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.

ORAL ARGUMENT REQUESTED

BRIEF IN SUPPORT OF RESPONDENTS' APPEAL OF THE ADMINISTRATIVE LAW JUDGE'S RECOMMENDED DECISION DATED NOVEMBER 25, 2014

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ABBREVIATIONS USED IN THIS MEMORANDUM

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. MIs: refers generally to entities providing private mortgage insurance.
18. Pmi: private mortgage insurance, a credit enhancement. Tr. 412, 1849.
19. NOC: Notice of Charges dated January 28, 2014.
20. OCC: Office of the Comptroller of the Currency.

21. OTS: Office of Thrift Supervision.
22. Radian: Radian Guaranty, Inc.
23. RD: Recommended Decision.
24. Rules: CFPB Rules of Practice for Adjudication Proceedings.
25. Tr.: Administrative Hearing Transcript.
26. UGI: United Guaranty Residential Insurance Company.
27. UGI 2009 Book: Contained loans originated between January 1, 2009 and December 31, 2009.

INTRODUCTION

Rather than the "fair" and "impartial" hearing the Bureau promised, the Agency's first administrative adjudication was hijacked by the ALJ. EC's theory that Atrium's reinsurance agreements were a "sham" because there was no transfer of risk fell apart when the ALJ found that there was sufficient risk transfer in connection with the only two agreements at issue. Thereafter, unbeknownst to Respondents, the ALJ took over the case and assumed the roles of investigator, prosecutor, expert witness, and even fact witness. As a result of the ALJ's conduct, and his incorrect RESPA analysis, Respondents were denied the fundamental right of due process. The RD must be rejected as it is not based on the evidence adduced at the hearing and is replete with internal inconsistencies, which is to be expected because Respondents were not afforded a full and fair opportunity to challenge the ALJ's new allegations. This matter should be dismissed or, in the alternative, remanded for a new hearing in front of a different ALJ.

RELEVANT FACTUAL AND LEGAL BACKGROUND

The 102-page, single-spaced RD is replete with factual and legal errors.[1] With respect to this appeal, Respondents note the following relevant facts that were established at the hearing:[2]

- Pmi reinsurance has existed since the 1980s, and captive reinsurance arrangements involving lender-affiliates have been part of the real estate mortgage market since 1995. Such arrangements were specifically approved by numerous federal and state regulators, including the OCC, OTS, and, in the case of Atrium, the New York and Vermont Departments of Insurance. RD 5-8; RCX 821; RCX 143; ECX 583.
- In 1997, HUD recognized that the establishment by a lender of an affiliated reinsurer 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." ECX 594, HUD Letter at 1. HUD specifically allowed such arrangements "so long as the payments for reinsurance under captive reinsurance arrangements are solely 'payment for goods or facilities actually furnished or for services actually performed.'" *Id.* (citing RESPA § 8(c)(2)). *See, e.g.,* ECX 194; RD 39-41.

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[1] Respondents respectfully refer the Director to all of their previously filed memoranda, which are part of the Administrative Record in this case.

[2] Given the page limit for this appeal, Respondents must presume a basic understanding of RESPA, pmi reinsurance, and the HUD Letter.

- Pmi rates are filed rates; that is, they are filed with, and subject to the approval of, each states' insurance regulator. Accordingly, the pmi premium paid by a borrower was the same regardless of whether the MI purchased reinsurance. Tr. 119, 383.
- Atrium was subject to regulation by the New York Department of Insurance; Atrium Re was subject to regulation by the Vermont Department of Insurance. At all relevant times, Atrium obtained an annual statement of actuarial opinion, and every year it was determined that Atrium: (1) met the requirements of the insurance laws of New York; (2) maintained sufficient reserves in accordance with the Standards of Practice issued by the Actuarial Standards Board; and (3) made "reasonable provision for all unpaid losses and loss expense obligations of the Company under the terms of its contracts and agreements." RCX 32-35; Tr. 767; 776; 1924-25.
- The only reinsurance arrangements at issue are 25% cede, which were approved by Freddie Mac and advocated by state regulators. *See* RD 21; Tr. 1073, 2232; ECX 583.
- EC's expert, Dr. Crawshaw, repeatedly agreed that Respondents were entitled to rely on the opinions issued by Milliman. *See, e.g.,* Tr. 807 ("I think it's reasonable, . . . for [Atrium] to hire Milliman and rely on what Milliman said."); *id.* 961; 1059.
- All of Respondents' reinsurance agreements were in run-off as of January 1, 2010, or more than a year prior to the creation of the Bureau. Tr. 2325;
- In connection with the reinsurance agreements with Radian and CMG, Respondents returned all of the premiums Atrium received along with all capital contributions and any earnings on July 22, 2009, and August 31, 2009, respectively. Tr. 582; 804-06.
- Atrium paid every claim for reinsurance presented by an MI, and such claims exceeded $126 million. Atrium paid claims on books of business originated as far back as 2004, and it paid full limit losses in 2005, 2006, 2007 and 2008 in connection with its reinsurance agreements with UGI and Genworth, thus, for those book years, Atrium paid more in losses than it would ever collect in premiums. Tr. 1421; 2317-19.
- The only two book years within the statute of limitations determined by the ALJ -- that is, that contain loans originated after July 21, 2008 -- and for which Atrium did not return all received premiums through terminations are the Genworth 2008-B and UGI 2009 Books. The auditors for Respondents, along with Genworth and UGI, all accounted for the reinsurance for these two books as "insurance" on the companies' audited financial statements, and the ALJ has not disputed that accounting treatment. Tr. 1061.
- In commuting the UGI and Genworth agreements, Atrium paid UGI and Genworth the net present value for expected losses occurring in the future, including expected losses on the Genworth 2008-B and UGI 2009 Books. RD 15; Tr. 2326-27; ECX 790 at 62-14.
- The ALJ rejected the Bureau's allegations in the NOC that Respondents' reinsurance agreements were a "sham" and suggested that EC pursue an "alternative theory of the case" – that the price was too high. EC never moved to amend the NOC nor pursued such a theory through the presentation of evidence; yet the ALJ held Respondents liable with respect to the UGI 2009 Book under his "alternative theory." Tr. 962-63.
- The ALJ is not an expert in accounting or actuarial analysis.

ARGUMENT

I. LEGAL ERROR: BURDEN OF PROOF

Each and every aspect of the relief awarded to the Bureau in the RD was based upon the ALJ's mistaken ruling that Respondents bore the burden of proving that Atrium had provided actual services to the MIs (that is, that the reinsurance was real) and that the price of that reinsurance—which the ALJ found was real reinsurance, with a genuine transfer of risk—was precisely correct. Even if one were to accept each and every one of the ALJ's findings, this impermissible burden shifting resulted in an excessive amount of disgorgement because the ALJ found that the reinsurance had a real value to the MIs, but he assigned *a zero value* to it for purposes of calculating disgorgement.

First, regardless of whether Section 8(c)(2) of RESPA is an "affirmative defense," EC—and not Respondents—bear the burden of establishing all "ultimate issues" in these proceedings. 12 C.F.R. § 1081.303. Whether the reinsurance transferred risk and whether it was priced appropriately (in the ALJ's view) were the ultimate issues in this enforcement action.[3] The ALJ violated the Bureau's own regulations by shifting the burden of proof to Respondents on the ultimate issues giving rise to liability.[4]

Second, Section 8(c)(2) of RESPA is not an affirmative defense. The language of the provision ("Nothing in this section shall be construed as prohibiting . . . ") makes clear that it is a rule of construction and not a separate defense. *See Public Emps. Ret. Sys. v. Betts*, 492 U.S.

