

Client Alert

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The CFPB Targets Mortgage Reinsurance Yet Again

By Nancy Thomas and Angela Kleine

The Consumer Financial Protection Bureau filed an administrative enforcement action against PHH Corporation, alleging a nearly 15-year “mortgage insurance kickback scheme” by its mortgage origination and reinsurance subsidiaries involving “hundreds of millions of dollars” in allegedly improper reinsurance fees. This action follows on the heels of the Bureau’s consent orders totaling \$15.5 million with five mortgage insurers, settling allegations that the insurers’ agreements with mortgage originators violated the Real Estate Settlement Procedures Act (RESPA). How this new action might relate to those settlements remains to be seen. But statements by PHH indicate that this could be one of the first contested CFPB administrative actions.

THE ALLEGED “SCHEME”

In accordance with the CFPB’s rules governing administrative proceedings, the Notice of Charges will not be published until ten days after service. The CFPB’s January 29, 2014 [press release](#) alleges generally that PHH referred borrowers to mortgage insurers “partners.” “In exchange for this referral, these insurers purchased ‘reinsurance’ from PHH’s subsidiaries,” taking the reinsurance fees as kickbacks. The Bureau contends PHH (1) “pressured” mortgage insurers into participating in the scheme and (2) “steer[ed]” business toward the mortgage insurers “even when it knew the prices [they] charged were higher than competitors’ prices.” The press release does not distinguish between PHH and its subsidiaries, but states that the Bureau is bringing the complaint against the corporation, its residential mortgage origination subsidiaries and its subsidiaries Atrium Insurance Corporation and Atrium Reinsurance Corporation, defining the entities collectively as “PHH.”

The Bureau alleges PHH received up to 40% of the premiums borrowers paid to mortgage insurers, which added up to “hundreds of millions of dollars.” Borrowers allegedly paid more in mortgage insurance (“MI”) premiums than they otherwise would have paid, and PHH purportedly charged some borrowers more for loans that its “kickback partners” did not insure.

The Bureau described this alleged scheme as “similar” to those in its actions against five mortgage insurers in April and November of 2013. In those cases, the Bureau (evidently picking up investigations originally started at HUD) alleged that the mortgage insurers¹ entered into agreements through which they paid illegal kickback payments and unearned fees, disguised as reinsurance premiums, to captive reinsurance affiliates of mortgage lenders, in exchange for the referral of MI business.² The Bureau contended that these agreements violated RESPA because “the projected value of the reinsurance to Defendant was far less than the premiums [the] Defendant[s] expected to cede,” which ranged from 12 to 40%. None of the settling mortgage insurers admitted to liability in the respective Consent Orders.

¹ The related CFPB materials are available at <http://www.consumerfinance.gov/newsroom/the-cfpb-takes-action-against-mortgage-insurer-to-end-illegal-kickbacks-to-lenders/> and <http://www.consumerfinance.gov/newsroom/the-cfpb-takes-action-against-mortgage-insurers-to-end-kickbacks-to-lenders/>.

² See, e.g., *CFPB v. Republic Mort. Ins. Co.*, No. 1:13-cv-24146 (S.D. Fla. filed Nov. 15, 2013), available at http://files.consumerfinance.gov/f/201311_cfpb_complaint_RMIC.pdf.

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The CFPB alleged that the respondents entered into these “captive arrangements with . . . more than one hundred captive reinsurers, including those affiliated with virtually every major lender participating in the U.S. housing market.” The Bureau’s Director of Enforcement specifically declined to name the lenders, citing its ongoing investigation. But, he added, “[i]n every kickback situation, there is somebody paying and somebody receiving. *It takes two to tango*. Today we’re dealing with those paying the kickbacks. But we have more work to do on this matter.”³ How, if at all, the Bureau’s present action against PHH relates to the Bureau’s priorities with respect to RESPA-related investigations and enforcement actions remains to be seen.⁴

LEGAL BACKDROP

As the CFPB acknowledged in its press release, mortgage insurance “can help borrowers get a loan when they cannot make a 20 percent down payment” and serves to “protect[] the lender against the risk of default.” Mortgage insurers purchase reinsurance in order to transfer risk to help “cover their own risk of unexpectedly high losses.” In other words, “[r]einsurance’ is simply insurance for insurance companies.”⁵ “When a mortgage lender sets up a subsidiary company to provide reinsurance to the mortgage insurers, it becomes a ‘captive’ arrangement.”

