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[Banking and Finance Law Daily Wrap Up, TOP STORY—D.C. Cir.: CFPB's sails are trimmed, but it isn't sunk, (Oct. 11, 2016)]

Banking and Finance Law Daily Wrap Up

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By Richard A. Roth, J.D.

The Consumer Financial Protection Bureau's single-director structure is unconstitutional for an independent agency, a two-judge majority of the U.S. Court of Appeals for the District of Columbia Circuit has decided. However, the remedy likely will not satisfy the bureau's attackers—rather than striking down the entire agency, the court ruled only that the President must be deemed to have the authority to discharge the director at will and without cause (*PHH Corporation v. CFPB*, Oct. 11, 2016, Kavanaugh, B.).

The three-judge panel unanimously rejected the bureau's claims that there is no statute of limitations that restricts its ability to enforce the Real Estate Settlement Procedures Act against a mortgage lender accused of taking illegal kickbacks. To successfully show a RESPA violation by PHH Corporation, the bureau will need to prove that mortgage insurers paid a PHH-affiliated reinsurer above-market premiums less than three years before the enforcement action was initiated.

Enforcement action. The challenge to the CFPB's existence arose from the bureau's efforts to enforce RESPA's anti-kickback provisions against PHH. As described by the majority opinion, the CFPB changed a long-standing Department of Housing and Urban Development RESPA interpretation that allowed captive reinsurance arrangements as long as the reinsurance was purchased at market prices. The CFPB then applied its reinterpretation of RESPA to past PHH conduct, determined that there was no time limit on its enforcement authority, and imposed a $109 million disgorgement order.

PHH appealed the bureau's administrative enforcement proceeding, asserting that the CFPB was unconstitutional and that the retroactive application of RESPA had denied the company due process.

Executive v. independent agency. To analyze the constitutionality of the CFPB, the majority first noted that the Constitution gives executive authority to the president. Executive agency leaders serve at the president's will and can be discharged at his discretion. This is necessary because the president, as the chief executive, is responsible for their actions.

Leaders of independent agencies are in a different position, the majority pointed out. They can be discharged only for cause, which greatly reduces the president's influence over them. The Dodd-Frank Act gives the CFPB director this protection. Dodd-Frank also gives the CFPB director the authority to initiate and prosecute enforcement actions. In fact, the CFPB director's powers and his independence from presidential control essentially make him the "President of Consumer Finance," the majority asserted.

Past practices. The majority conceded that the Constitution does not explicitly condemn this arrangement; on the other hand, neither does the Constitution explicitly approve it. However, "A long line of Supreme Court precedent tells us that history and tradition are important guides in separation of powers cases that, like this one, are not resolved by the constitutional text alone."

Historical practice consistently allowed an executive agency to have a single director, while requiring independent agencies to have multi-member boards, the majority then said. The use of a multi-member board provides a check against arbitrary actions and abuses of power because power is not concentrated in hands of one person.

"In a multi-member independent agency, no single commissioner or board member possesses authority to do much of anything," the majority opinion said. "A multi-member independent agency can only go as far as the middle vote is willing to go."

In the absence of any meaningful precedent supporting an independent agency with a single director, the majority would not approve the structure. Describing the bureau’s structure as "exceptional in our constitutional structure and unprecedented in our constitutional history," the majority decided that it was unconstitutional.

Remedy. However, that did not mean that the CFPB was to be discarded. The majority was not prepared to strike down the entire Dodd-Frank Act due to one flaw. A severability analysis was called for.

It was unnecessary for the majority to wonder whether Congress would have wanted Dodd-Frank to continue in effect without the restriction on the president’s power to discharge the CFPB director, according to the majority. Dodd-Frank included a severability clause that made congressional intent clear.

Moreover, there was no reason the act could not function without the "for cause" requirement because the bureau could continue to do its job. The majority added that the court did not have the authority to rewrite the act to create a multi-member board. The proper remedy was to remove the for-cause requirement from the act.

"As a result, the CFPB now will operate as an executive agency. The President of the United States now has the power to supervise and direct the Director of the CFPB, and may remove the Director at will at any time," according to the majority opinion.

Kickback case. RESPA Section 8 says that nobody may either give or receive "any fee, kickback, or thing of value" under any agreement that a real estate settlement service business related to a federally related mortgage loan will be referred to anybody (12 U.S.C. §2607(a)). However, it also provides a safe harbor for bona fide payments for goods, facilities, or services that actually are provided (12 U.S.C. §2607(c)).

PHH began participating in captive reinsurance arrangements in 1995. Under these arrangements, PHH would refer borrowers who needed mortgage insurance to its preferred mortgage insurers. These insurers were preferred because they had agreed to buy reinsurance from a PHH subsidiary. HUD approved this type of arrangement beginning in 1997, with the condition that the mortgage insurer paid only reasonable market value for reinsurance that actually was provided.

