agreement with UGI. Pursuant to its terms, as long as UGI (as well as the other MIs that were part of this litigation and subject to identical injunctions), acted in conformity with the terms of the injunction, the acts of UGI were "deemed to be in compliance with RESPA." There is no evidence that HUD, or any other person or entity, has alleged that UGI did not adhere to the terms of the Injunction. Accordingly, EC is absolutely precluded from arguing that UGI, and thus, Atrium, failed to comply with RESPA at any time prior to December 31, 2003.

Similarly, EC's attempt to distinguish *Mullinax* and *Menichino* – both allegedly "incorrectly decided" cases – on the grounds that they were not "in the context of a government enforcement proceeding," EC Brief at 7, is without merit. Again, EC cite no authority for this curious proposition that statutes have two meanings, one for private parties and one for the

Bureau. Such a notion – that there exist multiple interpretations of RESPA based on the party enforcing it – was most recently rejected in *Carter v. Welles-Bowen Realty, Inc.*, 736 F.3d 722, 727 (6th Cir. 2013), wherein the Sixth Circuit refused to read RESPA differently based on whether the statute was being enforced criminally or civilly. *See also* discussion, *infra*, at IV.E (regarding rule of lenity). Likewise, EC's assertion that RESPA should be expanded because of its "charge[] with ensuring consistent adherence to Federal consumer financial law" and its "broad authority to enforce RESPA and other Federal consumer financial laws" is nothing more than the same argument in support of expanding RESPA's reach that was rejected in *Freeman v. Quicken Loans, Inc.*, 566 U.S.___, 132 S. Ct. 2034, 2044 (2012) (rejecting expansion of RESPA based on "[v]ague notions of statutory purpose").

The Fifth Circuit's decision in *Snow* is well-reasoned and the lack of any contrary authority is a testament to its persuasiveness. EC filed this administrative action for the sole purpose of trying to avoid RESPA's three-year statute of limitations as well as the application of the *Snow* decision. However, contrary to EC's belief, Respondents are constitutionally protected against retroactive application of the law as well as arbitrary and capricious agency action. EC's attempt to circumvent these constitutional protections must be rejected.

II. EC CANNOT DENY THE EFFECT OF COMMUTATION

EC argue that payments to the "co-conspirator" MIs in the form of loss payments should not be used to offset the disgorgement of ceded premiums. It bears repeating that the ALJ found that the reinsurance had "value." RD at 69. EC's theory that the insurance had "no value" was rejected by the ALJ and, despite their efforts to "recover" on the last day of the hearing by offering their discarded expert as a witness on the "value" of the reinsurance, the fact remains that EC did not prevail on their theory of liability. As it relates to the payment of losses, it is undisputed that Atrium paid more than $156 million in claims for book years starting in 2004. While EC and the ALJ continue to claim that Respondents "made a great deal of money," neither EC nor the ALJ bother to explain, on a yearly basis, when that purported "great deal of money" was "made." This is because to do so would highlight the extent to which this action relates to conduct occurring prior to at least 2004.

Specifically, for UGI, Atrium paid losses, and Milliman projected further losses, as follows:

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

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

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

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

Book Year	Paid Losses in Layer as of 3/31/12	Projected Future Paid Losses	Projected Ultimate Loss Ratios
2004	$0.00	$1,957,000	25.2%
2005	$6,191,000	$8,151,000	169.8%[7]
2006	$9,335,000	$2,141,000	183.3%
2007	$6,967,000	$4,666,000	201.7%
2008A	$6,079,000	$16,398,000	190.5%
2008B	$0.00	$12,058,000	137%

RCX 2004, at Tab M, pp. 22, 44. Once again, for years 2005 to 2008 (both books), Atrium was projected to pay out more in claims than it would ever collect in premiums and, as of March 31, 2012, Atrium had already paid Genworth $28,571,000 in reinsurance claims.[8] *See also* Hearing Tr. 940 (Crawshaw admitting that Atrium had "full limit losses" in connection with the UGI agreement for 2005, 2006, 2007 and 2008, and that the claims that would be paid in connection with the 2004 UGI Book were projected to exceed 90% of the premiums Atrium received).

Further, as it specifically relates to the Genworth 2008-B and UGI 2009 Books, Atrium paid the expected claims on those books through the commutations of those agreements and that

[7] *See* Hearing Tr. 932-33 (Dr. Crawshaw explaining in connection with the Genworth 2005 Book that the ratios are the projected ultimate claims divided by the projected premium, so the 169.8% means that Atrium was projected to pay out 169.8% of the premiums it was projected to receive.).

