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### **3RD CIRCUIT DECISION HOLDS THAT CAPTIVE REINSURANCE ARRANGEMENTS VIOLATE SECTION 8(A) OF RESPA**

In *Alston v. Countrywide Financial Corporation*, 585 F.3d. 783 (3rd Cir. 2009), the United States Court of Appeals for the 3rd Circuit held that homebuyers may pursue a class action claim that Countrywide Financial Corporation engaged in taking kickbacks in violation of Section 8(a) of the Real Estate Settlement Procedures Act (RESPA) by steering private mortgage insurance policy referrals to insurers who agreed to reinsure a portion of the policies with Countrywide's affiliate.

Plaintiffs obtained mortgage loans from Countrywide. Because plaintiffs' down payment was less than 20%, Countrywide required plaintiffs to purchase private mortgage insurance. The rates charged by mortgage insurers in Pennsylvania are set by the Pennsylvania Insurance Department. Countrywide allegedly required the plaintiffs to purchase their mortgage insurance only from one of a number of insurers who agreed to reinsure a portion of the policies with Countrywide's affiliate, Balboa Reinsurance Company. Because insurance rates are fixed, the plaintiffs paid the same amount for the private mortgage insurance as they would have paid had they selected their own insurer.

Balboa entered into a reinsurance arrangement with the mortgage insurers where in return for a portion the premiums, Balboa agreed to be responsible for a band of losses under the reinsurance policies. Plaintiffs alleged this "excess loss agreement" was a disguised kickback because Balboa did not assume risk commensurate with the premiums it received. They supported this allegation with evidence that since 1999, Balboa had collected over \$892 million in premiums but had paid nothing in claims.

The District Court dismissed plaintiffs' claims on grounds the plaintiff homebuyers could not establish they suffered any loss. The Third Circuit reversed, holding that RESPA does not require a plaintiff to allege or prove it suffered any actual loss from the alleged kickback, but merely that a kickback existed. The Court also rejected Countrywide's defense that the rates the private insurance companies charged were necessarily reasonable because they were set by the state, noting that "plaintiffs challenge Countrywide's allegedly wrongful conduct, not the reasonableness or propriety of the rate that triggered that conduct."

For some time, HUD has questioned the propriety of this type of captive reinsurance arrangement. [First name of opinion, in italics] also brings into doubt the validity of captive reinsurance arrangements based on excess loss agreements unless the mortgage lender can establish the captive reinsurer actually paid out a

reasonable amount in losses. In addition, the Court's reasoning could apply in the context of HUD's requirements for affiliated business arrangements (AfBAs). From time to time, HUD has argued that an AfBA where a business partner receives distributions that are not commensurate with the risks it incurs is really a disguised kickback (and therefore a sham arrangement) in violation of RESPA because it, too, does not appropriately reflect market risks and rewards of the market.

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