Is the CFPB bound by its non-binding guidance?

The implications of the PHH due process decision for TRID and other CFPB rules

By Benjamin K. Olson, Brandy A. Hood, and Steven R. vonBerg[1]

Predictability and certainty are crucial components of the consumer finance market. Consumers crave it, as do industry participants. A common understanding of legal requirements promotes uniformity in the application of consumer protections and allows lenders, servicers, systems providers, investors, and others to cooperate and compete on a level playing field. In contrast, ambiguity can harm consumers and industry participants alike because it places competitors on uneven ground and makes it difficult for consumers to compare products and identify bad actors. If a lender can gain an advantage over its more risk-averse competitors by adopting an aggressive interpretation of an ambiguous regulation, that ambiguity harms everyone in the market, including the consumer. While competition on price and quality is generally beneficial, competition on compliance is not.

This need for certainty and predictability produces an insatiable industry appetite for regulatory guidance. A common sentiment among compliance professionals is "We don't care what the answer is, as long as we get an answer." Since July 2011, the Consumer Financial Protection Bureau (CFPB or the Bureau) has been the agency with primary responsibility for providing answers on regulatory requirements for consumer financial products and services. While the CFPB's guidance is often criticized, there is little doubt that the Bureau surpasses its predecessors in the quantity of guidance it provides. In addition to the "formal guidance" provided in regulations and official interpretations, the Bureau constantly communicates with the industry and the general public through "informal guidance" in reports, preambles to proposed and final rules, supervisory guidelines and highlights, compliance bulletins, letters, webinars, speeches, press releases, blog posts, and other vehicles.

While this informal guidance is frequently helpful, the Bureau undercuts its value by claiming that it is "non-binding" and "do[es] not contain legal interpretations, legal guidance, or legal advice." These disclaimers appear to be intended to allow the Bureau to provide informal guidance without following the time and

[1] Ben Olson is a former deputy assistant director for the CFPB's Office of Regulations and a partner in the Washington, D.C. office of Buckley Sandler LLP. Brandy Hood and Steve vonBerg are associates in the firm's Washington office. Collectively and individually, they advise a wide spectrum of providers of consumer financial products and services on compliance with federal and state law, particularly CFPB regulations. The opinions expressed are those of the authors and do not necessarily reflect the views of the firm or its clients. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

resource-consuming procedural requirements that apply to more formal actions.[2] Getting informal guidance sooner can be better than getting formal guidance later—and is usually much better than getting no guidance at all—but the disclaimers leave doubts in the minds of industry as to whether they can safely rely on that guidance.

These fears were fueled, in significant part, by the CFPB's imposition of a $109 million penalty on PHH Corporation and its affiliate for following another agency's informal guidance, which the Bureau viewed as non-binding and incorrect. This action, combined with the Bureau's aggressive approach to enforcement generally, led to concerns that the Bureau or another agency might similarly disregard informal Bureau guidance and hold financial service providers retroactively liable if, at some point in the future, doing so was deemed necessary to further a new policy initiative. After all, if an agency can ignore guidance in one instance, what would prevent it from doing so in other instances?

These fears lessened with the change in CFPB leadership in November 2017. Acting CFPB Director Mick Mulvaney has publicly promised that the Bureau's "days of aggressively 'pushing the envelope' are over" and that "the people we regulate should have the right to know what the rules are before being charged with breaking them."[3] However, lenders and other financial service providers cannot rely on the good will and restraint of whoever happens to be running a government agency at any particular point in time. Most mortgages, for example, last 30 years, and financial products and systems cannot be redesigned with each election cycle or change in agency leadership.

In a recent decision, the judicial branch addressed this concern, at least in part. In January 2018, the U.S. Court of Appeals for the District of Columbia Circuit issued its long-awaited decision on PHH's appeal of the CFPB's penalty. The court concluded that the CFPB violated the U.S. Constitution's Due Process Clause by disregarding informal guidance issued by the U.S. Department of Housing and Urban Development (HUD), which was responsible for RESPA before the CFPB's creation, and retroactively applying its own interpretation of RESPA to PHH. This article explores whether the court's decision means that, notwithstanding the Bureau's claims that its informal guidance is non-binding, regulated entities that rely on that guidance are protected from government enforcement actions.