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

amount was roughly equivalent to the premiums Atrium was expected to receive. It is undisputed that "[c]ommutation 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." Crawshaw Rebuttal Report at 74, n.128.; Hearing Tr. 2327 (Crawshaw: "But the general idea would be to look at the contract and see what would happen, what you would expect to happen to the contract if it plays out over the ten-year runoff.").[9] Because they were arms-length transactions, the commutation of the UGI and Genworth reinsurance agreements provided for the net present value of the arrangements to be "settled" as between the insured (UGI and Genworth) and insurer (Atrium). In the case of the Genworth 2008-B Book – the only Genworth reinsurance book that contained loans originated after July 21, 2008, and thus the only Genworth 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 2008-B 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 UGI 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); Hearing Tr. 2326 (Crawshaw: "I think on the 2009 for UGI, I think it was -- there were certainly more

[9] 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. There was 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. *See also* Hearing Tr. 1391 (ALJ: "Dr. Crawshaw opined that sort of you might call it the starting point for commutation negotiations is that the commutation is supposed to provide for coverage for future claims because you're essentially canceling the agreement.").

premiums and there were more losses and more claims, and they would all net against each other.). 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.[10]

III. EC'S DEMAND FOR CIVIL MONEY PENALTIES VIOLATES DUE PROCESS

EC's demand for civil money penalties of "at least $240 million" cannot stand. The purported referral of mortgage insurance business to the MIs with which Atrium had reinsurance agreements ceased as of January 1, 2010. The Bureau assumed responsibility for RESPA enforcement as of July 21, 2011, more than 18 months after the last remaining agreement, the UGI 2009 Book, was closed and the agreement was placed in runoff. By EC's own admission, continued ceding payments to a reinsurer after the purported referral of the borrower to a particular MI is simply a "contractual" process. That is so because the alleged illegal referral occurred, if at all, no later than the closing of the loan, which is the point when the borrower became committed to the payment of a mortgage insurance premium.

EC's effort to impose civil money penalties for conduct that occurred ***prior*** to the Bureau's assumption of responsibility for RESPA constitutes an attempt to apply the Dodd-Frank Act retroactively. The "presumption against retroactive legislation is deeply rooted in our jurisprudence." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994). The Supreme Court has made clear that a statute that would "revive" an action that had been foreclosed or otherwise

[10] There is no dispute 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.

"extend[] a statute of limitations after the pre-existing period of limitations" "impermissibly revives a moribund cause of action." *Hughes Aircraft Co. v. United States*, 520 U.S. 939, 950 (1997) (citation omitted). A statute operates retroactively when it "attaches new legal consequences to events completed before its enactment." *Landgraf*, 511 U.S. at 270. Such new legal consequences include, for example, "impair[ing] rights a party possessed when he acted, increas[ing] a party's liability for past conduct, or impos[ing] new duties with respect to transactions already completed." *Id*. at 280. *See also Hughes Aircraft Co.*, 520 U.S. at 951 (Court refused retroactive application of the 1986 amendment to the False Claims Act); *Vartelas v. Holder*, 132 S. Ct. 1479, 1491 (2012) (when evaluating retroactivity, the "essential inquiry" is "whether the new provision attaches new legal consequences to events completed before its enactment") (quoting *Landgraf*, 511 U.S. at 269-70).[11]

EC's assertion that they can demand any civil money penalties for an alleged violation of RESPA is unavailing because the alleged referrals occurred before July 21, 2011, and Dodd Frank is not retroactive.

IV. EC CANNOT READ SECTION 8(c)(2) OUT OF RESPA

Unable to escape the fact that the reinsurance contracts at issue here unquestionably satisfied the risk transfer requirements for reinsurance, EC now seek to take a scalpel to Section 8 of RESPA and excise Section 8(c)(2) from the law, on the basis of no authority whatsoever except that the Bureau previously filed a similarly flawed *amicus* brief in the Ninth Circuit that *also* did not cite any relevant authority. Not only is EC prohibited from rewriting RESPA, but—as demonstrated below—the surgery that EC propose would be more akin to taking an axe to

[11] In *Marrie v. SEC*, 374 F.3d 1196 (D.C. Cir. 2004), the D.C. Court of Appeals reversed the SEC's Order which imposed new legal consequences and new legal duties on the actions of accountants by eliminating the good faith defense and requiring that materiality be proved by showing that a false or misleading financial statement had been filed. 374 F.3d at 1207.

