WISCONSIN REALTORS® ASSOCIATION

LEGAL UPDATE

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A MONTHLY GUIDE TO WISCONSIN REAL ESTATE LAW & POLICY

RESPA Enforcement

The Real Estate Settlements Procedures Act (RESPA) protects consumers by banning kickbacks that tend to unnecessarily increase the cost of mortgage settlement services. RESPA also helps promote a level playing field by ensuring companies compete for business on fair and transparent terms. Real estate brokers and agents are impacted by RESPA with respect to their relationships with other settlement service providers participating in residential real estate closings.

This *Legal Update* reviews the types of transactions that are covered by RESPA and the rules prohibiting referral fees and kickbacks. The *Update* next delves into the mandatory requirements for Affiliated Business Arrangements (AfBAs). These arrangements provide a legitimate safe harbor exception from the RESPA § 8 anti-referral fees and kickback prohibitions when a referral is made to a related settlement service provider. The *Update* continues with a review of some recent RESPA enforcement actions and concludes with a series of RESPA Hotline questions and answers.

RESPA Basics

In 1974, Congress enacted the Real Estate Settlement Procedures Act (RESPA) as a consumer disclosure and anti-kickback statute. RESPA requires disclosures that list settlement costs to be given to homebuyers and sellers, and eliminates abusive practices, such as kickbacks and referral fees, which increase the costs paid by consumers. "Kickbacks drive up the costs of getting a mortgage and put law-abiding companies at a disadvantage," said Richard Cordray, director of the Consumer Financial Protection Bureau (CFPB). "The Consumer Bureau will continue to take action against companies that seek to attract consumers through illegal schemes."

RESPA covers real estate transactions involving a federally related mortgage loan. This will generally cover the vast majority of residential closings financed by a mortgage loan or other lien (first or subordinate position) on one-to-four family residential property located within the United States. The residential structure may be a condominium unit, a cooperative interest or a mobile home if purchased together with the real estate or acquired with the loan proceeds. The residence may be the buyer's principal residence or a second or vacation home.

RESPA does not apply to cash sales, land contract sales or transactions involving seller financing. Other exclusions include business loans, temporary financing, vacant land not used for residential purposes and loans to governmental agencies.

For further details see pages 1-3 of the November 2006 *Legal Update*, "RESPA and the Real Estate Broker," at www.wra.org/LU0611.

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RESPA Section 8: Kickbacks and Referral Fees

REALTORS® are generally most familiar with Section 8 of RESPA which prohibits referral fees and kickbacks to settlement service providers. Section 8(a) of RESPA prohibits any person from giving or accepting any fee, kickback or thing of value, pursuant to any written or oral agreement or understanding, for the referral of settlement service business involving a federally related mortgage loan.

RESPA Section 8 Definitions

Settlement Service: any service provided in connection with a real estate settlement including, but not limited to:

1. The origination, processing or funding of a federally related mortgage loan.
2. Mortgage broker services such as counseling, taking applications, obtaining verifications and appraisals, lender-borrower communications, etc.
3. Title searches, title examinations, title commitments, title

insurance, abstracts and other related services.

4. An attorney's legal services.
5. Closing document preparation, notarization, delivery and recordation.
6. Credit reports.
7. Appraisals.
8. Property inspections.
9. Pest and fungus inspections.
10. Property surveys.
11. Conducting the closing or settlement.
12. Mortgage insurance.
13. Hazard, flood or casualty insurance; and home warranties.
14. Flood zone certification.
15. Mortgage life, disability or similar insurance.
16. Real property taxes and assessments.
17. Real estate brokerage services.

This list is broad but not all-inclusive. Services that occur at or prior to the purchase of a home are typically considered settlement services. Anything listed on a HUD-1 and paid for by the buyer or seller could be a settlement service, and the company providing the service could be a settlement service provider.

Services that occur after closing usually are not considered settlement services. This generally, but not always, includes moving companies, gardeners, painters, interior decorators and home improvement contractors.

Thing of Value: "any payment, advance, funds, loan, service, or other consideration." It can be an item of personal property, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing money that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another's expenses or the reduction in credit against an existing obligation.

Agreement or Understanding: any agreement or understanding that a "thing of value" will be given in exchange for a settlement service referral does not need to be written or verbalized. Such an agreement can be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.

Referral: for purposes of RESPA, includes any oral or written action directed to a person that has the effect of affirmatively influencing the selection by any person of a settlement service provider or a related incidental business. The person will pay for the selected settlement service or incidental business or pay a charge attributable in whole or in part to the service. A referral also occurs whenever a person paying for a settlement service or incidental business is required to use a particular provider.

