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' PREHEARING BRIEF

Respondents PHH Corporation, PHH Mortgage Corporation, PHH Home Loans, LLC, Atrium Insurance Corporation, and Atrium Reinsurance Corporation (collectively "Respondents") hereby submit their Prehearing Brief in advance of the hearing of this matter which is scheduled to commence on March 24, 2014.

## INTRODUCTION

The Notice of Charges ("NOC") filed by the Consumer Financial Protection Bureau (the "Bureau" or "CFPB") alleges that Respondents violated Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607, through captive mortgage reinsurance agreements that Atrium had with certain private mortgage insurance providers. According to the Bureau, Respondents "solicit[ed] and collect[ed] illegal kickback payments and unearned fees, disguised as reinsurance premiums, [], in exchange for the referral of private mortgage insurance business." NOC at 1.

Specifically, Sections 8(a) and 8(b) provide as follows:

(a) Business referrals

> 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.
>
> (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(a) and (b). To demonstrate a violation of Section 8(a), the Bureau must demonstrate: 1) a payment or a thing of value; 2) made pursuant to an agreement to refer settlement business; and 3) an actual referral. *Egerer v. Woodland Realty, Inc.*, 556 F.3d 415, 427 (6th Cir. 2009) (citing *Culpepper v. Irwin Mortgage Corp.*, 491 F.3d 1260, 1265 (11th Cir.2007)). To demonstrate a violation of Section 8(b), the Bureau must "demonstrate that a charge for settlement services was divided between two or more persons," *Freeman v. Quicken Loans, Inc.*, 132 S. Ct. 2034, 2044 (2012), and that the person receiving the "portion, split or percentage" in fact "performed" no "services." 12 U.S.C. § 2607(b).

Further, RESPA is clear that there can be no violation of either Section 8(a) or 8(b) if actual services are provided:

> Nothing in [Section 8] 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). This safe harbor is absolute: where "goods or facilities [were] actually furnished or [] services actually performed," there can be no violation of Section 8. 12 U.S.C. § 2607(c)(2).

A statute that provides for both civil and criminal penalties must be interpreted the same way in both civil and criminal cases. *See Freeman*, 132 S. Ct. at 2041 (applying this principle to RESPA § 8). Accordingly, because Section 8 of RESPA provides for criminal penalties, its

interpretation is governed by the rule of lenity which "tells all interpreters to resolve uncertainties in laws with criminal applications in favor of the defendant." *Carter v. Welles-Bowen Realty, Inc.*, 736 F. 3d 722, 729 (6th Cir. 2013) (Sutton, J., concurring); *id.* at 736 ("Agencies, no less than courts, must honor the rule of lenity."); *see also United States v. Thompson/Center Arms Co.*, 504 U.S. 505, 518 (1992) ("It is proper, therefore, to apply the rule of lenity and resolve the ambiguity in [defendant's] favor.") (plurality); *id.* at 519-23 (Scalia, J., concurring) (agreeing to the application of the rule of lenity to a civil statute that also provides for criminal penalties); *Crandon v. United States*, 494 U.S. 152, 158 (1990) ("[B]ecause the governing standard is set forth in a criminal statute, it is appropriate to apply the rule of lenity in resolving any ambiguity in the ambit of the statute's coverage."). Since the rule of lenity resolves any statutory ambiguities in favor of the defendant/respondent, after application of the rule of lenity there is no remaining ambiguity and therefore no occasion to defer to any interpretation of RESPA by the Bureau. *Carter*, 736 F.3d at 730-33. For the same reason, any new or revised interpretation of RESPA could not in any case be given retroactive effect without violating the *ex post facto* clause. *Id*. at 733.

The Bureau has the burden of proof on all issues, including the burden of proving that no "goods or facilities" were "actually furnished" and no "services" were "actually performed," under Section 8(c)(2). 12 C.F.R. §1081.303 ("Enforcement Counsel shall have the burden of proof of the ultimate issue(s) of the Bureau's claims at the hearing."). The Bureau's burden is to prove each element of each asserted violation by a preponderance of the evidence. Accordingly, the Bureau must show that it is more likely than not that no reinsurance was provided by Atrium/Atrium Re, the recipients of the ceding payments. *See*, *e.g.*, Third Circuit Model Jury

Instructions – Civil 1.10 ("more likely so than not so"); Fifth Circuit Pattern Jury Instructions – Civil 2.20 ("more likely true than not true").