Section 8(c) as a whole, leaving large parts of the mortgage industry subject to criminal liability for widespread practices that Congress, as well as HUD, has specifically approved.

The text of § 8(c)(2), the implications of EC's argument for the rest of § 8(c), the history of HUD's official interpretations of RESPA—including interpretations that have been adopted by the Bureau—the fact that EC's interpretation would render § 8(c)(2) a dead letter, and the rule of lenity each show—and together prove overwhelmingly—that § 8(c)(2) means what it says: the provision of services in exchange for payments exempts the reinsurance agreements at issue in this action from § 8(a)'s scope. That is true *even if* those agreements had been entered into in exchange for the referral of real estate settlement services (which Respondents do not concede).

A. <u>The Text of Section 8(c)(2) Belies EC's Position</u>

Section 8(c)(2) clearly states 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), (c)(2) (emphasis added). "[T]his section" means Section 8 as a whole, which most assuredly includes § 8(a). So, the statute says that *nothing* in § 8—which includes § 8(a)—"shall be construed as prohibiting . . . the payment to any person of . . . compensation or other payment for goods or facilities actually furnished or for services actually performed." *Id*. And EC cannot dispute that § 8(a) is part of § 8, and therefore that Section 8(a) shall not be "construed as prohibiting . . . payment . . . for services actually rendered." EC's attempt to avoid the plain statutory language by manufacturing a false distinction between the "payment" proscribed in § 8(a), on the one hand, and the "payment" described in § 8(c)(2), on the other, makes no sense. *See* EC Br. at 24 ("It authorizes certain types of *payments*, and only when those payments are not for referrals of real estate services, but it does not permit . . ..") (internal quotation marks omitted).

EC attempt to avoid the clear meaning of the statute by trying to distinguish between the money paid for the reinsurance coverage, and the reinsurance agreements that provide for those payments, a distinction without a difference. The only reason that a reinsurance agreement has any "value" for the reinsurer is because it provides for the ceding of money in exchange for the risk assumed. Nothing in RESPA supports EC's micro-parsing of the applicable provisions, and in fact, as discussed below, if such a distinction were valid, other important parts of § 8(c) would have no application at all. Moreover, the Court of Appeals for the Eighth Circuit addressed—and squarely rejected—the argument that EC now attempts to make, in the *Glover* case, on the basis of the clear statutory text:

> [I]nventive minds making clever arguments can turn virtually *any* payment flowing from a lender to a broker, in connection with the placement of a mortgage loan, into a purported payment for the unlawful referral of business. **However, Section 8(c) clashes with this result. It clearly states that reasonable payments for goods, facilities or services actually furnished are *not prohibited* by RESPA, even when done in connection with the referral of a particular loan to a particular lender**. [Plaintiffs'] approach tends to turn the interrelated sections upside down, putting total emphasis on the prohibitory language of Section 8(a) and no emphasis on the permissive language of Section 8(c).

Glover v. Std. Fed. Bank, 283 F.3d 953, 964 (8th Cir. 2002) (emphasis added); *see also id*. at 965 ("Section 8(c) clearly anticipates payments to individuals for goods or facilities actually furnished or for services actually performed, and specifically excludes these payments from the Section 8(a) proscription."). It stands to reason, in fact, that § 8(c) was enacted precisely to guard against this type of prosecutorial overreach. *Cf.* Prepared Statement of Edwin B. Brooks, Jr., Real Estate Settlement Costs, Subcomm. on Housing of the Comm. on Banking and Currency (Dec. 4, and 5, 1973, and Jan. 29, and 30, 1974), at pp. 302-03 (Commending the changes made to "meet[] some of the objections raised to earlier proposed 'kickback' prohibitions, which were considered unclear, and in some respects, vague").[12]

Since the statutory provision is clear, the fact that a single *amicus* brief drafted by the Bureau itself took a different position is simply irrelevant. *See Freeman*, 132 S. Ct. at 2040.