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[3] Other regulators' procedural rules differentiate between elements of a claim and affirmative defenses for purposes of assigning the burden of proof, but the Bureau's Rules do not. *See*, *e.g.*, 16 C.F.R. § 3.43 (FTC rule: "Counsel representing the Commission . . . shall have the burden of proof, but the proponent of any factual proposition shall be required to sustain the burden of proof with respect thereto."); 12 C.F.R. § 308.529 (FDIC rule, differentiating between claims and affirmative defenses).

[4] *See United States v. Kloess*, 251 F.3d 941, 947 (11th Cir. 2001) ("Any defense which tends to negate an element of the crime charged, sufficiently raised by the defendant, must be *disproved* by the government.") (citations omitted).

158, 165 (1989) (statutory exemption providing that "it [wa]s *not* unlawful for an employer 'to observe the terms of . . . any bona fide employee benefit plan . . .'" defined conduct that was not illegal, was not an affirmative defense) (*quoting* 29 U.S.C. § 623(f)(2)); *see also Rambam v. Long & Foster Real Estate, Inc.*, No. 11-5528, 2012 U.S. Dist LEXIS 184839, at *2 (E.D. Pa. June 22, 2012) (burden of pleading and proving the transaction is not exempt under RESPA § 8(c) is on plaintiff); *Capell v. Pulte Mortg. L.L.C.*, No. 07-1901, 2007 U.S. Dist. LEXIS 82570, at *18 (E.D. Pa. Nov. 7, 2007) (same). Moreover, § 8(d)(3) provides an affirmative defense for failure to comply with § 8(c)(4)(A) and explicitly shifts the burden to a defendant to prove that defense. 12 U.S.C. § 2607(d)(3). To consider § 8(c) an affirmative defense would render § 8(d)(3) surplusage. *See Ratzlaf v. United States*, 510 U.S. 135, 140-41 (1994) (presumption against treating statutory language as surplusage "heightened" for statute defining a crime).

HUD has long interpreted the Section 8(c) provisions as qualifying—rather than providing defenses to—Sections 8(a)-(b). *See*, *e.g.*, ECX 594, HUD Letter at 7 ("If [HUD] concludes that the compensation paid for the reinsurance exceeds the value of the reinsurance . . . the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA."); *Dominguez v. Alliance Mortg. Co.*, 226 F. Supp. 2d 907, 913 (N.D. Ill. 2002) (noting that HUD placed the burden on plaintiffs to prove that the payment did not bear a reasonable relationship to the services provided). And the Bureau's own regulation envisions that the *Bureau* will investigate and attempt to prove RESPA violations based upon whether "the payment of a thing of value bears [any] reasonable relationship to the market value of the goods or services provided," with no hint that such a burden should fall upon Respondents. 12 C.F.R. § 1024.14.

Referrals are not per se illegal. Regulation X states: "Any referral of a settlement service is not a compensable service, **except as set forth in section 1024.14(g)(1)**." 12 C.F.R. §

1024.14(b) (emphasis added). Section 1024.14(g), entitled "Fees, salaries, compensation, or other payments," in turn, sets forth the seven categories of payments that "Section 8 of RESPA permits[,]" including "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 C.F.R. § 1024.14(g)(1)(iv). RESPA, as interpreted by HUD, and now the Bureau, absolutely contemplates that there will be referrals that accompany the provision of real estate settlement services. While payments for referrals are prohibited under RESPA, payments for services provided in connection with a referral are not. *See, e.g.*, *Kiefaber v. HMS Nat'l, Inc.*, 284 F.R.D. 370, 372 (E.D. Va. 2012) ("if the fee is for a 'compensable service,' then the fee is exempt from liability under § 2607(c)"). Thus, it is inconsistent with the Bureau's own regulation to simply allege the existence of a referral and then require the respondent to prove the lack of a violation.

II. LEGAL ERROR: STATUTE OF LIMITATIONS

The ALJ correctly concluded – over the strenuous objections of EC – that the statute of limitations begins to run on the date the loan closes. *Snow v. First Am. Title Ins. Co.*, 332 F.3d 356, 357 (5th Cir. 2003). The ALJ erred as a matter of law, however, in concluding that EC was entitled to go back three years from the creation of the Bureau – finding that there is no statute of limitations for Bureau administrative adjudications.

Section 16 of RESPA 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). Section 1054 of the CFPA, 12 U.S.C. § 5564(g)(2)(C) ("Transferred Authority"), provides that "[i]n any action arising solely under laws for which authorities were transferred under subtitles F and H [which includes RESPA], the Bureau may commence, defend, or intervene in the action *in accordance with the requirements of that provision of law,* as applicable." (emphasis added)).

The ALJ accepted EC's argument, which relied on *BP America Production Co. v.*

Burton, 549 U.S. 84 (2006), for the proposition that administrative actions have no statute of limitations. This is incorrect. At issue in *BP America* was the application of the general six-year statute of limitations period to the enforcement of a Department of Interior administrative payment order. In rejecting the argument that the general statute of limitations would apply, the Supreme Court explained that, by its plain language, "§ 2415(a) applies when the Government commences any 'action for money damages' by filing a 'complaint' to enforce a contract, and the statute runs from the point when 'the right of action accrues.'" 549 U.S. at 91. The Court then noted that the "key terms in this provision – 'action' and 'complaint' – are ordinarily used in connection with judicial, not administrative, proceedings." *Id.*

The Court's holding that an administrative payment order does not fall within the statute of limitations for an "action for money damages" is not dispositive. First, unlike *BP America*, the Bureau's action is brought under RESPA, which has a Congressionally-mandated limitations period for "any action" brought by "the Bureau, the Secretary, the Attorney General of any State, or the insurance commissioner of any State" under Section 8 of RESPA. Thus, unlike *BP America*, there is a specific statute of limitations in RESPA governing government "actions." Even under *BP America*, courts will first look to the statutory provision at issue for the relevant statute of limitations before reaching the conclusion that there is no such limitations period. *See Alden Mgmt. Servs. v. Chao*, 532 F.3d 578, 582 (7th Cir. 2008) ("Unless a federal statute directly sets a time limit, there is no period of limitations for administrative enforcement actions."). Here, RESPA has a specific limitations period which controls this administrative action.

The Court further explained that prior to the enactment of § 2415(a), there was no statute of limitations regarding contract actions brought by the government. *BP Am.*, 549 U.S. at 100-01. Thus, the Court found that this "rule" remains the "law, and the text of § 2415(a) betrays no

intent to change this rule as it applies to administrative proceedings." *Id.* at 101. Quite the opposite is true here; the "law" was that any government action under Section 8 of RESPA was required to be "brought" within three years. When Congress amended RESPA to insert the "Bureau" into the statute of limitations provision (through CFPA § 1098(9)), it did not indicate in any way that it was also changing the "law" to permit the Bureau to ignore the existing statute of limitations. Thus, the three-year statute of limitations for government actions remains the law and applies to the Bureau regardless of whether it brings an action administratively or in court.[5] *See, e.g., Maharaj v. Stubbs & Perdue, P.A.*, 681 F.3d 558, 572 (4th Cir. 2012) (rejecting an interpretation that represented a departure from prior practice in light of, *inter alia*, the lack of any clear statement in either the text of the amendment or the legislative history, and noting that "[t]his Congressional silence is telling").

In limiting "any action" to enforce Section 8 of RESPA to "3 years from the date of occurrence of the violation" Congress made clear its intention that the government, including the Bureau, is subject to a three-year statute of limitations for "any action" under Section 8. Accordingly, all of the Bureau's claims involving loans closed before January 25, 2009, are time-barred, and only the UGI 2009 Book is at issue.