The allegations in the NOC are without merit. The evidence will demonstrate that the captive reinsurance arrangements entered into by Atrium with four of the private mortgage insurers ("MIs") were fully compliant with all applicable laws, including RESPA.[1] Further, those arrangements provided substantial benefits to both parties to the transaction. Specifically, the arrangements aligned the interests of the lender and the respective MI in that both parties stood to benefit as a result of the origination of higher quality loans. The MIs further benefitted because reinsurance, among other things, provided the MIs with more stable financial results, catastrophic risk protection, and capital benefits.

While the Bureau speculates as to the motivation(s) for the reinsurance arrangements between the MIs and a captive reinsurer of a lender such as Atrium, the evidence at the hearing will demonstrate the following facts as they relate to Atrium:

- These were agreements between sophisticated parties and gave benefits to both sides;
- The arrangements were fully disclosed to state regulators and routinely reviewed by those regulators (*e.g.*, Atrium by the New York Department of Insurance, and Atrium Re by the Vermont Department of Financial Services);
- Reinsurance arrangements similar to those entered into by Atrium were utilized by hundreds of captive reinsurers; they were approved by the Office of the Comptroller of the Currency ("OCC") for a number of operating subsidiaries of National Banks and by the Office of Thrift Supervision ("OTS") for several savings and loans associations; and such arrangements were known to, and approved by, the Government Sponsored Enterprises ("GSEs") – Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac").

[1] While there are a number of MIs, Atrium had reinsurance agreements with only four: CMG Mortgage Insurance Company ("CMG"), Genworth Mortgage Insurance Company ("Genworth"), Radian Guaranty, Inc. ("Radian"), and AIG United Guaranty Mortgage Insurance Company ("UGI").

- Until December 31, 2003, the reinsurance agreement between Atrium and UGI was subject to, and incompliance with a Consent Order entered by the United States District Court for the Southern District of Georgia;
- The arrangements were reviewed by an outside independent actuarial expert – Milliman, Inc. ("Milliman") – which opined on book years regarding the transfer of risk;
- Even the Bureau's expert witness, Mark Crawshaw, believes that: 1) the reports issued by Milliman complied with all applicable actuarial and accounting standards; and 2) Atrium was entitled to rely on the opinions issued by Milliman;
- Atrium's trust accounts complied with all applicable statutory and regulatory requirements;
- Atrium fully complied with all of its obligations under the reinsurance arrangements with the four MI providers; and
- Atrium paid every claim under the reinsurance agreements presented by the four MIs.

Atrium was one of more than one hundred captive reinsurers that provided valuable reinsurance to several of the MIs pursuant to agreements that were fully complied with and provided advantages to both parties to the transaction.

## I. THE BUREAU CANNOT SEEK AN INJUNCTION WHERE, AS HERE, THERE IS NO REASONABLE LIKELIHOOD OF FUTURE VIOLATIONS

The Bureau requests that this tribunal grant "[a] permanent injunction to prevent and restrain *future* violations of Section 8 of RESPA." NOC ¶ 104(A) (emphasis added). This tribunal has already determined 15 specific facts relating to the underlying issue, including: the Radian reinsurance agreement was commuted on July 22, 2009; the CMG agreement was commuted on August 31, 2009; the Genworth reinsurance agreement was terminated on April 1, 2012; and the UGI agreement was terminated on May 31, 2013. *See* Order dated March 13, 2014. Thus, as of January 29, 2014, the date of the filing of the NOC, neither Atrium, nor Atrium Re, had any reinsurance agreements in place. Further, not only had the reinsurance contracts been terminated by that point, but three of the four MIs named in the NOC had signed

consent orders with the Bureau strictly prohibiting them from entering into future agreements for the next ten years. Thus, the Bureau's request for injunctive relief is inappropriate because there is no *future* conduct to enjoin.

The Supreme Court has said that "[t]he purpose of an injunction is to prevent *future* violations." *United States v. W.T. Grant Co.*, 345 U.S. 629, 898 (1953) (citation omitted, emphasis added). The Bureau requests in its NOC that this tribunal grant "[a] permanent injunction to prevent and restrain *future* violations of Section 8 of RESPA." (emphasis added). The Bureau does not allege, however, that Respondents will violate Section 8 of RESPA in the future. This is insufficient under Supreme Court precedent: "the 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 898 (affirming dismissal where defendant voluntarily terminated offending conduct after government filed suit).

The Bureau has not, and *cannot*, show that injunctive relief is needed in this case. It is undisputed that when the Bureau filed its NOC against Respondents in January 2014, the purportedly noncompliant agreements had all been terminated. PHH would also be hard-pressed to find partners for similar contracts in the future: three of the four MIs named in the NOC have signed consent orders with the Bureau, prohibiting them from entering into such agreements for the next ten years. Without willing partners, neither Atrium nor Atrium Re will have an opportunity to enter such agreements.

