

Court Strikes Down CFPB's Interpretation of RESPA

PHH Corporation v. CFPB and Its Impact on Your Business

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Introduction

- On October 11, 2016, a three-judge panel of the US Circuit Court of Appeals for the District of Columbia issued a ruling overturning a \$109 million monetary penalty imposed by the CFPB against PHH Corporation
 - The three-judge panel declared the CFPB:
 - wrong on its interpretation of RESPA
 - wrong on the penalty it imposed against PHH
 - wrong on claiming no SOL applied
 - wrong for retroactively applying a new RESPA interpretation
 - And, if that were not enough, two of three judges held:
 - CFPB unconstitutionally structured

Agenda

1. How we got here
2. Legal and factual matters at issue
3. How the court ruled
4. What the constitutional holding means
5. Ultimately, how does the opinion affect:
 - enforcement of RESPA
 - your business

How We Got Here

1. PHH Corporation, a large US home mortgage lender
 - refers mortgage insurance business to MI companies
 - some MI companies acquire reinsurance
 - PHH forms Atrium, a captive reinsurance company
2. PHH relies upon 1997 HUD Letter
 - captive reinsurance lawful
 - 2-part test under Section 8(c)(2)
3. Section 8(c)(2) legal underpinnings for captive reinsurance
 - most marketing and advertising activities also rely on Section 8(c)(2)

CFPB Files Enforcement Action Against PHH

1. Claims Atrium activities unlawful under RESPA
 - activities involve improper referral payments
 - in violation of Section 8(a)
2. CFPB files suit administratively before ALJ
3. ALJ
 - recognizes validity of Section 8(c)(2) as exemption
 - guided by 1997 HUD Letter
4. ALJ finds:
 - kickbacks in violation Section 8(a)
 - Disgorgement of ill-gotten profits = \$6M
 - Bureau not subject to 3-year SOL
5. PHH and CFPB appeal decision to Director

2015 Cordray Opinion

1. Claims CFPB not bound by:
 - ALJ rulings
 - 1997 HUD Letter
 - 3-year SOL
 - finds continuing violation
2. Claims Section 8(c)(2) is not an exemption
 - merely affirmative defense
 - if referrals present – no Section 8(c)(2) protection
3. Finds PHH received payment for MI referrals
 - payment was ceding of MI premiums
4. Defines Disgorgement
 - as ill-gotten gains = \$109M
5. PHH appeals to US Circuit Court of Appeals

Why Cordray Opinion Is So Critical

1. Extends SOL beyond three years
 - continuous violation
2. Ill-gotten gains result in gargantuan penalties
3. Guts Section 8(c)(2) Safe Harbor
 - if any referral in transaction
 - No Section 8(c)(2) protection
4. Opinion contrary to:
 - 37 years of HUD guidance
 - Federal court decisions
 - plain language of Act
5. Section 8(c)(2) foundation for most marketing activities

Section 8(c)(2) of RESPA

- CFPB's interpretation of Section 8(c)(2) problematic
 - **“Nothing in this section [Section 8] shall be construed as prohibiting ... the payment to any person of bona fide salary or compensation or other payment for goods or facilities actually furnished or services actually performed.” 12 U.S.C. § 2607(c)(2)**
 - Seems pretty clear Section 8(c)(2) is an exemption

HUD Established 2-Part Test for Section 8(c)(2) Compliance

- Part 1: Services and Goods
 - actual = real
 - necessary = useful, meaningful
 - distinct = not done elsewhere in transaction
- Part 2: Reasonable Market Value
 - payment commensurate with value of services and goods
 - amount in excess of FMV, considered a referral in violation of Section 8(a)

PHH Appeals Cordray Opinion to US Circuit Court for the District of Columbia

1. Interpretation of Section 8(c)(2) inaccurate
2. Retroactive application of new interpretation violates due process
3. Ignoring 3-year SOL = abuse of power
4. Disgorgement bears no relation to harm
5. CFPB unconstitutionally structured