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The CFPB has issued copious informal guidance to facilitate the implementation of its regulations, particularly the mortgage disclosure requirements in what is commonly referred to as the TILA-RESPA Integrated Disclosure or "TRID" rule.[4] In the absence of any practical alternative, the mortgage industry overcame reservations regarding ambiguities in the TRID rule and relied on this guidance to design systems

[2] For example, the Administrative Procedures Act, 5 U.S.C. § 500 *et seq*.; the Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq.*; and the Paperwork Reduction Act, 44 U.S.C. § 3501 *et seq.*

[3] Mick Mulvaney, *The CFPB Has Pushed Its Last Envelope*, THE WALL STREET JOURNAL (Jan. 23, 2018), https://www.wsj.com/articles/the-cfpb-has-pushed-its-last-envelope-1516743561.

[4] Although "TRID" is the common industry term, the CFPB often refers to its rule as "Know Before You Owe mortgage disclosure rules" or "KBYO."

and procedures, to decide which loans to buy, and to determine how to correct errors. Despite the Bureau's repeated statements that its guidance is not binding, the *PHH* decision appears to protect those who have relied on the CFPB's informal guidance from the risk that the Bureau could simply change its mind and apply a new interpretation to past conduct.

This protection may also extend to other government actors and courts. While courts need not blindly apply informal CFPB guidance in private litigation, the D.C. Circuit's due process analysis may persuade a court that a lender or other financial services provider should not be penalized for relying in good faith on that guidance, even if a court concludes the guidance is unsound.

Official interpretations of TILA and RESPA

The Administrative Procedure Act governs the rulemaking process for federal agencies. For substantive rules, the APA requires that a "[g]eneral notice of proposed rule making shall be published in the Federal Register," followed by a comment period in order to "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments[.]"[5] After consideration of the comments presented, a final rule is published in the Federal Register at least 30 days before its effective date.[6] However, the notice and comment procedure is not required with respect to interpretive rules, i.e., those which merely clarify or explain existing law or regulations.[7]

Both RESPA and the Truth in Lending Act (TILA) expressly provide protections against liability for persons relying on official interpretations. For example, RESPA states that there is no liability for "any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Bureau or the Attorney General, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason."[8] TILA contains similar language.[9]

However, Regulation X limits what is considered "a rule, regulation or interpretation of the Bureau," stating that "only the following" are included:

[5] 5 U.S.C. § 553(b)-(c).

[6] 5 U.S.C. § 553(d).

[7] *Rosetti v. Sullivan*, 788 F. Supp. 1380, 1386 (E.D. Pa. 1992) (quoting *Powderly v. Schweiker*, 704 F.2d 1092, 1098 (9th Cir.1983)).

[8] 12 U.S.C. § 2617(b); *see also* 12 C.F.R. § 1024, Supp. I, Introduction, comment 1.

[9] *See* 12 U.S.C. § 1640(f) (providing protections for "any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Bureau or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Bureau to issue such interpretations or approvals under such procedures as the Bureau may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason"); *see also* 12 C.F.R. § 1026, Supp. I, Introduction, comment 1.