According to the court, the CFPB reinterpreted RESPA to ban captive reinsurance agreements and then attempted to apply the reinterpretation to PHH’s earlier activities. The court, with little patience, rebuffed the bureau on both points.

Wrong RESPA interpretation. The proper interpretation of RESPA Section 8 "is not a close call," the court said, and the CFPB got it wrong. RESPA did not ban bona fide payments for services actually rendered. Determining whether the mortgage insurers’ payment were protected was "commonsensical," the court said—as long as reinsurance actually was provided, a payment up to the reasonable market price was bona fide, while a payment of more than that would be an illegal referral fee.

The CFPB argued that the reinsurance purchase was illegal because it was part of a tying arrangement, but "That makes little sense," the court said. Tying arrangements are illegal in some situations, but RESPA did not apply to them. A payment was no less bona fide under RESPA because it was part of a tying arrangement.

In fact, the CFPB’s own Reg. X—Real Estate Settlement Procedures (12 CFR Part 1024) explicitly permitted captive insurance arrangements, the court observed (12 CFR 1024.14(g)). CFPB’s reinterpretation "flouts not only the text of the statute but also decades of carefully and repeatedly considered official government interpretations."

After-the-fact application. Even if the CFPB’s reinterpretation was correct, it could not be applied to earlier conduct, the court continued.

HUD’s 1997 interpretation was widely relied on in the real estate settlement services industry, according to the court. It was reaffirmed in 2004. HUD’s RESPA regulation was consistent with the interpretation, as was that of the CFPB.

Reg. X says that a payment that has no relationship to the value of the goods or services provided is to be considered to be a referral fee. The CFPB tried to convince the court that this did not mean a payment that was reasonable was not, nevertheless, a referral fee. That was "a facially nonsensically reading" of the regulation, the court said.

Before the CFPB's reinterpretation, "everyone knew the deal," according to the court. The CFPB tried to change the deal retroactively. That violated the Constitution's Due Process Clause, which prohibits changing the legal consequences of an action after it has occurred.

The court also criticized the bureau's argument that companies had no reason to rely on HUD's interpretation. The HUD official's letter made clear that was not so. "We therefore find this particular CFPB argument deeply unsettling in a Nation built on the Rule of Law."

Statute of limitations. CFPB still can enforce the RESPA anti-kickback provisions against PHH if it can show that the mortgage insurers paid the PHH reinsurance subsidiary more than the reinsurance was worth, the court said. However, the violation also had to be within the statute of limitations. PHH claimed that most of the relevant activities were more than three years old—too old to be the basis of enforcement.

According to the court, "The CFPB says that *no statute of limitations* applies to its case against PHH" (emphasis in the opinion). That argument fared no better than the bureau's RESPA interpretation.

The CFPB argued that:

1. The enforcement provisions of the Dodd-Frank Act overruled the time limits established by specific consumer financial protection laws, such as RESPA.
2. If the statutory statutes of limitations are not overruled, they apply only in court, not in administrative enforcement proceedings.

Dodd-Frank says that the bureau can administratively enforce compliance with the consumer financial protection laws unless federal law specifically limits its ability to do so, according to the court. A statute of limitations obviously is a limit.

The three-year RESPA statute of limitations applies to administrative enforcement actions, the court then said. RESPA sets a one-year time limit for civil suits and a three-year time limit for government enforcement actions (12 U.S.C. §2614). That three-year limit applied to CFPB administrative enforcement actions. The court rejected the bureau's argument to distinguish between "actions" under RESPA that would be subject to the three-year limit and "proceedings" under Dodd-Frank that would not be covered as "flatly wrong."

The bureau had provided no explanation for why Congress would have created a "nonsensical dichotomy" between when the CFPB could sue and when it could proceed administratively, the court said. In fact, the bureau's argument was "especially alarming" due to its ability to impose civil penalties administratively.

Concurring opinions. Senior Circuit Judge Randolph also would have reversed the CFPB enforcement action for a completely different reason. From his point of view, the administrative law judge who presided over the hearing and recommended the penalty was, under the Constitution, an "inferior Officer" who had to be appointed by the president, a court, or a department head. The ALJ was not so appointed, so the entire proceeding was unconstitutional.

Judge Henderson dissented from part of Judge Kananaugh's opinion, asserting that the constitutionality of the CFPB's single-director structure should not have been addressed. The administrative order could have been reversed based on the bureau's misinterpretation of RESPA, rendering consideration of the constitutional issue unnecessary, she said.

The case is No. 15-1177.

Attorneys: Theodore B. Olson (Gibson, Dunn & Crutcher), Thomas M. Hefferon (Goodwin Procter LLP), and Mitchel Howard Kider (Weiner Brodsky Kider PC) for PHH Corporation, PHH Mortgage Corporation, and PHH Home Loans, LLC. John Robert Coleman and Lawrence DeMille-Wagman, Consumer Financial Protection Bureau.

Companies: PHH Corporation

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