III. LEGAL ERROR: AWARDING INJUNCTIVE RELIEF

"The purpose of an injunction is to prevent *future* violations." *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953) (citation omitted, emphasis added); *see also SEC v. Tourre*, 4 F. Supp. 3d 579, 598 (S.D.N.Y. 2014) (an injunction "is appropriate where there is a likelihood

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[5] The Court also relied upon the fact that "the sovereign is given the benefit of the doubt if the scope of the statute is ambiguous." *BP Am.*, 549 U.S. at 96. Any ambiguity in RESPA, a criminal statute, is construed ***against*** the government under the rule of lenity. *See United States v. Graham Mortg. Corp.*, 740 F.2d 414, 423 (6th Cir. 1984) (the rule of lenity mandated reversal of RESPA convictions because the statute was "ambiguous" on the issue of whether making a mortgage loan was a settlement service).

that, unless enjoined, the violations will continue") (internal quotation marks and citation omitted). "An injunction is a drastic and extraordinary remedy, which should not be granted as a matter of course." *Monsanto Co. v. Geerston Seed Farms*, 561 U.S. 139, 165 (2010).

The ALJ committed error by recommending injunctive relief where there is nothing to enjoin.[6] The Bureau conceded in the NOC that the conduct had ceased: "PHH expanded its referrals of business to additional providers with whom it lacked a captive arrangement, . . . only after PHH, like others in the market, had virtually stopped placing captive reinsurance on new mortgages." NOC ¶ 54. The ALJ initially agreed: "[W]hen I read the notice of charges, although there is an injunction requested in your prayer for relief, it seems like it's all very backward looking. There's really nothing in the notice of charges . . . that suggest that these violations are still occurring." Mar. 5 Tr. 59; *see also* May 22 Order at 7 (The NOC states that the conduct continued "until 'at least May 2013,' but does not unequivocally allege that the conduct is ongoing"); Tr. 377 (Culver: "probably about 2007 and 2008, you saw lenders no longer interested in putting new business into the captives"); *id.* at 381-82 (same).

All of Respondents' reinsurance agreements were in run-off as of January 1, 2010. Neither EC nor the ALJ ever bothered even to ask any fact witnesses, including PHH Mortgage employee Sam Rosenthal, whether Respondents had any intention to enter into any new reinsurance arrangements. Nor did EC proffer any documentary evidence to support a finding of prospective similar conduct, and the ALJ admits that there were "no discussions with potential counterparties in the past three years regarding establishment of a new captive arrangement."

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[6] The ALJ chastised the parties for not addressing the factors in *eBay, Inc. v. MercExchange, LLC,* 547 U.S. 388 (2006). RD 99; *id.* ("the parties' contentions regarding the *eBay* factors are unknown"). The ALJ's unilateral decision to undertake his own analysis, without the benefit of notice to the parties and an opportunity to be heard, is indicative of his entire approach to the proceeding. The ALJ's quote from *eBay* provides that the burden is on the "plaintiff" to demonstrate the four factors. *Id.* Since EC did not carry its burden, the ALJ did it for them.

RD 100. Left with no evidence, the ALJ summarily concluded that Atrium's acceptance of premiums from UGI "after UGI had been enjoined from entering into further captive arrangements," RD 100, and the fact that Respondents sought to intervene in the Florida litigation, purportedly demonstrate that "Respondents are likely to violate RESPA again if not enjoined." *Id.* at 100-01. The ALJ's analysis is nonsensical – Atrium accepted the premiums that the CFPB *specifically permitted* UGI to make. Further, the ALJ recommends punishment of Respondents for their efforts to vindicate their rights through the judicial system, despite the fact that such efforts are protected under the First Amendment. *See, e.g.¸ Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972) (the right of access to the courts is protected by the Bill of Rights); *Fabiano v. Hopkins*, 352 F.3d 447, 453 (1st Cir. 2003) (same). Finally, the ALJ erred in placing the burden on Respondents to "disprove" the necessity of an injunction; that burden rests with EC. Rule 303. EC failed to meet their burden, and, rather than rule for Respondents, the ALJ ignored the evidence and ruled in EC's favor anyway.[7]

IV. LEGAL ERROR: AWARDING DISGORGEMENT

The ALJ reasoned that because a court possesses inherent authority, and the Bureau "has statutory authority to impose those forms of relief," he saw "no reason" not to assert authority to impose equitable relief in this administrative action. May 22 Order at 13-14. The ALJ clearly erred. Not only are the relief provisions of the CFPA inapplicable to this action, but RESPA does not provide for the remedy of disgorgement.

[7] Respondents also object to the recommended Disclosure Order. RD 101-02. First, the purported factual basis for such relief is fundamentally flawed. The issue of the "preferred provider policy" after June 2009 was never questioned by EC, nor does it have any relevance to the issue of reinsurance. The ALJ's speculation regarding the CMG License Agreement is off the mark, as evidenced by the plain language of that document, and whether or not the dialer information was "inconsistent with other evidence" is a matter that should have been explored at the hearing, but was not. The ALJ's decision to conduct his own "fact finding" without notice to Respondents – and in spite of EC – resulted in blatant errors of fact.

RESPA provides a detailed remedial scheme, which includes the ability of the government to enjoin the offending activity. 12 U.S.C. § 2607(d). Nowhere does the statute provide for disgorgement. "'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.'" *Transamerica Mortg. Advisors v. Lewis*, 444 U.S. 11, 20 (1979) (quoting *Botany Worsted Mills v. United States*, 278 U.S. 282, 289 (1929)). In the presence of such specific remedies, a court is "'compelled to conclude that Congress provided precisely the remedies it considered appropriate' absent 'strong indicia of a contrary congressional intent.'" *Mullinax v. Radian Guar.*, 199 F. Supp. 2d 311, 334 (M.D.N.C. 2002) (quoting *Middlesex Cnty. Sewerage Auth. v. Nat'l Sea Clammers Ass'n*, 453 U.S. 1, 15 (1981)). Because Congress identified an injunction as the Bureau's sole remedy, that is the only remedy the Bureau could pursue, and the only remedy the ALJ could recommend.[8]

Administrative tribunals, unlike judicial courts, have no inherent equitable authority. *See Ramos v. D.C. Dep't of Consumer & Regulatory Affairs*, 601 A.2d 1069, 1073 (D.C. 1992) ("[A]dministrative law tribunals . . . within agencies of the executive branch—by definition and design do not have the inherent 'equitable authority' that courts in the judicial branch have derived from common law traditions and powers."); *see also Feistman v. C.I.R.*, 587 F.2d 941, 943 (9th Cir. 1978) (Tax Court was an administrative agency that lacked ancillary equitable

[8] Respondents have identified only one district court case that held that the disgorgement of profits is available under RESPA Section 8. *Jackson v. Prop. I.D. Corp.*, No. 07-CV-3372, Order Re: Defendants' Motions to Dismiss, Dkt. 52 (C.D. Cal. Mar. 24, 2008). *Jackson*, an unpublished opinion on a motion to dismiss not available on LexisNexis that does not appear to have been cited by any other court, was wrongly decided and never appealed because the case was settled after a motion to certify an interlocutory appeal was denied. Moreover, *Jackson* is wholly distinguishable. In *Jackson*, the court specifically found that, assuming the truth of the allegations in the Complaint and viewed in a light most favorable to the plaintiff, that the allegations that defendants' conduct would continue unless enjoined – *if proven* – would support injunctive relief. Slip Op. at 2. The court made clear that "on a motion to dismiss we cannot simply accept Defendants' assurances that the allegedly wrongful conduct will not continue." *Id.*

powers). Nor does the Director have any inherent equitable authority to award such relief. The Court made clear in *Porter v. Warner Holding Co.*, 328 U.S. 395 (1946), that "a decree compelling one to disgorge profits, rents or property acquired in violation of the Emergency Price Control Act may properly be entered by a District Court *once its equity jurisdiction has been invoked.*" 328 U.S. at 398-99 (the Court also noted that the statute explicitly gave courts the authority to enter "a permanent or temporary injunction, restraining order, *or other order*").