(i) All provisions, including appendices and supplements, of [Regulation X]. Any other document referred to in [Regulation X] part is not incorporated in this part unless it is specifically set out in [Regulation X];

(ii) Any other document that is published in the *Federal Register* by the Bureau and states that it is an "interpretation," "interpretive rule," "commentary," or a "statement of policy" for purposes of section 19(a) of RESPA. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official interpretation to this part, which will be amended periodically.[10]

Regulation X goes on to expressly exclude "any other statement or issuance, whether oral or written, by an officer or representative of the Bureau, letter or memorandum by the Director, General Counsel, or other officer or employee of the Bureau, preamble to a regulation or other issuance of the Bureau, Public Guidance Document, report to Congress, pleading, affidavit or other document in litigation, pamphlet, handbook, guide, telegraphic communication, explanation, instructions to forms, speech or other material of any nature…."[11]

While neither TILA nor Regulation Z contains a comparable limitation or exclusion for informal guidance, it nevertheless appears that, in the Bureau's view, a bright line exists between formal and informal guidance. As discussed below, however, the D.C. Circuit's decision in *PHH* may require the CFPB to reconsider this distinction—or, at the very least, prevent the Bureau from changing course without first issuing new guidance.

CFPB v. PHH Corporation

Preliminary Proceedings

In January 2014, the CFPB's Office of Enforcement commenced an administrative proceeding against PHH and several affiliates, alleging that PHH selected mortgage insurers for its loans based on whether those insurers purchased reinsurance from a PHH affiliate. This is sometimes referred to as a "captive reinsurance arrangement." The Office of Enforcement alleged that these actions violated Section 8(a) of RESPA, which states that "[n]o 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."[12]

PHH contested the allegations. Among other points, PHH argued that its arrangements were consistent with Section 8(c)(2) of RESPA, which states that "[n]othing in this section shall be construed as prohibiting … 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." PHH further argued that, in structuring its business arrangements, it relied in good faith on informal guidance provided by HUD. This guidance, which was first

[10] 12 C.F.R. § 1024.4(a)(1).

[11] 12 C.F.R. § 1024.4(a)(2).

[12] 12 U.S.C. § 2617(b).

set forth in a 1997 letter from Assistant Secretary Nicholas P. Retsinas and subsequently restated elsewhere, stated that captive reinsurance arrangements were permissible so long as reinsurance services are actually furnished and any payments are “bona fide compensation that does not exceed the value of such services.”

In November 2014, the CFPB’s administrative law judge found that PHH violated RESPA and ordered disgorgement of $6.4 million in reinsurance premiums. Both PHH and CFPB Enforcement staff appealed this decision to CFPB Director Cordray, consistent with the CFPB’s rules of practice for administrative proceedings.

Director Cordray’s decision

In June 2015, CFPB Director Cordray affirmed the conclusion that PHH violated RESPA but increased the required disgorgement of premiums from $6.4 million to $109 million. In rejecting PHH’s argument that it relied in good faith on HUD’s informal guidance, Director Corday concluded that “[t]he HUD letter is not in such a form as to be binding on any adjudicator” and “provides no protection to PHH in this proceeding” because, “[u]nlike some other forms of written guidance issued by HUD, the letter was never published in the Federal Register” and therefore did not constitute a formal interpretation under Regulation X.[13]

Director Cordray further concluded that the HUD letter misinterpreted RESPA to the extent that it concluded that “payments are bona fide as long as they do not exceed the value of the reinsurance” because, in his view, “the opportunity to participate in a money-making program would be enough to find a violation, regardless of what amounts were paid for that opportunity.”[14] PHH appealed Director Cordray’s decision to the D.C. Circuit.

The D.C. Circuit panel decision

In October 2016, a three-judge panel of the D.C. Circuit reversed the CFPB’s determination that PHH violated RESPA. The panel concluded, among other things, that “even if the CFPB’s new interpretation [of RESPA] were consistent with the statute (which it is not), the CFPB violated due process by retroactively applying the new interpretation to PHH’s conduct that occurred before the date of the CFPB’s new interpretation.”[15]

In the panel’s words, “[a]t the time PHH engaged in its captive reinsurance arrangements, everyone knew the deal: Captive reinsurance arrangements were lawful under Section 8 so long as the mortgage insurer paid no more than reasonable market value to the reinsurer for reinsurance actually furnished.”[16]

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[13] Decision of the Director, *In the Matter of PHH Corp. et al.*, Admin. Proc. File No. 2014-CFPB-0002, at 17 (June 4, 2015), *available at* http://files.consumerfinance.gov/f/201506_cfpb_decision_by_director_cordray_redacted_226.pdf.