PHH's Constitutional Argument

1. Article II of US Constitution says
 - executive power vested in President
2. Congress created single-director of CFPB
 - Section 5491(c)(3) removal for cause only
 - “inefficiency, neglect of duty or malfeasance in office”
3. No accountability to any elected official
4. Requests CFPB be disbanded

October 11 Circuit Court Opinion

A. CFPB Unconstitutionally Structured (2-1 Vote)

1. Director more powerful than President on consumer financial issues
2. For-cause only provision violates Article II of Constitution
3. Severs Section 5491(c)(3) from CFPA
 - making CFPB an executive agency
4. Other provisions of CFPB left intact
 - only for-cause provision deemed unconstitutional
 - CFPB to become executive agency of US government

October 11 Circuit Court Opinion

B. Section 8(c)(2) is Exemption

1. “Not a close call...”
 - NOTHING means NOTHING...
2. Even if referrals going on in transaction
 - unpaid referrals are lawful
 - tying arrangements have value
3. Follows HUD guidance on Section 8(c)(2)
 - commonsensical
 - actual, necessary services and goods at reasonable market value
4. Court repudiates CFPB’s strained reading of the Act
5. Banner day for industry

October 11 Circuit Court Opinion

C. Retroactive Application of New Interpretation Violates Due Process

1. Even if new interpretation were lawful
 - may not be applied retro-actively
 - by making activities that occurred before change – a violation
2. PHH and industry properly relied upon 1997 HUD Letter
3. Another rebuke of Director

October 11 Circuit Court Opinion

D. SOL Determined by Consumer Financial Law, NOT Whim of Director

1. Director must apply SOL set forth in each of 19 consumer financial laws he or she administers
2. No more unlevel playing field
3. RESPA has 3-year SOL – therefore, SOL is 3-years
4. Timing of 3-years an issue not resolved by this Court

October 11 Circuit Court Opinion

E. Court Defines Disgorgement

1. ALJ said ill-gotten profits
 - $\$109\text{M} - \$103\text{M} = \$6\text{M}$
2. Director said ill-gotten gains
 - $\$109\text{M}$
 - every cent refundable
3. Circuit Court says disgorgement
 - difference between amount paid and reasonable market value
 - any excess is refundable
 - huge deal to PHH

October 11 Circuit Court Opinion

F. Circuit Court

1. Grants PHH petition for review
2. Vacates CFPB order
3. Remands for further proceedings to determine, consistent with 3-year SOL, whether MI companies paid more than reasonable value to PHH (CFPB has burden on remand)
4. In the meantime, decision on hold pending appeal

Appeal Options

1. 45 days to appeal three-judge panel decision
 - en banc review
2. CFPB may appeal constitutional issue or RESPA ruling – or both
 - in either case, ruling stayed
3. En banc likely to take additional year
4. CFPB could appeal directly to Supreme Court
 - ask Circuit Court for stay on appeal

Bottom line – case not over yet

Effect of Decision on Your Business

- A. In interim, will CFPB follow circuit court rulings on RESPA?
1. Six circuit courts now agree = Section 8(c)(2) exemption
 2. CFPB may:
 - treat Section 8(c)(2) as exemption, even with unpaid referrals
 - not retroactively apply new interpretations
 - adhere to 3-year SOL
 - accept court definition of disgorgement
 3. That said, CFPB message post PHH Decision – “we will continue to consider best way to apply RESPA to specific factual situations”
 - continue to adhere to 2015 MSA Bulletin

Effect of Decision on Your Business

- B. Renewed interest in MSAs and other advertising arrangements
 - 1. Court did not sever Section 8(c)(2)
 - 2-part test still required
 - no payment for referrals
 - 2. CFPB still disfavors these arrangements
 - been wounded by this decision
 - but beware
 - 3. At end of day – each company must
 - be vigilant in complying with the Act
 - assess its own tolerance for risk
 - 4. **KEEP YOUR SEAT BELTS FASTENED...**
 - victory for industry – setback for CFPB
 - roller coaster ride far from over!

Questions?

- Please submit questions using the chat feature on the right panel of the WebEx portal



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