EC conceded that the Bureau "stands in the shoes of HUD" with respect to conduct occurring before July 21, 2011. Feb. 14 Tr. 10-11; *see also* CFPA § 1061(b)(7) (12 U.S.C. § 5581(b)(7)).[9] RESPA, however, only gave HUD the right to seek injunctive relief ***in court***, *i.e.,* administrative proceedings were not available to enforce RESPA.[10] Mar. 5 Tr. 38 ("[T]o the extent that the [CFPA] creates additional remedies . . . that HUD did not possess, [EC] agree that those can only apply to conduct that occurred after the effective date of the statute."). Thus, disgorgement through an administrative adjudication is not available for conduct occurring before July 21, 2011. If the Bureau wanted disgorgement it should have filed suit in court, because that is all that HUD could do. 12 U.S.C. § 2607(d)(4).

All of the relevant conduct occurred before the passage of the CFPA – and the statute is not retroactive – therefore, the only relief available is an order enjoining future conduct, which, as discussed in Section III, *supra*, is unwarranted in this case.

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[9] Section 1061(b)(7) of the CFPA provides, in pertinent part:

> The Bureau shall have all powers and duties that were vested in the Secretary of the Department of Housing and Urban Development relating to the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. § 2601 et seq.), . . . on the day before the designated transfer date.

[10] And HUD's implementing regulation, Regulation X, did not contain any provision authorizing it to bring an administrative action for alleged violations of Section 8.

V. <u>LEGAL ERROR: INCLUSION OF ATRIUM AND ATRIUM RE</u>

All relief in the RD directed at Atrium and Atrium Re must be rejected. Section 1053(b) of the CFPA limits Cease and Desist proceedings to Covered Persons and Service Providers, and therefore also to Related Persons. *See* Feb. 14 Tr. 17-18. After previously denying dismissal based upon a different interpretation (May 22 Order at 8), the ALJ now concludes that Atrium and Atrium Re were Related Persons to PHH Corp., simply and solely because Atrium and Atrium Re were purportedly the "agents" of PHH Corp. RD 82. Not so. See 12 U.S.C. § 5481(25)(C) (defining related person).

First, not every "agent" of a Covered Person is a Related Person (defined as "any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person"). Since a subsidiary that arguably performed certain functions at the direction of its corporate parent is nothing like a "director, officer, or employee charged with managerial responsibility for, or controlling shareholder," who would have authority over the Covered Person, this provision is inapplicable here under the canons *noscitur a sociis*[11] and *ejusdem generis*.[12] Second, there is no evidence in the Record that Atrium and Atrium Re were any kind of "agents" of the other Respondents. The ALJ's holding impermissibly ignores the corporate form on the basis of a mere subsidiary relationship and the sharing of personnel. *See United States v. Bestfoods*, 524 U.S. 51, 69 (1998). Third, asserting jurisdiction over Atrium and Atrium Re as Related Persons to PHH Corp. is too attenuated because PHH Corp. is not a Covered Person but rather is itself merely a Related Person to Lender Respondents. *See* Document 73 at 2.

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[11] *See United States v. Williams*, 553 U.S. 285, 294 (2008) ("a word is given more precise content by the neighboring words with which it is associated").

[12] *See Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-15 (2001) ("[W]here general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to . . . the preceding specific words.") (citation omitted).

VI. LEGAL ERROR: THE BUREAU CANNOT REGULATE INSURANCE

The McCarran-Ferguson Act precludes the Bureau from attempting to use RESPA to retrospectively regulate reinsurance that was subject to the jurisdiction of state insurance regulators. Respondents repeatedly raised this issue (*e.g.*, Document 75), but the ALJ failed to address it squarely, instead holding that "RESPA does not run afoul of the McCarran-Ferguson Act." RD 82 (citing Tr. 23).[13] But Respondents never argued that RESPA somehow "ran afoul" of McCarran-Ferguson. Rather, McCarran-Ferguson precludes the Bureau from construing RESPA to regulate the business of insurance. 15 U.S.C. § 1012.

The ALJ relied exclusively on a single opinion that was based upon the misconception that "underwriting" in the mortgage finance context refers to insurance. Tr. 23 ("[T]here were other grounds in *Patton* for why they decided the way they did. And, even if I were to simply ignore the whole underwriting analysis that they went through, there were other reasons which I think are well reasoned. I think it's actually a well-reasoned case.") (citing *Patton v. Triad Guar. Ins.*, 277 F.3d 1294, 1299 (11th Cir. 2002)). Yet the other three "grounds" underlying *Patton*'s conclusion that RESPA "explicitly reveals [Congress'] intent to regulate the business of insurance" are easily disposed of. *Patton*, 277 F.3d at 1298. First, "that RESPA explicitly authorizes enforcement of all violations by state Insurance Commissioners" simply recognizes that companies regulated by state insurance commissioners may be subject to RESPA. *Id.* at 1299. Second, regulating escrow accounts that may contain insurance proceeds does not equal regulating insurance. Third, HUD had no authority to avoid the application of McCarran-Ferguson to RESPA. 15 U.S.C. § 1012(b) ("unless such Act specifically relates").

At issue in this action as prosecuted by the ALJ is the assertion that the reinsurance was

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[13] The ALJ never explained this holding in writing, instead issuing a terse oral ruling, Tr. 23, and then twice summarily denying "reconsideration" of that ruling (Document 152 at 3; RD 83).

not "real insurance" and/or was not priced correctly. These insurance issues belong to the state insurance commissioners, not to the ALJ who lacks the expertise to opine on such issues.

VII. LEGAL ERROR: FAILURE TO APPLY JUDICIAL ESTOPPEL

The ALJ erred in failing to apply judicial estoppel to preclude EC from contending that the ceding payments received by Atrium after entry of the consent order with UGI were unlawful.[14] First, the ALJ erred in focusing on whether the Florida Court had explicitly ruled that the ceding payments were legal. RD 81. That is not relevant. The judicial estoppel analysis must focus, instead, on the inconsistent positions taken by the Bureau. *See* Document 18 at 21-25; Document 101-A at 37-44. The ALJ concedes that EC "compromised its claims against the MIs by agreeing to carve out premium cedes on existing mortgages," RD 80, but fails to reconcile his ordering of "disgorgement" of the very same ceding payments that the Bureau asked the Florida Court to permit, and which that court did, in fact, permit. It is impossible under RESPA to declare that it is legal for UGI to cede premiums to Atrium yet at the same time declare that it is illegal for Atrium Re to receive those very same payments. *See, e.g., Freeman v. Quicken Loans, Inc.*, 566 U.S. __, 132 S. Ct. 2034, 2041 (2012) ("under [RESPA] it is (so to speak) as accursed to give as to receive").