[14] *Id*. at 18 (internal quotation marks omitted).

[15] *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F.3d 1, 44 (D.C. Cir. 2016).

[16] *Id*. at 46.

Therefore, the panel explained, the CFPB could not change the deal with respect to PHH's past conduct because:

> Retroactivity – in particular, a new agency interpretation that is retroactively applied to proscribe past conduct – contravenes the bedrock due process principle that the people should have fair notice of what conduct is prohibited. As the Supreme Court has emphasized, individuals should have an opportunity to know what the law is and to conform their conduct accordingly…. Due process therefore requires agencies to provide regulated parties fair warning of the conduct a regulation prohibits or requires.[17]

After discussing prior court decisions on retroactivity, the panel continued:

> All of those fundamental anti-retroactivity principles are Rule of Law 101. And all of those fundamental anti-retroactivity principles fit this case precisely. PHH did not have fair notice of the CFPB's interpretation of Section 8 at the time PHH engaged in the conduct at issue here. PHH participated in captive reinsurance arrangements in justifiable reliance on the interpretation stated by HUD in 1997 and restated in 2004. The CFPB therefore violated due process by retroactively applying its changed interpretation to PHH's past conduct and requiring PHH to pay $109 million for that conduct.[18]

Most significantly for purposes of this discussion, the panel rejected the CFPB's contention that PHH was not entitled to rely on HUD's informal guidance because it was not reflected in a binding HUD rule:

> To trigger … due process protection, an agency pronouncement about the legality of proposed private conduct need not have been set forth in a rule preceded by notice and comment rulemaking, or the like. Here, the agency guidance was provided by top HUD officials and was given repeatedly. Although we do not imply that those two conditions are necessary to justify citizens' reliance for purposes of the Due Process Clause, they are surely sufficient. Here, the regulated industry reasonably relied on those agency pronouncements.
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> Put aside all the legalese for a moment. Imagine that a police officer tells a pedestrian that the pedestrian can lawfully cross the street at a certain place. The pedestrian carefully and precisely follows the officer's direction. After the pedestrian arrives at the other side of the street, however, the officer hands the pedestrian a $1,000 jaywalking ticket. No one would seriously contend that the officer had acted fairly or in a manner consistent with basic due process in that situation…. Yet that's precisely this case. Here, the CFPB is arguing that it has the authority to order PHH to pay $109 million even though PHH acted in reliance upon numerous government pronouncements authorizing precisely the conduct in which PHH engaged.

[17] *Id*. at 46 (internal citations and quotation marks omitted).

[18] *Id*. at 48.

The Due Process Clause does not countenance the CFPB's gamesmanship….[19]

The Bureau successfully petitioned the full D.C. Circuit for en banc review, which temporarily vacated the panel's decision.[20] However, on January 31, 2018, the D.C. Circuit reinstated the panel decision "insofar as it related to the interpretation of RESPA and its application to PHH … in this case…."[21]

Implications for CFPB informal guidance

As noted above, the CFPB has issued extensive informal guidance, particularly with respect to the implementation of the TRID mortgage disclosure rule. The Bureau has provided this guidance to the mortgage industry in various forms, including webinars, compliance guides, sample forms and calendars, factsheets, and letters.[22] This guidance has been vital because the TRID rule contains a large number of technical disclosure requirements, many of which are ambiguous when applied to specific transactions or scenarios.

Uniform application of the TRID requirements is critical for consumers and the mortgage industry. Not only would the purpose of the disclosures be frustrated if borrowers do not receive consistent disclosures that they can use to make "apples to apples" comparisons between loans, but disagreements between lenders and investors over the correct interpretation can severely restrict the number of loans that are saleable on the secondary market, which could in turn reduce consumers' access to credit.