Section 8 of RESPA prohibits paying a referral fee in connection with a residential mortgage transaction, including, as interpreted by the CFPB, mortgage insurance transactions. Specifically, Section 8, as promulgated by Regulation X, prohibits “accept[ing] any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise” in exchange for the referral of any real estate settlement business.⁶ A Section 8 violation may result in civil and/or criminal liability, including (1) a fine of up to \$10,000, (2) imprisonment up to one year, and (3) civil liability of up to three times the amount of the amounts paid for the settlement service at issue.

Captive reinsurance is perfectly legal, but CFPB and HUD enforcement actions reflect these agencies’ distrust of these arrangements and willingness to push the boundaries of Section 8. In the PHH action, the legal issues likely will include whether PHH’s MI arrangements violated RESPA and the application of RESPA’s three-year statute of limitations,⁷ given that PHH’s misconduct allegedly occurred between 1995 and 2009.

PHH’S RESPONSE

PHH responded quickly to the CFPB’s press release, explaining “We believe the CFPB’s allegations grossly mischaracterize the legitimate business activities of our mortgage reinsurance subsidiary.”⁸ Its spokesman emphasized that its reinsurance companies “assumed significant risks, paid substantial claims and we believe complied with applicable statutory and regulatory requirements.”

³ See Carter Dougherty, *AIG Among Mortgage Insurers Fined by CFPB in Kickback Probe* (Apr. 4, 2013), <http://www.businessweek.com/news/2013-04-04/aig-among-mortgage-insurers-fined-by-cfpb-in-bank-kickback-probe> (emphasis added).

⁴ These actions follow numerous, similar smaller actions by the Bureau. For example, earlier this year, Fidelity Financial Mortgage Corp. agreed to pay the Bureau \$81,000 for allegedly funneling kickbacks to a bank in exchange for real estate referrals. And, in October of 2013, the Bureau sued a law firm in Louisville federal court for allegedly paying kickbacks for real estate settlement referrals through a network of shell companies. See *CFPB Files Suit Against Borders & Borders, PLC for Paying Illegal Real Estate Kickbacks* (Oct. 24, 2013), <http://www.consumerfinance.gov/newsroom/cfpb-files-suit-against-borders-borders-plc-for-paying-illegal-real-estate-kickbacks/>.

⁵ *The CFPB Takes Action Against Mortgage Insurers to End Kickbacks to Lenders* (Apr. 4, 2013), <http://www.consumerfinance.gov/newsroom/the-cfpb-takes-action-against-mortgage-insurers-to-end-kickbacks-to-lenders/>.

⁶ 12 U.S.C. § 2607(a) (2014); Prohibition against kickbacks and unearned fees, 12 C.F.R. § 1024.14 (2014); see also CFPB, *Consumer Laws and Regulations, RESPA* (Aug. 2013), available at http://files.consumerfinance.gov/f/201308_cfpb_respa_narrative-exam-procedures.pdf.

⁷ 12 U.S.C. § 2614 (2014).

⁸ Alan Zibel, *Mortgage Lender PHH Is Accused of Taking Kickbacks from Insurers*, Wall Street Journal, Jan. 29, 2014.

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Indeed, PHH has been fighting this action for years. The CFPB's press release discloses that, like the five MI actions discussed above, the CFPB inherited this investigation from HUD on the July 21, 2011 Designated Transfer Date.