B. EC's Position Would Retroactively Criminalize a Broad Array of Conduct Universally Understood to be Permitted under RESPA

If EC's position were correct and § 8(c)(2) "authorize[d] certain types of payments . . . but d[id] not permit referral *agreements*," then by logical extension the other paragraphs of § 8(c) would not apply to protect persons from § 8(a) claims either, a preposterous and potentially ruinous result. EC Br. at 24 (internal quotation marks omitted). For example, § 8(c)(1)(B) permits a title company to pay "its duly appointed title agent for services actually performed in the issuance of a policy of title insurance." As a provision of § 8(c), the operative language is the same phrase, "[n]othing in this section shall be construed as prohibiting . . .." The usual practice in the title industry is for the title agent to refer the borrower to the title insurer, and also to receive a commission on the title premium in exchange for services performed for the title insurer in connection with the transaction. If EC's extreme interpretation of § 8(c) were correct, then a title company could not possibly pay the title agent who referred the business to the title insurer for the services that agent performed for the title insurer, because the payment would be permitted but the "referral" that invariably accompanies it would not be. Yet that is clearly not

[12] Respondents have previously explained why "bona fide" in § 8(c)(2) modifies salary but cannot grammatically modify "compensation or other payment," and why it makes more sense logically that "bona fide" would modify "salary." *See, e.g.*, Respondents' Post-Hearing Brief, Docket No. 178 at 28 n.17 (incorporated herein by reference). Even if EC were correct about "bona fide" modifying "compensation or other payment," however, those two modest Latin words could not do the work that EC now ask of them. Rather, even under EC's mistaken position (that "bona fide" modifies "compensation or other payment"), at most it could become relevant whether the amount of the payment was so excessive in comparison with the value of the services, as to call into question whether the payment was being made, *in good faith* (*bona fide*), for the services at all.

the law. *See, e.g.*, *Howland v. First Am. Title Ins. Co.*, 672 F.3d 525, 533 (7th Cir. 2012) ("[A]s long as the agents performed any services on First American's behalf, they are allowed a reasonable fee under Section 8(c)(2).").

Similarly, a mortgage broker may receive compensation for performing services in connection with the origination of a mortgage loan pursuant to § 8(c)(1)(C) and (c)(2). *See, e.g.*, *Glover*, 283 F.3d at 964-65 (citing HUD Statement of Policy on yield spread premiums). Yet, the mortgage broker will only have the opportunity to receive such compensation if the broker has referred the loan to the lender.[13] If EC's "interpretation" of § 8(c) were correct, every lender-paid mortgage broker (and every lender who paid them) would be committing a crime. This "preposterous result" illustrates plainly why EC's contention cannot be correct. *Francis v. Lyman*, 216 F.2d 583, 588 (1st Cir. 1954).

C. EC's Position Contradicts Years of Official Guidance, Including the Interpretive Rule Issued by HUD and Adopted by the Bureau

EC cannot reinterpret § 8(c) without undoing years' worth of official interpretations and policy statements issued by HUD, including HUD's 2010 Interpretive Rule concerning Home Warranty Companies' Payments to Real Estate Brokers and Agents. 75 Fed. Reg. 36271 (June 25, 2010) (the "Interpretive Rule").

The Interpretive Rule explains, in relevant part:

> To evaluate whether a payment from an HWC is an unlawful kickback for a referral, HUD may look in the first instance to whether, among other things:
> . . .
> • Payments to real estate brokers or agents by the HWC are based on, or adjusted in future agreements according to, the number of transactions referred.
> <u>If it is subsequently determined, however, that the payment at issue is for only compensable services, the existence of such arrangements and agreements would not be an indicator of an unlawful referral arrangement, and would be permissible.</u>

[13] And why – although it does receive valuable services from the broker – does a lender decide to contract with a mortgage broker at all, if not to receive a referral of mortgage loans?

75 Fed. Reg. 36271, 36272 (emphasis added, footnote omitted). Thus, according to HUD's official interpretation of RESPA Section 8(c)(2), even if a home warranty company was receiving referrals from a real estate broker or agent, *and at the same time was making payments to the broker or agent based on the number of transactions referred*, Section 8(a) of RESPA is not violated where the payments are "for only compensable services." *Id*. This means – contrary to EC's newly adopted position – that Section 8(c)(2) *does* apply to alleged violations of Section 8(a).

The Bureau adopted the "official . . . guidance" of HUD, "issued prior to July 21, 2011," concerning RESPA, including the Interpretive Rule. *See* 76 Fed. Reg. 43569, 43570 (July 21, 2011). Regulation X (former 24 CFR § 3500.4 and current 12 CFR § 1024.4) provides that official guidance like the interpretive rule remains in effect unless and until it is "revoked or amended by a subsequent document published in the Federal Register." Even though EC apparently have been taking their new position since at least October 2013 (when the Bureau filed its *amicus* brief in the Ninth Circuit), no such notice has been published. The Bureau cannot simply change RESPA's meaning by taking a different position in an administrative enforcement action. And, in any case, the Bureau cannot retroactively prohibit conduct that HUD's official interpretation of RESPA would have permitted. *See* discussion at III., *supra*.