The CFPB's informal guidance has often cleared up confusion or resolved debates over certain requirements. For example, in the year after TRID took effect, liability for errors in completing the disclosures—both "true" errors and perceived errors resulting from disagreements over interpretation—were a major point of contention in the industry. However, in December 2015, CFPB Director Richard Cordray wrote a letter to the Mortgage Bankers Association explaining that, although TRID incorporates RESPA requirements into TILA's implementing regulation (Regulation Z), the rule "did not change the prior, fundamental principles of liability under either TILA or RESPA."[23] In particular, the CFPB's letter indicated that the risk of a borrower lawsuit is generally limited to a small subset of disclosures, that the final Closing Disclosure may limit civil liability for any errors on prior disclosures, and that errors can generally be "cured" by notifying the consumer of the error and providing refunds where appropriate.[24]

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[19] *Id*. at 48-49 (citations omitted).

[20] *PHH Corp. v. Consumer Fin. Prot. Bureau*, No. 15-1177 (D.C. Cir. Feb. 16, 2017) (order granting hearing en banc).

[21] *PHH Corp. v. Consumer Fin. Prot. Bureau*, 881 F.3d 75, 83 (D.C. Cir. 2018). Notably, the three judges who would have upheld the CFPB's interpretation of RESPA nevertheless agreed that, "[f]or substantially the reasons given by the panel, … the Bureau ran afoul of the due process clause by failing to give PHH adequate notice in advance of imposing penalties for past conduct." *Id.* at 113.

[22] *See, e.g.*, CFPB TILA-RESPA Integrated Disclosure rule implementation page, *available at* https://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/tila-respa-disclosure-rule/; Buckley Sandler's Unofficial Transcripts of CFPB Webinars, *available at* http://www.buckleysandler.com/stand-alone/trid-resource-center.

[23] Letter from CFPB Director Richard Cordray to David Stevens, President & CEO, Mortg. Bankers Ass'n (Dec. 29, 2015).

[24] Benjamin K. Olson & Brandy Hood, *TRID Liability Will Be A Dominant Issue In 2016*, LAW360 (Jan. 12, 2016) *available at* https://www.law360.com/articles/743518/trid-liability-will-be-a-dominant-issue-in-2016.

Over the succeeding years, the industry has had no choice but to rely on this and other informal staff guidance, despite the Bureau's refusal to formalize it through publication in the *Federal Register* or otherwise. Rather than closing up shop, lenders make mortgage loans and investors purchase them based on the CFPB's informal guidance, despite lingering concerns that the guidance is not binding on the Bureau or a court.

Conclusion

The CFPB is to be applauded for its efforts to support the implementation of TRID and other rules through guidance. Nothing in this article is intended to discourage the Bureau or other regulators from issuing guidance that helps the industry navigate the inherent complexities and ambiguities of regulations so that consumers receive the required protections and lenders avoid liability for unintentional errors or mistaken interpretations.

Instead, this article is intended to provide some degree of comfort to industry participants who have hesitantly chosen to rely on the Bureau's informal guidance despite the "non-binding" disclaimers and the Bureau's attempts to disregard HUD's informal guidance when pursuing PHH. The due process principles affirmed by the full D.C. Circuit in *PHH* indicate that the Bureau and other regulators cannot take actions inconsistent with their own informal guidance without first providing notice to the public and, even then, cannot apply a new interpretation to past conduct. In addition, while informal CFPB guidance is not entitled to the same degree of deference from a court as the Bureau's formal interpretations, the due process analysis may help a lender or other financial services provider defend itself against private litigation by persuading a court that it should not be penalized for relying in good faith on that informal guidance when the regulation and the formal guidance was unclear.[25]

[25] *See, e.g., Martin v. Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 157 (1991) ("[a]lthough not entitled to the same deference … informal interpretations are still entitled to some weight on judicial review."); *United States v. Mead Corp*., 533 U.S. 218, 234 (2001) ("an agency's interpretation may merit some deference whatever its form[.]") (citing to *Skidmore v. Swift & Co*., 323 U.S. 134 (1944)).