As the Supreme Court has stated, "[a]n injunction is a drastic and extraordinary remedy, which should not be granted as a matter of course." *Monsanto Co. v. Geerston Seed Farms*, 130 S. Ct. 2743, 2761 (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 PHH's inability to find partners for future violations, weighs heavily against the imposition of such a drastic remedy.[2] In addition, the overbreadth 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 quotations 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, 1292-93 (M.D. Fla. 2010) (finding such an "obey-the-law" injunction unenforceable and ineffective; gathering cases); *see also Miglionico v. Birmingham News Co.*, 378 So. 2d 677, 681 (Ala. 1979) (finding that such injunctions are "repugnant to the American spirit and should not lightly be either administratively sought or judicially granted") (citation omitted).

## II. THE ALLEGED VIOLATIONS OCCURRED NO LATER THAN THE LOAN CLOSING DATES

For purposes of RESPA, the evidence will show that the settlement service at issue – private mortgage insurance – is acquired for a mortgage loan no later than the time of the loan closing. Likewise, the evidence will show that Atrium's commitment to provide reinsurance pursuant to its agreements with the MIs was in place before the closing of the mortgage loan. Thus, while the Bureau contends that the reinsurance furnished by Atrium was not "real" and

[2] 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 (2nd 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.").

instead constituted a kickback and/or unearned fee split in violation of RESPA Section 8, "the date of the occurrence of the [alleged] violation," is the mortgage loan closing date – *i.e.*, the point in time by which the private mortgage insurance, along Atrium's commitment to reinsure the same, were in place.[3]

As the Bureau conceded at the hearing on Respondents' motion to dismiss, even assuming that no statute of limitations applies to administrative actions, this enforcement action can only reach back to conduct occurring after July 21, 2008. This is because HUD, the federal agency with prior RESPA enforcement authority, was limited to bringing court actions under a three-year statute of limitations. Accordingly, on July 20, 2011, the day before HUD's authority transferred to the Bureau, HUD could only have initiated a court action against Respondents going back to July 20, 2008. The next day, July 21, 2011, the Bureau assumed authority for RESPA enforcement and, while no longer confined to bringing "court" actions only, it cannot reach back farther than the three-year period to which HUD was bound on the day before. *See* March 5, 2014 Tr., at 47:12-20 (Enforcement Counsel stating that "as long as any part of the

[3] The fact that the Bureau cannot bring an action for alleged RESPA violations beyond the three-year statute of limitations is dictated by the plain language of the statute which states that "[a]ny action" by the Bureau "may be brought within 3 years *from the date of the occurrence* of the violation." 12 U.S.C. § 2614 (emphasis added). The language used by Congress can only apply to a discrete event, one that occurs on a single identifiable date, as opposed to any assertion of a "continuing violation" that runs for years and occurs on some unidentifiable date. *See Snow v. First Am. Title Ins. Co.,* 332 F.3d 356, 357 (5th Cir. 2003) ("Had Congress wanted the various steps in a single transaction to trigger the statute of limitations multiple times, it would have spoken of multiple "violations."). Further, as the court in *Mullinax v. Radian Guar*., 199 F. Supp. 2d 311, 325 (M.D.N.C. 2002), explained, an interpretation that would allow borrowers to initiate their suit within one year from the date of any single primary mortgage premium payment "would create disparate results among borrowers, who apparently can elect either to pay for their insurance in one lump sum or through multiple payments. . . . 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. . . . If Congress had intended the statute of limitations to float in this way, it could have so provided in explicit language."

conduct occurred after July 21st, 2008, it would be encompassed here because HUD could have brought that claim before we existed, we could have brought it the day after.”).

## III. ATRIUM PROVIDED A “SERVICE” FOR PURPOSES OF RESPA SECTION 8(C)(2) AND, IN ANY EVENT, THE REINSURANCE ARRANGEMENTS PROVIDED FOR SUFFICIENT RISK TRANSFER

Pursuant to RESPA’s Section 8(c)(2) safe harbor provision, the performance of a service precludes a finding of liability under RESPA Section 8(a) or (b). Further, as *Freeman* makes abundantly clear, once a service has been provided, the cost of the service cannot be scrutinized. Thus, to prevail against Respondents under RESPA Section 8, the Bureau must show that Atrium performed **no** services in exchange for the reinsurance premiums it received. *Boulware v. Crossland Mortg. Corp.*, 291 F.3d 261, 268 (4th Cir. 2002) (“Congress ‘directed § 8 against a particular kind of abuse that it believed interfered with the operation of free markets – the splitting and kicking back of fees to parties **who did nothing** in return for the portions they received.’”) (quoting *Mercado v. Calumet Fed. Sav. & Loan Ass’n*, 763 F.2d 269, 271 (7th Cir. 1985) (emphasis added)).

