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PHH v. CFPB, Part II: CFPB's RESPA Duplicate Fail

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Part I of this alert addressed the DC Circuit's holding in PHH Corp. v. CFPB *that the Consumer Financial Protection Bureau's single director structure is unconstitutional. Part II addresses the next part of the opinion, where the DC Circuit found that the CFPB misinterpreted the Real Estate Settlement Procedures Act (RESPA), violated due process by retroactively applying the misinterpretation to* PHH Corp.*, and failed to apply RESPA's statute of limitations in contravention of the Dodd-Frank Act's authorizing provisions. The decision substantially reins in the CFPB's power; in response, the CFPB filed a petition for rehearing* en banc *to the DC Circuit Court of Appeals last Friday.*

This alert is the second of a two-part series about the recent *PHH Corp. v. CFPB* opinion of the United States Court of Appeals for the District of Columbia Circuit involving the Real Estate Settlement Procedures Act (RESPA) and the Consumer Financial Protection Bureau.[1] Part I addresses the DC Circuit's holding that the CFPB's single director independent agency structure is unconstitutional, and explores the implications of the CFPB being found unconstitutional going forward.

Here, the focus is on the substantive part of the opinion, which is no less a rebuke to the CFPB than the rejection of the single director structure. After finding the CFPB unconstitutional, the DC Circuit also found that the bureau not only misinterpreted RESPA, but also violated "bedrock due process principles" by retroactively applying that misinterpretation to mortgage lender PHH Corp. (PHH). In some ways, these issues could have a much greater impact on how the bureau conducts itself than the constitutionality ruling, and as such, this part of the decision may inform the way companies navigate future CFPB enforcement actions.

[1] Michael J. Halloran of Pillsbury advised the Board of Directors of PHH Corp. on this matter, including its decision to take the appeals.

Since the opinion was released, two major developments have occurred. First, the election of Donald Trump to the presidency on November 8 has rendered the future of the CFPB much less certain. The President-elect has been clear throughout his campaign that he intends to "get rid of" or "dismantle" the CFPB's enabling statute, the Dodd-Frank Act. Although it remains unlikely the entire law could be repealed anytime soon, the Republican-controlled Congress may be able to make substantial revisions relatively quickly once President-elect Trump transitions into the White House. What the CFPB may look like under a Trump administration is not addressed in detail here. Nevertheless, the *PHH* decision only bolsters congressional Republican arguments about CFPB overreach and provides support for changes that President-elect Trump may want to make in the interim.

Second, last Friday the CFPB filed a petition for *en banc* rehearing of the *PHH* decision, citing serious concerns about the DC Circuit's "dramatic and unprecedented ruling."[2] The petition requests review of the holdings that found (1) the CFPB's single-director structure to be unconstitutional, and (2) that the bureau misinterpreted RESPA.

I. Captive Reinsurance Arrangements and HUD's RESPA Section 8 Guidance

First, understanding "captive reinsurance arrangements" is critical to understanding the DC Circuit's opinion. Mortgage lenders like PHH often require certain homebuyers—for instance, those who cannot afford a 20 percent down payment—to buy mortgage insurance that at least partially protects the lender in the event the homebuyer defaults. Then, to protect their own losses, these mortgage insurers frequently purchase mortgage reinsurance, usually paying for it with a portion of the homebuyer's monthly mortgage insurance. Often, as in PHH's case, the mortgage lender (PHH) will establish its own reinsurance business (Atrium), and the relationships between and among PHH and the mortgage insurance companies are called "captive reinsurance arrangements."

Now enter the RESPA concerns that the CFPB has with captive reinsurance arrangements. Section 8(a) of RESPA prohibits companies like PHH from receiving "kickbacks" relating to mortgage lending (paying for a referral, for example).[3] Section 8(c), however, provides exceptions to that broad prohibition, including an exception that allows payments for services or goods actually provided.[4]

Specifically, Section 8(a) provides:

> 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.

And Section 8(c) details safe harbors, including, in relevant part:

> Nothing in this section 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.

[2] Petition for Rehearing En Banc, *PHH Corp. v. CFPB*, No. 15-1177 (D.C. Cir. Nov. 18, 2016).

[3] 12 U.S.C. § 2607(a). Without the exception in Section 8(c), this language would prohibit lenders like PHH from accepting any type of payment from the mortgage insurers it referred homebuyers to, even if the payment was to a subsidiary like Atrium.

[4] 12 U.S.C. § 2607(c).

