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The PHH Decision And The Future Of CFPB

By **Eric Mogilnicki** (June 21, 2018, 12:51 PM EDT)


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When Consumer Financial Protection Bureau Acting Director Mick Mulvaney dismissed the bureau's case against PHH on June 7, it marked the end of an important chapter in the short life of the new agency. CFPB v. PHH spanned one bureau name change, two directors, three appeals, and more than four years. And although the parties ended up roughly where they began, the twists and turns in the case provide valuable lessons for the future of the bureau.

To begin, the PHH case stands as a cautionary tale about regulation by enforcement. The mortgage reinsurance practices at issue were common throughout the industry, and the U.S. Department of Housing and Urban Development had long ago provided guidance that at least suggested that such practices complied with the relevant statute, the Real Estate Settlement Procedures Act, or RESPA. Thus, the case did not present the kind of clear-cut, out-of-bounds wrongdoing that might appeal to a fledgling agency launching an enforcement program.

However, the "new cop on the beat" was eager to demonstrate that the rules had changed. Accordingly, the bureau brought an action against one mortgage reinsurer, PHH Corp., to simultaneously announce and enforce its view of RESPA. The bureau's press release reflected a black-and-white view of the world. Without disputing that PHH's practices were common in the industry, or noting that RESPA is a complicated statute on which it had not previously opined, the bureau alleged that PHH had engaged in a "15-year scheme" in which it "manipulated" its business and "pressured" its insurers in order to collect "hundreds of millions in kickbacks." The bureau's absolute certainty that it was reading RESPA correctly would strengthen its advocacy, justify its proceeding with enforcement rather than guidance — and turn out to be its Achilles heel.

CFPB v. PHH also illuminates the perils of administrative adjudication. Despite the bureau's expressions of outrage, it declined to take PHH to court. Instead, the bureau decided to bring its very first administrative proceeding, which meant that its claims would be heard by an administrative law judge supplied by the U.S. Securities and Exchange Commission at the bureau's request, and conducted under rules written by the bureau. The absence of checks and balances in this system became even clearer when, after a partial victory for the bureau in the administrative proceeding, PHH's only appeal route was to then-Director Richard Cordray, who had approved the investigation in the first place.

Cordray's opinion in CFPB v. PHH reflects the hazards inherent in asking an agency head to provide neutral judgments about his agency's actions. In his written opinion, the director mows down the arguments made by PHH, while accepting and embellishing the bureau staff's defense of the bureau's factual assertions and legal arguments. Unsurprisingly, the bureau director also easily rejects PHH's contention that it was denied due process during the proceeding. On many issues where the ALJ had disagreed with the bureau staff, the bureau director found that the ALJ misunderstood the relevant case law or misinterpreted RESPA. Finally, the director found that the ALJ underestimated the extent of PHH's guilt and undercalculated its punishment. In short, the bureau director's decision reads like a bureau brief.

The flaws in the administrative process were put into sharp relief when the bureau's position was exposed to a truly independent evaluation. Hearing PHH's appeal of the director's decision, a panel of the D.C. Circuit found that the bureau had failed in myriad ways: in the way it read RESPA; in retroactively applying its view of the statute to PHH's actions; and in the way it had extended its enforcement action beyond the relevant statute of limitations. Moreover, the court found that the bureau's single-director structure was unconstitutional. In sum, the opinion transformed the bureau's first administrative proceeding from an important victory to a significant defeat.

The court's opinion was in many ways a twin of the director's opinion. Both knock down opposing arguments with a vigor that appears animated by strong pre-existing set of views about important legal and policy issues. Both go well beyond merely reviewing the decision below to make groundbreaking rulings that dramatically increased the stakes of the dispute. Moreover, the two opinions are related in another way: It appears highly likely that the substance and tone of the director's forceful ruling against PHH contributed to the court's substantial concerns with the amount of power vested in a single director.

Ultimately, it took the D.C. Circuit, sitting en banc, to moderate the wide swings that had characterized the first three years of litigation. That court found a middle ground that rejected both the panel's view that the bureau was unconstitutional and the director's view that PHH had violated RESPA. Both parties got the ruling they most needed, and both declined to file for U.S. Supreme Court review. After remand, the case landed where it started — with the bureau assessing whether PHH had violated RESPA. The acting director last week announced that they had not.

What should the new bureau learn from the old bureau's longest and most expensive enforcement action? First, it may want to focus on enforcement cases that rest on a sturdy legal footing. Mulvaney has already absorbed this lesson, explaining early on that the bureau would no longer be "pushing the envelope" in enforcement actions. Not only is such an approach fairer to the regulated, but it offers a path to the bureau becoming less of a political football and more an established part of the regulatory firmament. As much of the bureau's activities to date demonstrate, there are ample opportunities for the bureau to bring enforcement cases that involve enforcing well-established law.

Second, the bureau should review its use of administrative proceedings. CFPB v. PHH demonstrates that an agency that controls the rules of both the trial and the immediate appeal of its own enforcement actions may find that it prevails only until a court becomes involved. In particular, the bureau should consider adopting written standards defining and limiting when it will bring an administrative proceeding and reasserting the importance of due process in the administrative context. For example, administrative proceedings should allow more discovery — and less use of hearsay evidence.

Third, the bureau should find ways to ensure that diverse perspectives are represented in its decision-making. An agency led by a single person, who cannot be removed except for cause, may not adequately focus on competing values and concerns. This root cause of the PHH case is applicable across bureau administrations. In this regard, the recent termination of all of Cordray's appointees to the bureau's Consumer Advisory Board by the new bureau administration is just as discouraging as the prior administration's relative disinterest in financial institutions' input on bureau initiatives. Absent a commission structure, every bureau director would benefit from advisory boards that supplement and challenge, rather than merely echo, the director's assumptions and priorities.

Building effective government agencies takes decades, not years, and so is a job that must be shared by leaders with different political and policy views. For example, the agencies established in the New Deal were enriched — and made truly permanent — when they were subsequently run by Republican appointees. As CFPB v. PHH demonstrates, the new leader of the bureau will have an opportunity to learn from the victories and failures of her or his predecessors and, in the process, help carve out a permanent role for an agency focused on protecting consumers of financial services.

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