First, as a fundamental matter, given the nature of insurance, even if Atrium never paid a claim – which of course it has – the Company still would have provided a service for purposes of RESPA. As explained in *Kay v. Wells Fargo & Co.*, 247 F.R.D. 572 (N.D. Cal. 2007):

> [I]t is an indisputable fact in this case that [the reinsurer] was and remains obligated to operate as the reinsurer for each borrower’s private mortgage insurance. That [the reinsurer] has yet to be called upon to make any payments in no way means that it does not continue to be liable in the event that any of the requisite contingencies occur. [The reinsurer] continues to provide a service, namely reinsurance. By definition, therefore, [the reinsurer] has provided and will continue to provide a service.

*Id.* at 577.[4] *See also Van Arnam v. GSA*, 332 F. Supp. 2d 376, 394 (D. Mass. 2004) ("In fact, a principal purpose of insurance is to reduce one's risk of liability by spreading the cost among a large number of insureds, only a small number of whom will actually suffer a loss.").

Second, Atrium unquestionably has provided a service as evidenced by, among other things, its payment of more than $156 million in claims. It is simply undisputed that Atrium abided by its obligations under the reinsurance agreements and paid claims to the MIs in accordance with those arrangements. Accordingly, because Atrium performed actual services in exchange for the reinsurance premiums it received, RESPA's Section 8(c)(2) safe harbor applies and Atrium cannot be held liable under either Section 8(a) or 8(b). *Arthur v. Ticor Title Ins. Co.*, 569 F.3d 154, 160 n.2 (4th Cir. 2009) ("At no point have plaintiffs explained why [defendant's] commissions to its agents should be regarded as referral fees in the circumstance in which the agents have indisputably performed settlement services. Because Section 8(c) makes clear that [defendant] has not violated any of the provisions of Section 8 in this circumstance, plaintiffs' Section 8(a) claim fails [in addition to their Section 8(b) claim]."); *Cedeno v. IndyMac Bancorp, Inc.*, No. 06-Civ-6438, 2008 U.S. Dist. LEXIS 65337, at *13 (S.D.N.Y. Aug. 25, 2008) (dismissing RESPA Section 8(a) case "[b]ecause the safe harbor provision of RESPA permits payment to a person for services actually performed").

Third, to the extent the tribunal concludes that "risk transfer" is a necessary element of demonstrating that a service has been provided, expert testimony will demonstrate that the underlying reinsurance agreements provided for sufficient risk transfer. Further, despite the

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[4] In those instances where Atrium had not paid a claim on a particular book year, the Atrium agreements still met this requirement because "the band of the reinsurer's potential exposure is such that a reasonable business justification would motivate a decision to reinsure that band." *See* Informal guidance letter dated August 6, 1997, from Nicholas P. Retsinas, Assistant Secretary for Housing, to Sandor Samuels, General Counsel for Countrywide Funding Corporation (the "HUD Letter").

Bureau's allegations to the contrary, the evidence will demonstrate that Atrium's contracts were legally binding and consistent with industry standards for reinsurance agreements. In the NOC, the Bureau alleges generally that the reinsurance agreements were a sham because they contained "trust caps" which purportedly limited Atrium's exposure only to the funds in the trust account established for each MI arrangement. As the evidence will demonstrate, the Bureau is mistaken; the trust caps were placed in reinsurance agreements for reinsurers domiciled in Vermont at the request of the Vermont regulator. Atrium , by contrast, was domiciled in New York; accordingly, the "trust cap" provision was not required for its agreements.

## IV. EVEN THE BUREAU'S EXPERT WITNESS CONCEDES THAT THE MILLIMAN REPORTS COMPLIED WITH THE REQUIRED STANDARDS OF THE ACTUARIAL INDUSTRY AND ATRIUM WAS ENTITLED TO RELY ON MILLIMAN'S ACTUARIAL OPINIONS

The evidence will show that Atrium utilized the services of Milliman, a third-party actuarial firm, to perform the risk analysis to ensure that there was sufficient risk transfer and that the risk was commensurate with the premium that was being received. Specifically, Respondents' witnesses and exhibits will demonstrate that Milliman assessed the historical risk profile of the various books of loans underwritten for MI providers to evaluate whether there had been a transfer of risk. Consistent with that analysis, Milliman also provided guidance to Atrium with respect to the establishment of the appropriate corridor of losses to be reinsured, as well as the entry and exit points of that corridor. Milliman also provided assistance to Atrium in establishing adequate loss reserves based on the performance of the books of loans. Atrium always met its contractual funding obligations with respect to the four trusts that were created in connection with its reinsurance arrangements.