Prior to the creation of the CFPB under the Dodd-Frank Act, the U.S. Department of Housing and Urban Development was in charge of enforcing Section 8 of RESPA. In 1997 and 2004, HUD released guidance, in the form of letters, confirming that Section 8's exceptions specifically allowed captive reinsurance arrangements where "the mortgage insurer paid no more than reasonable market value for the reinsurance."[5] The letter explicitly recommended that the mortgage industry rely on the guidance to legally conduct business under RESPA.

In other words, as long as the PHH reinsurance business did not overcharge for the reinsurance it sold to mortgage insurers (charging more than reasonable market value would constitute an illegal "kickback"), the arrangement was permissible under HUD's interpretation of RESPA.

With HUD expressly stating that captive reinsurance arrangements were not *per se* illegal, PHH—and the mortgage industry in general—relied for years upon this interpretation. That is, until the Dodd-Frank Act gave the CFPB authority to enforce Section 8 of RESPA by bringing actions against potential violators.

The CFPB set to work quickly, and, alleging violations of RESPA due to captive reinsurance businesses, it obtained consent orders from companies like Fidelity Mortgage Corporation and Republic Mortgage Insurance Corporation. Issued in 2013 and 2014, around the same time the CFPB instigated its action against PHH, orders like these enjoined companies from participating in captive reinsurance arrangements and required them to pay large penalties. The bureau alleged in these cases that the captive reinsurance arrangements were in fact illegal kickback schemes that constituted violations of Section 8 of RESPA. The CFPB has never issued any guidance or statement reflecting this new interpretation. Until CFPB Director Richard Cordray's opinion in the PHH matter, which is the subject of the appeal to the DC Circuit, the CFPB had never otherwise indicated that the prohibitions in its consent orders superseded HUD's previous guidance.

II. DC Circuit's RESPA Holdings

The DC Circuit's opinion notes that when the CFPB took over enforcement of Section 8, it "carried forward HUD's rules, policy statements, and guidance," at least until the CFPB decided to reinterpret the rules or make changes to any previously issued guidance.[6] This would include, of course, the guidance on Section 8 from HUD. Having utilized captive reinsurance arrangements since 1995, PHH and its captive reinsurance business, Atrium, continued to rely on that HUD interpretation throughout the change in enforcement authority.

Then, in January 2014, following an investigation of PHH's practices, the CFPB began an administrative proceeding against the lender for violating Section 8 of RESPA with its captive reinsurance arrangements. After a hearing, the administrative law judge issued a decision against the company, but relied on the HUD guidance in doing so. Specifically, the decision imposed a $6 million penalty on PHH for violating Section 8 when, acting as the reinsurer Atrium, the judge found that PHH charged more for reinsurance than it otherwise might have, save for some incentives it offered to the mortgage insurers to buy the reinsurance. The judge stated that these extra costs must have ultimately been passed on to customers in the form of higher mortgage insurance premiums.

PHH appealed the decision to Director Cordray, who agreed that a RESPA violation had occurred, but disagreed with the administrative law judge's methodology for determining the penalty. It is here that the

[5] *PHH Corp. v. CFPB*, No. 15-1177, Slip Op. at 15 (D.C. Cir. Oct. 11, 2016).

[6] *PHH Corp. v. CFPB*, No. 15-1177, Slip Op. at 16 (D.C. Cir. Oct. 11, 2016).

bureau pivoted 180 degrees from the HUD guidance. It asserted its new interpretation of Section 8 in the decision, as foreshadowed by the earlier RESPA consent orders with other mortgage lenders.[7]

Thus, in 2015, the CFPB asserted for the first time that Section 8 barred captive reinsurance arrangements *even if* the mortgage insurer paid reasonable market value for reinsurance.[8] The CFPB then went even further, retroactively applying this new interpretation to PHH's conduct since 2008—conduct which may have been acceptable under HUD's previous guidance—and increased the penalty from $6 million to $109 million. Finally, the CFPB ordered that PHH refrain from entering into any future captive reinsurance arrangements.

PHH appealed to the DC Circuit, asserting that the CFPB misinterpreted Section 8 and that HUD's original interpretation was correct. The court resoundingly agreed.