By asking the Florida courts to enter the consent orders, the Bureau implicitly represented to the courts that the payments were lawful. *See*, *e.g.*, *Howard v. McLucas*, 871 F.2d 1000, 1008

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[14] There is no dispute that pursuant to the Florida Consent Order the MIs, including UGI, were permitted to continue to make payments to reinsurers such as Atrium and to account for these arrangements as reinsurance on their financial statements. As UGI repeatedly explained, "because [the Florida Court] already approved the Consent Order, including the provision in it that expressly authorizes PHH's conduct in question" there was no need for intervention by Respondents. UGI's Memorandum in Opposition to Respondents' Motion to Intervene in *CFPB v. United Guaranty Corp.*, No. 13-cv-21189 (S.D. Fla. Feb. 14, 2014), ECF No. 18 at 2; *id.* at 12 ("United Guaranty negotiated a settlement that "*explicitly permitted* the continuation of the payments under the reinsurance contracts between UGI and Atrium."); *id.* (the Consent Order includes "a provision that declared the ceded payments from [UGI] to be lawful").

(11th Cir. 1989) (district court must "ensure that [consent order does] not violate federal law"); *Robertson v. N.B.A.*, 556 F.2d 682, 686 (2d Cir. 1977) ("[A] settlement that authorizes the continuation of clearly illegal conduct cannot be approved, but a court in approving a settlement should not in effect try the case by deciding unsettled legal questions."). Having obtained entry of the Consent Order based on that representation, the Bureau is now estopped from taking the opposite position. Moreover, EC did not even bother to inform the Florida courts that they considered the continued payments to be illegal.[15] Rather, the Bureau took civil money penalties from the MIs and then turned a "blind eye" to the continuation of the exact same conduct it deems to be illegal.[16] Respondents are aware of no authority, and to date neither EC nor the ALJ has cited any, that stands for the remarkable proposition that a court can permit a "person" to continue to participate in conduct that a federal agency of the United States believes is a violation of federal law that carries criminal penalties. Accordingly, the Bureau is judicially estopped from asserting that the ceding payments by UGI after the entry of the consent order violate RESPA.

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[15] The Bureau and the MIs were fully aware of this issue, but the Bureau had no intention of letting that stand in the way of getting a settlement. Specifically, on February 4, 2013, counsel for the MIs advised the Bureau: "[W]e are concerned that if the release of claims would only apply to practices that occurred prior to the date the Complaint was filed, it would seem to leave the companies technically at risk for premium cedes on run-off books occurring after the complaint was filed even though the premium cedes are not prohibited by the Consent Order." *See* Emails dated February 2013, Exhibits B and C to Document 101.

[16] EC's inconsistent position regarding their treatment of UGI vis-à-vis Respondents is further highlighted by Crawshaw in his Rebuttal Report wherein he states:

> [B]ecause Atrium's captive arrangements did not in fact transfer risk, **I do not believe it would have been appropriate for the MIs to reflect any reduction of risk in their financial statements as a result of entering into those arrangements**.

Crawshaw Rebuttal Report at 121 (emphasis added). Neither EC nor the ALJ explain how or why it allowed UGI to continue to cede premiums and to account for the agreement with Atrium (and other lender-captive reinsurers) as insurance on its books while at the same time, EC is taking the position that such accounting treatment is inappropriate.

VIII. DENIAL OF DUE PROCESS

A. *Per Se Liability During the Hearing*

On the first day of the hearing, the ALJ declared this matter "really big" and that he needed to do something to "pair (sic) this case down." Tr. 33-35. His "something" was to direct another round of dispositive briefs after hearing a portion of the EC's case-in-chief. Thus, in a ruling the ALJ conceded was "unorthodox," May 22 Order at 21, he determined that Respondents had violated Section 8(b), and all but held that they had violated Section 8(a). *Id.* 15-16, 20. This preemptory ruling foreclosed Respondents from presenting evidence in support of their position on these liability issues. Accordingly, the appropriate standard of review on the *per se* liability findings in the May 22 Order is *de novo*. In other words, no deference is to be accorded to any factual findings in the RD that relate to liability as determined by the May 22 Order because the ALJ had already made up his mind on those issues before Respondents put on their case. Respondents are entitled to a full and fair opportunity to contest those findings in front of an ALJ that has not prejudged those issues.

B. *The ALJ Rendered the NOC Irrelevant*

Respondents are entitled to fair notice of what actions may be deemed crimes. *United States v. Santos*, 553 U.S. 507, 514 (2008) (noting the "fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed."). That did not happen here.[17]

The theory of liability in the NOC is that the reinsurance services provided by Atrium

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[17] In connection with the ALJ's efforts to take official notice of certain facts, EC stated that Respondents are not entitled to notice before the issuance of the RD. *See* Document 102 at 6 ("Moreover, even assuming, *arguendo*, that a party were entitled to know the "context" or challenge the materiality of an officially noticed fact, any such context will be fully supplied in the Tribunal's Recommended Decision. *See* 12 C.F.R. § 1081.400(c)."). It is impossible to reconcile Rule 302's requirement for "a fair, impartial, expeditious, and orderly" hearing if notice can be provided for the first time in the RD.

were worthless. The ALJ disagreed. At the end of the first week of the hearing, he proffered his "alternative theory of the case," which he stated that he did not "see[] in anybody's prehearing brief." Tr. 962-63. The ALJ's theory was that Atrium provided a service, reinsurance, but it was a participant in "an over-billing scheme." *Id.* Clearly, before the ALJ had heard any part of Respondents' "case-in-chief," he had both rejected EC's theory that no services were provided and established his own theory, purportedly for "consideration." *Id.* The ALJ admitted that his theory was not in the NOC, but he "th[rew it] out there for [EC's] consideration," and stated that if EC did not pursue that theory, it would be "moot." *Id.* EC did not pursue the ALJ's theory; they never moved to amend the NOC; nor did they put on a case to demonstrate "over-billing." EC did none of this because their expert would not – indeed, could not – opine on the cost of reinsurance because he repeatedly and steadfastly refused to believe that *any* service was provided. This did not deter the ALJ, however. Rather than concluding that his theory was "moot," the ALJ used it to impose liability on Respondents. While Respondents answered the allegations in the NOC, they could not respond to the ALJ's allegations because they were revealed for the first time in the RD. The ALJ's conduct rendered the hearing inherently prejudicial. *N.L.R.B. v. Tamper, Inc.*, 522 F.2d 781, 789-90 (4th Cir. 1975) (by acting as a litigant, the ALJ "failed to act with the impartiality necessary to the conduct of his office").

C. *ALJ's Use of Documents Not Testified to at the Hearing*

While the ALJ admitted, with few exceptions, all of the Exhibits proffered by both parties, which numbered "[a]lmost 2000," Tr. 33, the mere admission of such documents does not justify the ALJ's decision to take it upon himself to draw erroneous conclusions from exhibits in the absence of testimony, rebuttal, and/or argument as contemplated by the Bureau's adversarial rules. While Respondents are filing herewith a motion to supplement the record, the additional documents cannot take the place of additional testimony that is necessary to refute the

numerous baseless conclusions reached by the ALJ discussed *infra*.