Further, even the Bureau's own expert, Mr. Crawshaw, will testify that Milliman's actuarial analysis met the standard of care for a Fellow of the Casualty Actuarial Society

("FCAS"). While Mr. Crawshaw concludes that the Atrium reinsurance agreements did not provide sufficient risk transfer, the difference in the conclusions of these actuaries rests with the methodology used. Specifically, Mr. Crawshaw's "dispute" with Milliman's analysis is over the issue of whether an actuarial analysis of risk transfer should be done on a book-year basis, as Milliman did, or over the life of the arrangement, as Mr. Crawshaw suggests. However, Mr. Crawshaw will not, because he cannot, point to any actuarial or accounting rule that *requires* the use of one methodology over the other. Thus, Mr. Crawshaw cannot testify that Milliman was "wrong" in its analysis. Indeed, the testimony from Milliman and Respondents' expert will be that it is inappropriate to assume that the type of reinsurance arrangement at issue here will continue for a substantial period of time because, among other things, the Atrium agreements permitted a party to unilaterally cancel the agreement upon 90-days notice and with no penalty. But this dispute is beside the point. Where Respondents retained outside independent experts who opined that there was a sufficient transfer of risk, the Bureau cannot now allege otherwise simply on the ground that it found a different actuary who reached a different conclusion.

## V. REGARDLESS OF WHAT THIS TRIBUNAL DECIDES ON THE STATUTE OF LIMITATIONS, BASED ON A 2001 CONSENT ORDER, THE BUREAU CANNOT CHALLENGE THE REINSURANCE ARRANGEMENTS BETWEEN UGI AND ATRIUM BEFORE DECEMBER 31, 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. 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.[5] That injunction was in place from June 25, 2001, through December 31, 2003.

[5] A copy of the Injunction that was agreed to by UGI as part of the settlement in *Pedraza v. United Guaranty Corp., et al.*, No. CV199-239 (S.D. Ga.), is attached hereto as Exhibit 1.

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." The evidence will show that the reinsurance agreement between UGI and Atrium was in existence and subject to the terms of the Injunction. The evidence with further show that no party or government entity has claimed that UGI did not adhere to the terms of the Injunction. Accordingly, the Bureau is precluded from arguing that UGI, and thus, Atrium, failed to comply with RESPA at any time prior to December 31, 2003.

## VI. THE BUREAU IS PRECLUDED FROM CHALLENGING THE CEDING PAYMENTS FROM UGI TO ATRIUM RE AFTER THE SIGNING OF THE CONSENT ORDER ON APRIL 5, 2013

The evidence will demonstrate that UGI continued to cede premium payments for reinsurance after the entry of the Consent Order entered into by UGI and the Bureau. The evidence with further demonstrate that the Bureau and the settling MIs deliberately crafted the terms of the Consent Orders to specifically allow the continuation of ceding payments pursuant to agreements such as Atrium's – agreements that the Bureau now contends violate RESPA. Since the Bureau allowed the private mortgage insurance premium ceding payments from UGI to Atrium Re to continue after the U.S. District Court signed the UGI Consent Order on April 5, 2013 – just as it allowed the continuation of ceding payments under at least 160 other reinsurance arrangements from UGI, Radian, Genworth and MGIC after their respective Consent Orders – the Bureau cannot now change its mind and bring claims against Respondents for the very payments that it permitted. *See CFPB v. United Guar. Corp.*, No. 13-cv-21189 (S.D. Fla.), Tr. of Mar. 10, 2014, Hr' on Mot. to Intervene at 22 ("There is no argument or contention the Bureau has sought to prevent the ceding of premiums on the contracts; that was *allowed* to

happen for a period of less than two months.") (emphasis added); *see also* Resp'ts' Mot. in Limine to Strike Claims Predicated on Ceding Payments Allowed by the Bureau in April and May 2013.[6]

## VII. THE OTHER ALLEGATIONS BY THE BUREAU ARE WITHOUT MERIT

The NOC contains a number of allegations regarding Atrium's reinsurance agreements, none of which have any evidentiary support:

### A. Borrowers were not "overcharged" for private mortgage insurance.

The evidence will show that, contrary to the Bureau's contention, borrowers were not overcharged for private mortgage insurance. The evidence will further show that the rates among the various MIs were similar; thus, the selection of a particular MI provider had little, if any, effect on the borrower. Critically, Respondents will demonstrate that the amount paid by a borrower for private mortgage insurance remains the same regardless of the existence of any reinsurance arrangement. This is because insurance rates, including private mortgage insurance rates, are subject to strict scrutiny by state regulators. For example, Pennsylvania, which is similar to other states, requires that all insurance rates, including private mortgage rates, must be filed and approved. 40 Pa. Stat. Ann. § 710-5(a). In Pennsylvania, the Department of Insurance reviews filed rates and may disapprove those rates it deems excessive or inadequate. *Id.* § 710-7. Further, Pennsylvania has a comprehensive regulatory scheme for reinsurers conducting business in the Commonwealth. 40 Pa. Stat. Ann. § 442 ("Reinsurance regulated"). Because

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[6] Respondents will also introduce evidence at the hearing demonstrating the receipt of these substantial payments pursuant to a large number of existing reinsurance arrangements which are virtually identical in structure as the Atrium agreements at issue here. Respondents will further demonstrate that there is no legal or factual basis to differentiate between such agreements, such that the fact that the Bureau permitted UGI, Atrium's counterparty, to continue to cede payments, and it allowed Atrium's other counterparties *e.g.*, Genworth and Radian, to continue to cede payments under identical arrangements, bars the Bureau from pursuing its claims against Atrium.

private mortgage insurance rates are filed with and regulated by the Pennsylvania Department of Insurance, they are subject to the filed rate doctrine. "The filed rate doctrine provides that a rate filed with and approved by a governing regulatory agency is unassailable in judicial proceedings brought by ratepayers." *Alston v. Countrywide Fin. Corp.*, 585 F.3d 753, 763 (3d Cir. 2009) (citing *Wegoland Ltd. v. NYNEX Corp.*, 27 F.3d 17, 18 (2d Cir. 1994)).[7] *See also McCray v. Fid. Nat'l Title Ins. Co.*, 682 F.3d 229, 242 (3d Cir. 2012) (applying filed rate doctrine to antitrust case challenging title insurance rates because the relief sought would require the district court to engage in the ratemaking process and thereby "'subvert the authority' of the [Department of Insurance] by second-guessing its rate determination"); *In re N.J. Title Ins. Litig.*, 683 F.3d 451 (3d Cir. 2012) (same holding).

In *Alston*, a private mortgage reinsurance case, the Third Circuit held that the filed rate doctrine did not bar the plaintiffs' RESPA claim because the plaintiffs in that action were not challenging the "reasonableness or propriety of the rate[s]" themselves. *Alston*, 585 F.3d at 765. Here, by contrast, the Bureau is alleging that borrowers were overcharged for private mortgage insurance. Consequently, the Bureau is improperly challenging the "reasonableness or propriety of the rates" at issue in the instant case. Further, the Bureau is seeking "restitution in an amount to be determined at trial to compensate borrowers who paid more in mortgage interest and mortgage insurance premiums as a result of the illegal scheme." NOC ¶ 104(C). By explicitly

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[7] The filed rate doctrine has two purposes – non-discrimination and non-justiciability. *Clark v. Prudential Ins. Co. of Am.*, 736 F. Supp. 2d 902 (D.N.J. 2010). "The non-discrimination strand is premised in part on the concept that awarding damages to plaintiffs while leaving less litigious customers paying the filed rates would be discriminatory." *Id.* at 913. "The non-justiciability strand reflects the courts' general reluctance to substitute their judgment for the judgment of the regulatory agency vested with primary authority to make such decisions and the courts' limited ability to determine the reasonableness of rates." *Id.* (citing *AT&T v. JMC Telecom, LLC*, 470 F.3d 525, 535 (3d Cir. 2006)). Further, "[t]here is no fraud exception to the filed rate doctrine." *Id.*

seeking "restitution" of their mortgage insurance premiums, the Bureau is asking this tribunal to "step into the shoes" of insurance regulators and determine that borrowers should have paid less for their private mortgage insurance. Such relief unquestionably implicates the filed rate doctrine.

### B. Borrowers were not required to purchase "more coverage than was necessary."

The evidence at trial will demonstrate that the amount of mortgage insurance coverage was set by the ultimate investor, not by the Lender Respondents, and the Bureau's assertion that borrowers were required to purchase more "coverage" than was necessary is nonsensical.[8] First, as a matter of common sense, the Lender Respondents have no incentive to have a borrower purchase more mortgage insurance coverage than is absolutely necessary to originate the loan. That is so because borrowers will shop around for the best rate and terms for their mortgage. Borrowers who are unable to provide a down payment of 20% are required to purchase private mortgage insurance to protect the owner of the loan in the event of a default. The bulk of the loans originated by Lender Respondents during the time when the Atrium reinsurance arrangements were in place were sold to Fannie Mae and Freddie Mac.[9] The amount of mortgage insurance was set by these investors, and it was in the Lender Respondents' best interests to ensure that only the amount of mortgage insurance required by the investor was purchased for the loan because to require more coverage than necessary would unnecessarily increase the cost of the loan, thereby placing the Lender Respondents' loan product at a competitive disadvantage.