More significant, however, was the DC Circuit's finding that the CFPB violated due process by retroactively applying its new Section 8 interpretation to PHH. According to the opinion, which cites a long list of precedents, the CFPB's use of retroactivity "contravenes the bedrock due process principle that the people should have fair notice of what conduct is prohibited."[9]

The DC Circuit dismissed several of the CFPB's arguments on this point, explaining, for example, that although agencies could retroactively apply new interpretations to ambiguous statutes, this was a reversal of HUD's longstanding position and the CFPB was not dealing with an ambiguous statute. The CFPB's assertions that PHH should not have relied on HUD's guidance or that the guidance was not binding also failed to sway the court.

Even with these victories, PHH is not entirely in the clear. The CFPB was ordered to determine, on remand, whether the mortgage insurers paid higher than market value for reinsurance. If they did, PHH will be liable for violating Section 8 of RESPA under the court-sanctioned interpretation originally put forth in the HUD guidance.

If the CFPB does find PHH liable, however, it is unlikely that the lender will be subject to the original $109 million penalty based on the last section of the DC Circuit's opinion. This is because although Title X of the Dodd-Frank Act—which governs the CFPB's enforcement authority—does not impose an express statute of limitations on CFPB enforcement activities, the DC Circuit held that the CFPB is still subject to RESPA's statute of limitations based on a plain language reading of the Title X provisions. According to the opinion, it "would be absurd" to find that the CFPB was not subject to any statutes of limitation.

III. Concluding Thoughts

In sum, the DC Circuit's opinion is a warning shot across the bow that the broad enforcement authority the CFPB has been exercising has gone too far, and that the CFPB should be more restrained in wielding its

[7] *See PHH Corp.*, No. 2014-CFPB-0002, Slip Op. at 17 (June 4, 2014).

[8] According to Director Cordray's decision, "[r]egardless of whether the price that the mortgage insurers paid was inflated or was set at the fair market value of the reinsurance they received, PHH still benefited from the arrangement because Atrium received (profitable) business from the mortgage insurers that it would not otherwise have received. Accordingly, that agreement distorted the market for mortgage insurance, in direct contravention of RESPA's core provisions. . . . [S]ection 8(c)(2) only becomes relevant if there is a question as to whether the parties actually did enter into an agreement to refer settlement service business." *PHH Corp.*, No. 2014-CFPB-0002, Slip Op. at 16, 17 (June 4, 2014).

[9] *PHH Corp. v. CFPB*, No. 15-1177, Slip Op. at 83 (D.C. Cir. Oct. 11, 2016).

potent powers. At a minimum, the bureau is now on notice that it may not retroactively apply new interpretations of consumer financial protection law to past conduct.[10]

Director Cordray tried to read the Section 8(c) exception out of the statute, tried to retroactively repeal a long standing agency interpretation that permitted it to be relied upon by the industry, and appeared to ignore the express statute of limitations in RESPA in an effort to impose an enormous penalty on PHH. The CFPB's aggressive interpretation of its authority has already been noticed by Congress, which has taken up legislation to restructure the CFPB. See, for example, Section 2 of the pending Financial CHOICE Act by House Financial Services Committee Chair Jeb Hensarling.[11] This act would alter the CFPB by replacing its single director structure with a five Commissioner structure, and by subjecting it to annual Congressional appropriations funding, rather than its current mandatory funding scheme of around 10 percent of Federal Reserve Board operating expenses.

Now that the CFPB has petitioned for review of the decision, it will be a waiting game to find out if an *en banc* rehearing will be granted and, if it is, whether any aspects of the decision will be overturned. To date, CFPB supporters in Congress have defeated legislation to modify the CFPB's structure and authority, but under a unified GOP government, the Trump administration and congressional leaders may render an appeal moot if they are able to quickly repeal key sections of Dodd-Frank and implement new, less restrictive legislation to regulate financial institutions.

The PHH decision represents a potentially meaningful "check" on the CFPB's broad power, which the bureau has increasingly asserted as it remains insulated from the congressional appropriations process. As the DC Circuit decision shows, judicial checks on federal agencies are often narrow in scope, but incisive. If upheld, both aspects of the PHH decision will help to create a more level playing field between the CFPB and its enforcement targets.

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[10] In its petition for rehearing, the CFPB admitted that "the panel's refusal to permit the bureau to apply its interpretation retrospectively is perhaps not worthy of *en banc* review on its own," but does request an opportunity to address this aspect of the holding if the Court reviews the opinion's RESPA interpretation. Petition for Rehearing *En Banc* at 14-15, *PHH Corp. v. CFPB*, No. 15-1177 (D.C. Cir. Nov. 18, 2016).

[11] Financial CHOICE Act of 2016, H.R. 5983, 114th Cong. (2016).

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