Two years ago, in January 2012, the CFPB notified PHH that it was initiating an investigation "to determine whether the practice of ceding premiums from private mortgage insurance companies to captive reinsurance subsidiaries of certain mortgage lenders has violated Section 8" of RESPA.⁹ In May of 2012, after an initial, more limited data request, the CFPB issued a Civil Investigative Demand ("CID") on PHH seeking responses to 21 interrogatories and 33 broad document requests. PHH filed the first petition for an order to set aside or modify a CFPB CID, arguing the requests were overly broad and unduly burdensome, and not in compliance with Dodd Frank.¹⁰ The CFPB Director denied the petition on September 20, 2012.¹¹ Over a year later, the CFPB has initiated an enforcement action.

WHAT HAPPENS NEXT

The Dodd-Frank Act authorizes the CFPB to conduct hearings and adjudicative proceedings to enforce compliance with Title X of the Dodd Frank Act, any rules promulgated by the CFPB pursuant to Title X, and any other federal law or regulation the CFPB is authorized to enforce. The CFPB's Rules of Practice Governing Adjudication Procedures ("Adjudication Rules") establish the procedures that will apply to these adjudicative proceedings.¹² The Adjudication Rules are modeled on the uniform rules and procedures for administrative proceedings adopted by the prudential regulators, the FTC and the SEC.¹³ The PHH Notice of Charges initiates proceedings in the CFPB's Office of Administrative Adjudication. An Administrative Law Judge will preside over the action.¹⁴

The Adjudication Rules are designed to ensure relatively streamlined proceedings with much more limited discovery rights for the defendant. For example:

- The Bureau must produce specified documents, including "material exculpatory evidence." PHH, though, must seek approval to obtain any other documents, take depositions, or obtain any third party discovery.
- It remains to be seen whether the "clearly defined serious injury" standard required to seek protection for confidential information under the CFPB's administrative rules is similar to the standard applied by district courts in entering confidentiality orders.

In addition, the pace of the proceedings is much faster than typical federal litigation:

- PHH's answer is due within 14 days of service of the Notice (versus 21 days in federal court, where extensions are routinely granted).

⁹ PHH Corporation's Petition to Modify or Set Aside Civil Investigative Demand (June 12, 2012) Attachments A-C, available at http://files.consumerfinance.gov/f/201209_cfpb_phhcorp_petition_0001.pdf.

¹⁰ PHH Corporation's Petition to Modify or Set Aside Civil Investigative Demand (June 12, 2012), available at http://files.consumerfinance.gov/f/201209_cfpb_phhcorp_petition_0001.pdf.

¹¹ Decision and Order on PHH Corporation's Petition to Modify or Set Aside Civil Investigative Demand at 4-5 (Sept. 20, 2012), available at http://files.consumerfinance.gov/f/201209_cfpb_setaside_phhcorp_0001.pdf.

¹² 12 C.F.R. § 1081.

¹³ *Id.*

¹⁴ In the only other litigated administrative adjudication that the CFPB has conducted thus far, the Securities and Exchange Commission's Chief ALJ served as the Bureau ALJ pursuant to an Interagency Agreement. *In the Matter of 3D Resorts-Bluegrass LLC*, No. 2013-CFPB-0002 (June 20, 2013), available at <http://www.consumerfinance.gov/administrativeadjudication/2013-cfpb-0002/>.

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- The ALJ must conduct an initial scheduling conference within 20 days of service (versus typically two to three months or more after filing in federal court).
- The ALJ must issue a decision within 300 days (a speed that would be highly unusual in a large enforcement action brought in federal court).

The ALJ issues a "recommendation decision," which can be appealed to the Bureau Director.¹⁵ The respondent can then seek judicial review of the Director's decision.¹⁶

CONCLUSION

The PHH action reflects the Bureau's continuing focus on mortgage insurance, and in particular captive reinsurance arrangements. It may shed light on the CFPB's priorities in future investigations in light of the Bureau's comment that its ongoing mortgage insurance investigations potentially implicate "virtually every major lender participating in the U.S. housing market."

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.

¹⁵ The appellate brief is due within 30 days of decision, and the Director's decision is due 90 days after appellate briefing is complete. 12 C.F.R. §§ 1081.402, 1081.405.

¹⁶ The order will not be stayed pending judicial review unless the Director, at his discretion, does so. 12 C.F.R. § 1081.407