[8] The Lender Respondents are PHH Mortgage Corporation and PHH Home Loans, LLC, the only Respondents in the business of originating mortgage loans.

[9] Further, even where the Lender Respondents' loans were not sold directly to Fannie Mae or Freddie Mac, the loans were originated according to Fannie Mae's or Freddie Mac's guidelines to facilitate their sale on the secondary market.

**C. There is no evidence that borrowers who obtained loans through a loan correspondent were charged more for utilizing an MI provider that did not have a captive arrangement.**

The Bureau asserts that borrowers who utilized a "loan correspondent" to obtain a loan were charged more for their mortgage insurance. There is no evidence to support such an assertion. As the evidence will show, in a typical correspondent relationship, the loan closes in the correspondent's name and is subsequently sold to the Lender Respondents on the secondary market. While it varied somewhat over time, the evidence will show that correspondent loans typically made up less than 20% of the Lender Respondents' origination portfolio. The Lender Respondents would, at various times, impose pricing differentials in connection with the purchase of loans from correspondent lenders who elected not to use a "preferred provider," meaning an MI with which the Lender Respondents had an established relationship and the provider had an electronic data interface ("EDI") setup with the Lender Respondents that allowed for the electronic ordering of mortgage insurance. The purchase of a loan on the secondary market, however, is not a transaction covered by RESPA, and therefore, not relevant to the NOC. It is also noteworthy that at various times, the Lender Respondents' "preferred provider" list to the correspondent lenders included MI providers with which Atrium did not have a captive reinsurance arrangement, *e.g.*, MGIC and Republic.

Lender Respondents afforded the correspondent lenders the choice of selecting the MI provider(s) for the correspondent's loans or the correspondent could elect to have the Lender Respondents perform that task. It is important that the correspondent lenders – not the Lender Respondents – are the entities responsible for dealing with the borrowers and the correspondent lenders are under no obligation to use any particular MI provider. Indeed, the evidence will demonstrate that correspondent lenders are free to choose any MI and the correspondent lenders

were not required to sell their loans to the Lender Respondents. Further, Respondents will show that the inclusion of various MI providers on the list of "preferred providers" demonstrates that the driving factors were the quality of the existing relationship and ease of ordering the mortgage insurance, and not the existence of a reinsurance arrangement with Atrium.

**D. Respondents' use of a particular MI was based on a number of factors.**

The Lender Respondents' primary business was, and is, to originate high quality mortgage loans for qualified borrowers. As a result, the Lender Respondents needed to ensure that there were an adequate number of MI providers that covered the available array of loan products being offered. Thereafter, the evidence will show that the Lender Respondents' interests were in working with MIs who had: a history of good customer service; solid financial footing, *i.e.,* counterparty risk; and the ability to communicate electronically in terms of ordering and placing mortgage insurance. Lender Respondents never restricted a borrower's choice of an MI, much less restricted the provider to only an entity with which there existed a reinsurance arrangement. Further, the Lender Respondents allowed brokers and loan correspondents to select the MI. The evidence will show that the primary question regarding the selection of the MI was, and remains, whether the MI offered to insure the loan program sought by the borrower. After that, the Lender Respondents considered several other factors including counterparty risk, the MI's willingness to pay claims, and other business relationship factors.

At no time did the Lender Respondents inhibit or otherwise curtail their lending practices for the purpose of "driving" borrowers to an MI with a reinsurance arrangement. Rather, the evidence will demonstrate that the Lender Respondents dealt primarily with UGI prior to 2001, but expanded to include Genworth starting in 2001, and added other providers to its dialer – the system for randomly selecting mortgage insurance where the borrower (or correspondent) does

not select the MI provider – in 2008 (MGIC) and 2009 (Republic and Radian). The fact that the Lender Respondents never had a reinsurance relationship with MGIC or Republic, and that Radian was not added to the dialer until after its reinsurance arrangement had gone into run-off, further demonstrates that the existence of a reinsurance arrangement was not a primary consideration for the Lender Respondents with respect to the selection of an MI provider.[10] It is also worth noting that at various times when there was a reinsurance arrangement in place, Genworth was reduced to 0.0% in the dialer.