D. EC's Position Would Impermissibly Make Part of Section 8(c)(2) a Dead Letter

EC's argument that § 8(c)(2) does not apply to § 8(a) claims must fail because, since § 8(b) includes its own exemption for payment for services actually rendered, § 8(c)(2)'s services carve out is only needed when one considers § 8(a) claims.

The language of § 8(b) prohibits fee splitting "other than for services actually performed." 12 U.S.C. § 2607(b). Section 8(c)(2) provides that neither of the two proscriptions in § 8 "shall be construed as prohibiting . . . payment . . . for services actually performed." 12 U.S.C. § 2607(c), (c)(2).

While § 8(c)(2) does include other provisions that are not separately set forth in § 8(b), the provision that "payment . . . for services actually performed" is not covered by § 8 would be wholly duplicative if it did not also apply to § 8(a). *See Williams v. Taylor*, 529 U.S. 362, 404 (2000) ("It is . . . a cardinal principle of statutory construction that we must 'give effect, if possible, to every word of a statute.'") (quoting *United States v. Menasche*, 348 U.S. 528, 538-39 (1955)).

E. <u>The Rule of Lenity Precludes EC's Position</u>

Finally, even if it could be argued that § 8(c)(2) did not apply to § 8(a) claims, the rule of lenity would apply to require interpreting § 8(a) *not* to prohibit the things that § 8(c)(2) says that § 8(a) does not prohibit. *See Carter*, 736 F.3d at 729-36 (Sutton, J., concurring); *see also Freeman*, 132 S. Ct. at 2041 (interpreting § 8 in a civil case based on the implications of that interpretation for criminal prosecutions under the same statutory provision).[14]

RESPA Section 8 has both criminal and civil applications; accordingly, the rule of lenity applies, and any ambiguity in the statute must be resolved in Respondents' favor. *Leocal v. Ashcroft*, 543 U.S. 1, 11 n.8 (2004) ("Because we must interpret [a] statute consistently, whether we encounter its application in a criminal or noncriminal context, the rule of lenity applies.") (citing *United States* v. *Thompson/Center Arms Co.*, 504 U.S. 505, 517-18 (1992) (plurality

[14] Similarly, EC's argument that "[a]ny doubt" regarding the statute of limitations "should be resolved in favor of the Bureau," EC Brief at 7, n.10, runs counter to the rule of lenity. As Respondents have repeatedly pointed out, EC have not, because they cannot, find a case interpreting a criminal statute in such a manner. Rather, EC cite to *Interamericas Investments, Ltd. v. Board of Governors of the Federal Reserve Systems*, 111 F.3d 376 (5th Cir. 1997), but miss the significance of that case, which is that it specifically held that construction of a statute of limitations in favor of the government applies "***in the civil context***." *Id.* at 382. EC simply refuse to acknowledge that RESPA is a criminal statute.

opinion)); *Rodriguez v. Holder*, 705 F.3d 207, 213 (5th Cir. 2013). The ALJ acknowledged that RESPA is a statute to which the rule of lenity would apply. RD at 76. EC has not appealed that determination.

Since the rule of lenity applies to RESPA § 8, the Bureau cannot broaden the scope of § 8 by interpreting any purported ambiguity against Respondents.

CONCLUSION

EC's attempt to increase the monetary penalty against Respondents from the $6.4 million in the RD to either "$493,428,811" or "at least $121,719,499" is wholly unfounded and would trample on Respondents' constitutional rights. Further, as EC readily admit, their various theories of the case, *e.g.*, continuing violation and the unavailability of a § 8(c)(2) defense, have not been recognized by the Bureau or any court. While perhaps EC believe they can manufacture agency law "in secret," whereby persons and entities are only advised of such laws when an enforcement action is filed, the Constitution protects citizens against such arbitrary and capricious action. Further, it bears repeating that RESPA is a criminal statute; accordingly, the rule of lenity applies, and EC's cavalier treatment of its provisions cannot be squared with the bedrock principle that the government must provide clear notice of what constitutes a crime. For all these reasons, the Director should reject EC's appeal in its entirety.

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Respectfully submitted,
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CERTIFICATION OF SERVICE

I hereby certify that on the 9th day of February, 2015, I caused a copy of the foregoing Brief in Opposition to Enforcement Counsel's Appeal of the Administrative Law Judge's Recommended Decision Dated November 25, 2014, to be filed 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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