IX. FACTUAL ERRORS

The ALJ's decision to act as the grand inquisitor prejudiced Respondents and resulted in a number of factual errors, which is unsurprising given that Respondents were unaware that the purported "facts" were even at issue until they received the RD. The ALJ took it upon himself to spin a fanciful theory of the case based on his perception of the facts as determined by his review of whatever documents – or portions thereof – he selected from the more than 2,000 exhibits identified by the parties and his "expertise" in actuarial analyses.[18]

A. *Genworth 2008-B Book*:

The ALJ's conclusion that the Genworth 2008-B Book was a "sham" is based on faulty reasoning and a complete misunderstanding of actuarial analyses. RD 67. First, the ALJ's conclusion that the analysis must be performed before any loans are placed in the book makes no sense, because the characteristics of the actual loans in the book are a fundamental part of the risk analysis. Tr. 1856. Further, no witness testified that the analysis was required to be completed beforehand. Nor was the ALJ correct to find it significant that the structure was put in place after the book was closed.[19] Again, no witness testified to a requirement that the structure had to be in place before closing the book, and there was no evidence that Atrium failed to comply with the requirements of the structure that its auditors determined passed risk transfer. The timing of the change of the risk band is also irrelevant as long as it is in place when the band

[18] The ALJ's assertions that Rosenthal was "evasive" in his testimony are specious and without factual basis. *See* RD 15, 17. In each instance where the ALJ makes this spurious assertion, he proffers no support, because there is none. Rather, a fair reading of the transcript demonstrates that EC asked the same questions repeatedly and was simply unsatisfied with the truthful testimony from Rosenthal. The fact that Rosenthal's truthful testimony did not support either EC's or the ALJ's theory of the case is not a basis to label his testimony as "evasive."

[19] The ALJ's use of the term "run off" in this context demonstrates his misunderstanding. The book closed on March 31, 2009. "Run off" refers to the entire agreement, *i.e.*, no new books are being created. RD 15, n.15.

is penetrated, which happened here.[20] Indeed, the ALJ's complaint about the Genworth 2008-B analysis is flatly inconsistent with his finding that Milliman's "analyses were reliable" for 13 book years, RD 67, since the Milliman analyses for every one of those books was performed *after* the loans were in the book.

The ALJ's conclusions that Respondents violated the Genworth Reinsurance agreement and "nullified" the risk transfer analysis by taking the $5 million dividend are both wrong and nonsensical. These issues were not raised by EC; the RD provided the first notice to Respondents of any such allegations. Accordingly, the ALJ's conduct rendered the hearing meaningless and denied Respondents the opportunity to rebut these faulty accusations. Further, the assertion that the dividend to Atrium violated the Genworth agreement is wholly unsupported. Any dividend payment to Respondents was required to be approved in advance by Genworth. If both parties to the agreement agreed, then there was no breach. Further, had Respondents been put on notice that the ALJ thought there was an issue, they could have responded by demonstrating, *inter alia*, that the withdrawal of the $5 million was entirely proper based on the fact that there is a single trust account covering all book years back to 2000, and as loans pay off, the risk is less; accordingly, fewer funds are required to be retained in the trust account. It was undisputed that, at all relevant times, Atrium met its statutory and regulatory requirements for its trust accounts.

Similarly, there is no basis in the record to support the ALJ's belief that Atrium

[20] The ALJ claims that Respondents' "own auditors criticized this practice" of obtaining risk transfer opinions "significantly after the start of the book year in question." RD 65-66. As support, the ALJ uses an exhibit, ECX 461, which was not discussed at the hearing nor referenced in EC's post-hearing briefing. The ALJ's conclusion is baseless because, among other things, both Respondents' auditors, as well as the MIs', accounted for the arrangements with Atrium as insurance, meaning that they deemed that all of the various book years passed risk transfer.

"violated" the risk transfer opinion because it withdrew the $5 million. First, it is significant that EC's expert witness did not state that the withdrawal affected the Genworth 2008-B Book. Second, the ALJ simply ignores the fact that Genworth both approved of the withdrawal and accounted for that book as insurance on its financial statements. Simply stated, the ALJ attempts to construe snippets of documents against Respondents without any recognition of the business realities or the governing accounting and actuarial rules.

The ALJ accepts Milliman's application of the ERD test to the Genworth 2008-B Book, RD 44, yet he completely disregards it for purposes of risk transfer. It is undisputed that Milliman ran the ERD test for the Genworth 2008-B Book, that it passed by a significant margin, and that there is no evidence that even with the issues raised by the ALJ, the ERD test result would have changed. This is unrefuted evidence of risk transfer the ALJ simply ignored.

B. *UGI 2009 Book*:

Finding that Atrium provided a service in connection with the UGI 2009 Book, the ALJ assumes the role of an expert witness by finding that the compensation received by Atrium was not "reasonable" as related to the risk assumed. The ALJ is not competent to opine as an expert on this issue, and his conclusion runs counter to the evidence adduced at the hearing. Simply stated, the premiums paid by Genworth and UGI – 25% – for the band of risk assumed by Atrium was the same rate paid by others in the market place. The ALJ's disregard of the "industry standard" as "irrelevant," RD 69, demonstrates the degree to which he views his opinion as the only one that matters. Further, the two representatives from the MIs who testified, Culver (MGIC) and Walker (UGI), stated that similar insurance from non-affiliated lenders was not otherwise available in the marketplace. Tr. 423-24; 2128-30; 2141. Thus, parties in the marketplace acting in their own interests in connection with arm's length transactions decided the appropriate value for such services. Their opinions are definitive, and the ALJ's statement

that there is "insufficient evidence to derive a market value" is contrived so he can impose his own opinion. RD 69. Indeed, while the ALJ repeatedly questioned various witnesses regarding the cost of other "similar" types of reinsurance, no witness could provide such testimony because, as Schmitz testified, "the market for non-captive reinsurance was sparse and few such reinsurers existed." RD 46 (citing Tr. 1942, 2084).

The ALJ further demonstrates his bias in his rejection of Milliman's analysis of price commensurability with the value of the reinsurance services because Milliman did not consider three of the six factors in the HUD Letter. RD 69. The HUD Letter states that HUD's evaluation of the price "***may***" include the listed six factors. The ALJ's decision to make the six factors mandatory has no basis in law or the record.

The other purported reasons for the ALJ's rejection of Respondents' evidence of the reasonableness of the price of the reinsurance are nonsensical. For example, the ALJ compares the Radian 2004 book to the Genworth 2008-B Book, but fails to mention that the 2004 Radian Book was a 40% cede arrangement while the Genworth 2008-B Book was a 25% cede. The ALJ also relies on statements by Rosenthal, but he fails to note that those statements were in connection with the 2006 request for proposals for new agreements, and that no such agreements were consummated. In other words, there is no connection between those statements and the agreements actually in place. And, while rejecting EC's theory of the case, the ALJ deems cross-collateralization to be indicative of an unreasonable price. RD 70. That assertion makes no sense, and the ALJ misinterpreted EC's argument which went to the purported lack of value of the service, not to the price. The ALJ's conclusion that there was a cap on Atrium's liability for the Genworth agreement is flatly contradicted by the plain language of that agreement and, in

any event, is irrelevant because other Genworth Books passed risk transfer. RD 66.[21]

Further, setting aside the fact that Respondents believe that under RESPA and the Bureau's regulations, EC bore the burden to demonstrate that the price for the reinsurance services was "not reasonable," Respondents were prejudiced by the fact that this theory of liability was the ALJ's, not EC's. As Respondents noted repeatedly, EC's expert, Crawshaw, did not opine on the issue of the reasonableness of the compensation because, under his analysis, the value of the reinsurance was zero since it was his position that no service was provided. The ALJ rejected EC's theory of the case. RD 69 ("I have not relied on Crawshaw's opinion on this point."). However, in order to avoid ruling for Respondents, which should have occurred, he embarked on this own theory of the case. The ALJ acted inappropriately, and the RD should be disregarded in its entirety.