RESPA cannot be used to limit a lender's decision to partner with specific MI providers, nor can it be interpreted to obligate a lender to conduct business with specific MI providers. To hold otherwise would force a lender such as the Lender Respondents to deal with MI providers that provided poor customer service or refused to properly process claims.[11]

The HUD Letter specifically acknowledged 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." And HUD specifically allowed lenders to enter into such arrangements. Critically, if HUD had wanted to prohibit captive arrangements pursuant to its authority under RESPA, it had the opportunity to do so in 1997, but did not.

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[10] While Radian was not added to the dialer until August 2009, loans insured by Radian were included in books of loans where Atrium provided reinsurance. The loans that were placed in those books were generally either correspondent loans or loans where the mortgage insurance was lender-paid. Unlike borrower-paid mortgage insurance, where there is a monthly charge for the mortgage insurance, under the lender-paid option, the borrower's monthly payment did not include a separate charge for mortgage insurance.

[11] Nor will there be any evidence that Lender Respondents agreed to refer all or a predetermined volume of business to any MI, nor any evidence that any of the reinsurance agreements provide for a fluctuation of the premium based on volume referred. As noted above, the Lender Respondents' primary focus was to originate loans and, where the borrower was unable to put down 20% and thus MI was required, the first criteria was, and continues to be, whether the MI provider offered to insure the loan program sought by the borrower.

## CONCLUSION

Respondents followed the rules. Atrium was a reinsurance entity that always complied with all applicable statutory and regulatory requirements; Atrium's reinsurance agreements provided for adequate and real transfer of risk – they were not sham agreements; Atrium's trusts were always adequately capitalized; Atrium abided by the agreements it entered into; and when the real estate market collapsed in 2007-2008, Atrium paid reinsurance claims in the amount of $156,307,798. Respondents understood the requirements of RESPA and the evidence will demonstrate that they complied with all applicable statutes and regulations.

The MI providers, all of which are sophisticated insurance entities, freely agreed to enter into the reinsurance arrangements with Atrium. It is beyond dispute that private mortgage reinsurance is catastrophic insurance; that is, it exists for the purpose of providing assistance only during a period of calamitous losses. During the financial crisis, hundreds of millions of dollars flowed from the reinsurers to the MIs. Respondents had an interest in this type of arrangement because the higher quality loans they originated, the more likely they would be rewarded because losses on the books of loans would be less. This "skin in the game" element of these arrangements is consistent with the philosophy that lenders should have an interest in the performance of their loans after origination. Therefore, the Bureau's assertions of a RESPA violation are without merit.

Dated: March 19, 2014 Respectfully submitted,

WEINER BRODSKY KIDER PC

By: /s/ Mitchel H. Kider
Mitchel H. Kider, Esq.
David M. Souders, Esq.
Sandra B. Vipond, Esq.
Rosanne L. Rust, Esq.

1300 19th Street, N.W., Fifth Floor
Washington, D.C. 20036
(202) 628-2000

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

**CERTIFICATION OF SERVICE**

I hereby certify that on the 19th day of March, 2014, I caused a copy of the foregoing Respondents' Prehearing Brief to be filed with the Office of Administrative Adjudication and served by electronic mail on the following parties:

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|---|---|
| Lucy Morris<br>Lucy.Morris@cfpb.gov<br><br>Sarah Auchterlonie<br>Sarah.Auchterlonie@cfpb.gov<br><br>Donald Gordon<br>Donald.Gordon@cfpb.gov<br><br>Kim Ravener<br>Kim.Ravener@cfpb.gov<br><br>Navid Vazire<br>Navid.Vazire@cfpb.gov<br><br>Thomas Kim<br>Thomas.Kim@cfpb.gov<br><br>Kimberly Barnes<br>Kimberly.Barnes@cfpb.gov<br><br>Fatima Mahmud<br>Fatima.Mahmud@cfpb.gov<br><br>Jane Byrne<br>janebyrne@quinnemanuel.com<br><br>William Burck<br>williamburck@quinnemanuel.com<br><br>Scott Lerner<br>scottlerner@quinnemanuel.com | David Smith<br>dsmith@schnader.com<br><br>Stephen Fogdall<br>sfogdall@schnader.com<br><br>William L. Kirkman<br>billk@bourlandkirkman.com<br><br>Reid L. Ashinoff<br>reid.ashinoff@dentons.com<br><br>Melanie McCammon<br>melanie.mccammon@dentons.com<br><br>Ben Delfin<br>ben.delfin@dentons.com<br><br>Jay N. Varon<br>jvaron@foley.com<br><br>Jennifer M. Keas<br>jkeas@foley.com |

/s/Rosanne L. Rust
Rosanne L. Rust