

Client Alert

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CFPB Hit by Major Setback in D.C. Circuit

By Joseph R. Palmore and Donald C. Lampe

In a decision eagerly awaited by the financial services industry, the D.C. Circuit this week handed the Consumer Financial Protection Bureau (CFPB) a major defeat, throwing out a mortgage lender's \$109 million disgorgement remedy on constitutional, statutory, and administrative-law grounds. See *PHH Corp. v. CFPB*.¹ This may not be the last chapter in the story, however, as it is likely that the government will seek further review.

BACKGROUND. PHH, the mortgage lender involved in the case, established a subsidiary to provide reinsurance to mortgage insurers that insured mortgages generated by PHH. PHH often referred borrowers to mortgage insurers that used the subsidiary's reinsurance services. So long as the reinsurance was priced at market value, such arrangements had long been considered permissible under the Real Estate Settlement Procedures Act (RESPA), which prohibits kickbacks in connection with real estate settlement transactions. In particular, such market-price arrangements had been viewed by industry – and, critically, by the government in official guidance – as falling within a safe harbor created by RESPA Section 8(c) for “the payment to any person of a bona fide . . . payment for goods or facilities actually furnished or for services actually performed.”

In an action that deeply unsettled the industry, however, the CFPB concluded that PHH's reinsurance arrangement violated RESPA and imposed a \$109 million disgorgement remedy. The Bureau concluded that RESPA Section 8(c) did not actually establish a safe harbor and that PHH's arrangement constituted an illegal kickback. That reading of the statute was not necessarily limited to reinsurance arrangements, thus potentially putting at risk other longstanding, market-priced transactions surrounding real estate settlement.

D.C. CIRCUIT DECISION. PHH filed a petition for review in the D.C. Circuit. Tuesday's decision granted that petition and vacated the disgorgement remedy on multiple independent grounds:

- **Constitutional holding.** The court held that the structure of the CFPB was unconstitutional. Under the law that established the CFPB, the Bureau's director may be removed by the President only “for cause.” While such tenure protections are a common feature of multi-member regulatory bodies, the court noted it was novel to provide them to an individual regulator, like the director of the CFPB. The court held that “the combination of power that is massive in scope, concentrated in a single person, and unaccountable to the President” meant that the CFPB's structure violated constitutional separation of powers principles. The court adopted a narrow remedy for this violation, however, simply excising the Director's “for cause” tenure protection from the statute. Accordingly, the court said its constitutional holding would have “important but limited real-world implications.” “As before,” the court stated, “the CFPB will continue to operate and perform its many critical responsibilities, albeit under the ultimate supervision and direction of the President.”

¹ Morrison & Foerster filed an amicus brief in support of the mortgage lender on behalf of the American Financial Services Association, Consumer Bankers Association, Housing Policy Council of the Financial Services Roundtable, Independent Community Bankers of America, Leading Builders of America, Mortgage Bankers Association, and National Association of Home Builders.

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- **Statutory holding.** The court rejected the CFPB's reading of RESPA, holding that Section 8(c) is a real safe harbor that "allows captive reinsurance arrangements so long as the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of the reinsurance." The court held that the statute expressly permitted such "bona fide payments," meaning "payment[s] of reasonable market value."
- **Notice holding.** The court held that the disgorgement remedy imposed on PHH violated fair-notice principles rooted in the Due Process Clause and administrative law. The court observed that, even assuming the CFPB's interpretation of RESPA were correct, that interpretation was new. In fact, official government guidance and the CFPB's own regulations had long supported the view that Section 8(c) provided a real safe harbor for market-priced transactions. The court held that the CFPB's new interpretation was an abrupt departure from that longstanding view on which industry had relied and therefore could not serve as a basis for imposition of a penalty on PHH.
- **Statute of limitations holding.** The court rejected the CFPB's position that there is no statute of limitations for its administrative enforcement proceedings brought under RESPA. The court held instead that a three-year statute of limitations applies.

ROAD AHEAD. Given the high-profile nature of this case and the importance of the legal issues to the Bureau, a government effort to seek further review is likely. This is particularly true of the court's constitutional holding. The federal government typically seeks further review when, as here, a court holds a federal statute unconstitutional. Assuming that the government does so in this case, the full D.C. Circuit sitting en banc, the United States Supreme Court, or both will have an opportunity to weigh in on some or all of the issues addressed by the panel.

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