C. *The HUD Letter*:

While purporting to rely on the HUD Letter, the ALJ ignored the plain language of that informal guidance. Specifically, while reciting parts of the HUD Letter, RD 39-41, the ALJ skipped over the portion where HUD recognized that the establishment of an affiliated reinsurer gave the lender "a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance." ECX 594, HUD Letter at 1. Rather, the ALJ attributes the "financial incentive" statement to Respondents, RD 72, an obvious and significant error. By recognizing this financial incentive, and yet permitting the establishment of lender-affiliated captive reinsurers, it is irrelevant whether the Lender Respondents sent some, or even all, of their loans to MIs with reinsurance agreements as long as the other elements of the HUD Letter were met, which was the case here.

[21] The ALJ got it right that the UGI agreement did not have a trust cap. As for CMG and Radian, since those agreements are no longer at issue, the ALJ's analysis is dicta and Respondents need not spend time responding to the allegations regarding those agreements.

The ALJ's conclusion that there was no risk transfer where Atrium did not first obtain a Milliman opinion is without merit. The HUD Letter does not require a specific risk transfer opinion. Second, the ALJ seems to have forgotten his prior decision, issued before Respondents presented their case-in-chief, which limited the hearing to loans closed after July 21, 2008. Thus, Respondents had no reason to present evidence regarding their reinsurance arrangements for any books other than the only two at issue – Genworth 2008-B and UGI 2009.

The ALJ's attack on Respondents for negotiating arrangements that "bore as little risk as possible," RD 65, is telling. The two agreements at issue passed the risk transfer requirement. The ALJ's assertion that Atrium should have assumed even more risk than the amount required to comply with RESPA is of no moment legally, and disconcerting as a matter of public policy, because the ALJ has no authority to decide how Respondents should conduct their business.

X. IGNORED RELEVANT EVIDENCE

A. *The Benefits of Reinsurance and Paid Losses*:

The ALJ's bias against Respondents is demonstrated by his complete disregard for the benefits of reinsurance and his disingenuous observation that Atrium did not pay any losses until 2009. RD 35; 37. The actual date of a claim payment is irrelevant, as cross-collateralization exposes the reinsurer for losses for a ten-year period. Once a financial crisis strikes, as it did in the 2007 to 2008 timeframe, the losses run across books of business insured long before the crisis, as evidenced by the losses in the 2004 book years for both UGI and Genworth that were not paid until 2009 and later. The ALJ gave no credence to the fact that, as of March 31, 2013, Atrium had already paid claims of $125,683,000 in connection with its reinsurance agreement with UGI (*see* RCX 838 at 24, RD 35), and $28,571,000 in reinsurance claims in connection with the Genworth agreement. RCX 2004, at Tab M, pp. 22, 44; RD 34. That is because in order to justify his result, the ALJ needed to focus on the premiums earned over the entire period

the contracts were in place – as far back as 1995 – not on the relevant time period, *i.e.*, after July 21, 2008. Nowhere does the ALJ acknowledge that for years 2005-2008, Atrium had already paid, or would pay, losses far in excess of the premiums collected on those books of business.[22]

The ALJ cited, but ignored, the unrebutted evidence that pmi reinsurance through lender-affiliated entities gave the lender "skin in the game" by encouraging the lender to originate higher quality loans which would lead to fewer defaults. RD 14. The ALJ also ignored Respondents' unrefuted evidence that the decision to deal with a particular MI is based on, *inter alia*, counterparty strength, ability to pay claims, being good to work with, and ability to share automated systems with PHH. RD 14 (citing Tr. 108-09); *id.* (Danahy deposition: PHH sought to deal with a small number of high quality, well-capitalized MIs in order to build successful working relationships); *id.* 15 (Respondents sought information on the MIs' corporate strengths and servicing policies). Further, the ALJ simply paid lip service to the unrefuted fact that reinsurance reduced the MI's volatility in returns. RD 64-65. The reduction in volatility constitutes the "reasonable business justification" for the MIs to enter into such arrangements. *See* ECX 594, HUD Letter at 6. By ignoring such testimony, the ALJ was able to manufacture non-compliance with the HUD Letter and support his accusation that the only reason the Lender Respondents dealt with particular MIs is because of the existence of a reinsurance arrangement. Such an assertion both ignores the evidence adduced by Respondents at the hearing and would require lenders to do business with all MIs regardless of the quality of their operations to avoid

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[22] The ALJ rejected EC's expert's analysis that grouped all book years together, as he should have, because there was no support for such a novel theory of risk transfer. RD 64. Yet, by failing to acknowledge that the losses for which Atrium paid claims started with book year 2004 forward, the ALJ's analysis commits the same error as Crawshaw; that is, he fails to treat each book year separately. Had he done so, he would be forced to concede that Atrium paid, or was projected by Milliman to pay, losses far in excess of the premiums collected for those book years – a result that undercuts the ALJ's entire analysis. Indeed, nowhere does EC or the ALJ state that Atrium made a "profit" for any individual book year after 2004.

being accused of a RESPA violation.[23]

B. *Respondents' Efforts to Comply with RESPA*:

The hearing transcript is replete with statements by Rosenthal that Respondents undertook significant efforts to engage Milliman to ensure that they complied with RESPA. Danahy made similar statements in his deposition. ECX 153 at 35; 78; 107-13. The ALJ, while noting such statements, *see, e.g.*, RD 25, 26, 41 ("frequent" consultations with Milliman), simply ignored them despite EC's expert's testimony that it was "reasonable" for Respondents to rely on Milliman. Tr. 807; 961; 1059.

C. *Commutation Payments*:

There is no dispute here that long before this action was filed, Atrium had commuted its reinsurance agreements with Radian and CMG by returning all premiums, earnings, and capital contributions. Further, the other two reinsurance agreements, UGI and Genworth, were in run-off for more than 18 months before the Bureau came into existence. Those two agreements were subsequently commuted, again before this action was filed, and the undisputed facts show that both commutation agreements were arms-length transactions. This is significant because the commutation of a reinsurance agreement provides for the net present value of the arrangements to be "settled" as between the insured and insurer.[24] In the case of the Genworth 2008-B Book, Milliman's analysis expected that the losses on that book of business would far exceed the total premiums collected by Atrium. *See* Tr. 1905 (Schmitz noting Milliman's projected losses on the

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[23] The ALJ's hostility towards the concept of insurance is obvious by his conclusion that while Walker testified that UGI could not have kept the premiums ceded to Atrium in its own savings account, he "admitted" that because the premiums ceded exceeded the losses paid by Atrium, UGI would have been better off without reinsurance. RD 35. In other words, the ALJ believes that where an insurer collects more in premiums than it pays in claims, there is wrongdoing.

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

Genworth 2008-B book would be $12 million and the projected premiums would be $8.8 million); *id.* 2327 (Crawshaw agrees). With respect to the UGI 2009 Book, Milliman predicted losses of approximately 50%. *Id.* at 1907 (Milliman projected losses of $1.7 million and premiums of $3.2 million). Thus, between the two agreements, Atrium lost money, thereby rendering any claim for disgorgement of "profits" moot.

The ALJ's sleight of hand analysis, asserting that Respondents' "wrongdoing . . . resulted in almost $6 million in ill-gotten gains," RD 96, demonstrates his bias. Contrary to the ALJ's baseless characterizations of the commutation evidence as "murky," RD 91, it is undisputed that:

- Atrium paid every claim presented;
- Milliman projected losses on both the Genworth 2008-B and UGI 2009 Books in amounts totaling more than $6 million; *see also* RD 34 (2008-B predicted to be "unprofitable"); and
- Atrium commuted its reinsurance agreements with both Genworth and UGI whereby Atrium paid both Genworth and UGI the net present value of those expected losses. Tr. 2326-27.

Thus, the assertion of $6 million in "ill-gotten gains" was made up by the ALJ and has no basis in the record. Indeed, while the parties relied extensively on the Milliman projections during the hearing, the ALJ simply disregards them because they do not support his pre-determined conclusions.

XI. THE ALJ'S FABRICATED CONCLUSIONS

The ALJ fabricated a number of conclusions out of whole cloth to justify his unwarranted and unsupported recommendations regarding relief. While not complete, the following are demonstrative of the ALJ's conduct:

A. *Effect on the Housing Market*:

The ALJ posits:

> If 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.

RD 99 (citing ECX 35 at 0646). Simply stated, this is a made-up assertion, as no witness proffered that testimony. Further, the document the ALJ purportedly relied upon for this "conclusion" dates from 1998, was produced by an industry trade group, was directed toward "deep cede" arrangements (which are not at issue in this proceeding) and, most importantly, the state regulators, when presented with this assertion by the trade group ***did absolutely nothing in response to this assertion.*** The ALJ concedes all of these points on pages 6-7 of the RD, but apparently forgets them by page 99. In other words, the only person who responded to this 1998 assertion is the ALJ in connection with his first pmi reinsurance case – 16 years after the statement was purportedly made. The ALJ seized upon the assertion in an attempt to justify his unwarranted and unsupported recommendations regarding relief.

B. *The CMG License Agreement*:

While ultimately concluding that no relief was warranted in connection with the CMG reinsurance arrangement, the ALJ found it necessary to draw erroneous conclusions regarding Respondents' purported misconduct. Specifically, on the basis of a footnote in EC's brief, the ALJ held that Respondents never produced the CMG License Agreement. RD 101. In his May 22 Order, the ALJ concluded that he could not rule for EC on the issue of the CMG agreement because it "is not clear which Respondent entered into the License Agreement, or what other terms it may have had." May 22 Order at 17. The ALJ then stated that "it would be helpful for a CMG representative to testify about the License Agreement and whether and how the parties performed under it." *Id.* EC never produced the License Agreement nor called a CMG witness. Undeterred, and without any additional evidence, the ALJ now opines on the significance of an agreement he has never seen, *id.*, at 20-21, and concludes "by a preponderance of the evidence that CMG's License Agreement was a written 'agreement to refer real estate settlement business in consideration of premiums ceded to Atrium.'" *Id.* at 74.

C. *The Affiliated Business Disclosure*:

Despite the fact that EC never raised an issue of Respondents' affiliated business disclosure, which clearly and plainly advised borrowers of the fact that their loan may be reinsured (borrowers are also informed of such an arrangement in the standard mortgage or deed of trust), the ALJ took it upon himself to decide that it was "so misleading, however, that its use constituted knowing misconduct." RD 98; *id.* 78 ("no evidence that PHH would have ever honored a request" for a different MI provider). No borrower testified that the document was misleading; nor is there any mention of this issue in the NOC. The only cited testimony was to Culver, who worked for MGIC and admitted that he had no knowledge of Respondents' business practices, Tr. 385-86, which renders his testimony sheer speculation. Had Respondents been afforded an opportunity to respond to this baseless attack, they would have pointed out to the ALJ that the form they used is virtually identical to the form HUD promulgated in 1996 as well as taken the opportunity to demonstrate that borrowers had a choice. *See* 61 FR 58472, 58477 (Nov 15, 1996) (Appendix D to Part 3500).

D. *The Preferred Provider List*:

The ALJ states: "The preferred provider list accordingly qualified as a referral mechanism under RESPA, because it affirmatively influenced a borrower's selection of a mortgage insurer." This statement is utterly devoid of support as the only testimony at the hearing was that the preferred provider list dealt with correspondent loans, where the correspondent always had the option to select the MI. Tr. 521-23. There was no testimony or other evidence regarding any purported influence on a ***borrower's*** selection of a pmi provider.

E. *The UGI March 2007 Dividend*:

With respect to the March 2007 dividend to Atrium, which has nothing to do with the two books at issue but is used by the ALJ to spin his theory of the case, the ALJ states that "[n]othing

in the record explains why PHH's preference prevailed" with respect to the taking of the $52.56 million dividend. RD 20. That is false. The record is clear that the early book years were "finished" such that Atrium was no longer at risk; the UGI trust was "enormous," RD 8; and that at the time – indeed at all times – Atrium met its statutory and regulatory trust fund requirements. Tr. 767; 771-72; 776. In other words, Atrium was allowed by UGI to take a dividend because it was no longer necessary for the funds to be in the trust account given that the risk had dissipated.

CONCLUSION

For the myriad reasons discussed above, the Bureau's first adjudicative hearing was fundamentally unfair. After extracting nuisance-value settlements from the MIs, EC targeted Respondents, threatening them with an action for hundreds of millions of dollars if they did not settle as the MIs had done. Respondents refused, and EC filed a NOC that included a number of baseless allegations designed to embarrass Respondents, the bulk of which EC subsequently abandoned. Then EC literally dumped more than 1,000,000 pages of documents – purportedly their entire investigative file – on Respondents less than a week before the parties were required to designate exhibits. When Respondents sought to compel EC to identify those materials that were material to their case, a position consistent with the commentary to the Rules, the ALJ deemed such commentary irrelevant and rejected the motion. *See* Documents 35, 59, 60. By the end of the first week of the hearing, the ALJ declared himself part of "Enforcement," *see* Tr. 967, and urged EC to change its theory of the case and to prosecute a different theory of liability against Respondents. When EC failed to pursue such a theory, the ALJ pursued it himself, finding that Respondents provided a "service" in connection with the UGI 2009 Book, yet, putting on his "expert witness rate-setting hat," still finding a violation of RESPA. With respect to the Genworth 2008-B Book, the ALJ apparently concluded that there was a transfer of risk; however, because of a dividend from the Genworth trust more than a year after the loans were

placed in the Book, it no longer passed risk transfer.

This action should have never been filed. Congress enacted RESPA to prevent kickbacks and fee splits with parties "'who did nothing in return for the portions they received.'" *Boulware v. Crossland Mortg. Corp.*, 291 F.3d 261, 268 (4th Cir. 2002) (citation omitted). The ALJ rejected EC's theory that the reinsurance was valueless, but his decision mid-hearing to place the burden of proving the absence of a RESPA violation on Respondents was clear legal error. In any case, Respondents did ***not*** violate RESPA. The 25% cede was acceptable to every regulator that examined it, as well as to every accountant who reviewed the financial statements of Respondents and every lender and MI who had such an arrangement. Tr. 1061. As far back as 1997, HUD reviewed the very arrangements at issue here and concluded that they were permissible. Viewed fairly, the evidence demonstrates that Respondents repeatedly took steps to ensure that they remained in compliance with HUD's guidance. Also undisputed were the facts that Atrium paid more than $126 million in claims and compensated both Genworth and UGI for their future losses on the only two books at issue. The ALJ's failure to give credence to the undisputed evidence from industry representatives who testified to the benefits of such reinsurance is stunning.

Further, given RESPA's criminal penalties, any attempt to hold Respondents liable for conduct that was in compliance with HUD's guidance is inappropriate and contrary to the bedrock principle that the government must provide clear notice of what constitutes a crime. This proceeding denied Respondents due process, and the ALJ's overt hostility towards Respondents is evident in virtually every Order he issued as well as in the RD. If this case is not dismissed for the reasons discussed above, Respondents ask that any remand be to a different ALJ.

Dated: January 9, 2015

Respectfully submitted,

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CERTIFICATION OF SERVICE

I hereby certify that on the 9th day of January, 2015, I caused a copy of the foregoing Brief in Support of Respondents' 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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