Paying or receiving a fee or a thing of value for the referral of business related to the settlement of a federally related mortgage loan without rendering a service is illegal under RESPA. Receiving compensation simply for referring a buyer, seller or other person to a settlement service provider is prohibited — the referral of a settlement service is not a legally compensable service.

REALTOR® Practice Tip

There is one very critical exception to the anti-kickback and anti-referral fee rules: RESPA does not prohibit the payment of referral fees between real estate licensees, so broker-to-broker referrals are acceptable and perfectly legal.

For example, it is illegal for a mortgage brokerage firm to pay $200 per loan to real estate agents who steer homebuyers in its direction. Other forms of kickbacks illegal under RESPA include gifts, prizes and entries into raffles designed to reward agents for referring business, for example, to a title insurance company, surveyor or attorney.

REALTOR® Practice Tip

Under RESPA, no person may give or receive fees or kickbacks for the referral of settlement services. REALTORS® must carefully avoid paying referral fees or giving any thing of value to any other settlement service providers (except for other real estate brokers) in return for a referral.

Affiliated Business Arrangements (AfBAs)

The general rule of § 8 of RESPA prohibits a person from giving or accepting any thing of value in exchange for the referral of settlement service business. However, a real estate broker who has an interest in a title company or some other settlement service provider can refer a client or customer to that entity and not violate RESPA, but only if the broker strictly follows the requirements of the RESPA § 8(c)(4) safe harbor for affiliated business arrangements.

An affiliated business arrangement (AfBA) exists when a person in a position to refer settlement business, such as a real estate broker, or an "associate" of such person, has an affiliate relationship with, or a direct or beneficial ownership interest of more than one percent in, an entity to which the business is referred, such as a joint venture title or mortgage entity.

Affiliated Business Arrangement Definitions

Affiliated Business Arrangement: an arrangement in which:

1. A person who is in a position to refer business
2. To a real estate settlement service provider
3. In a transaction involving a federally related mortgage loan, or
4. An associate of such person in a position to refer settlement

service business,

5. Has either an affiliate relationship with the settlement service provider or
6. A direct or beneficial ownership interest of more than 1 percent (1%) in the settlement service provider,
7. And either of such persons directly or indirectly refers such business to that settlement service provider or affirmatively influences the selection of that provider.

Person in a Position to Refer Settlement Service Business: any real estate broker or agent, lender, mortgage broker, builder or developer, attorney, title company, title agent or other person deriving a significant portion of his or her gross income from providing settlement servicers

Person: includes individuals, corporations, associations, partnerships and trusts.

Associate: one who has one or more of the following relationships with a person in a position to refer settlement business:

1. A spouse, parent or child of such person (an individual).
2. A corporation or business entity that controls, is controlled by or is under common control with such person (entity).
3. An employer, officer, director, partner, franchisor or franchisee of such person (entity).
4. Anyone who has an agreement, arrangement or understanding with such person to enable the person in a position to refer settlement business to benefit financially from the referrals of such business.

Affiliate Relationship: the relationship among business entities where one entity has effective control over the other by virtue of a partnership or other agreement, or is under common control with the other by a third entity, or where an entity is a corporation related to another corporation as parent to subsidiary by an identity of stock ownership.

Direct Ownership: holding legal title to an interest in a settlement service provider except where title is being held for the beneficial owner.

Beneficial Ownership: the effective ownership of an interest in a settlement service provider or the right to use and control the ownership interest involved, even though legal ownership or title may be held in another person's name.

Control: as used in the definitions of “associate” and “affiliate relationship,” means that an individual or entity:

1. Is a general partner, officer, director or employer of another person.
2. Directly or indirectly or acting in concert with others, or through one or more subsidiaries, owns, holds the power to vote or holds proxies representing more than 20 percent (20%) of the voting interests of another person.
3. Affirmatively influences in any manner the election of a majority of the directors of another person.
4. Has contributed more than 20 percent (20%) of the capital of the other person.

Required Use: a situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable thereto. However, the offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional, the discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.

Affiliated Business Safe Harbor Test

A referral to an affiliated settlement service provider is not an illegal kickback under RESPA as long as three requirements are met:

1. Mandatory Disclosure Statement

First, the broker or other party who refers business to an affiliated or owned settlement service provider must provide a written disclosure statement to each consumer who is being referred. The disclosure must be in the RESPA Affiliated Business Arrangement Disclosure (AfBAD) statement format and must disclose the nature of the relationship, explaining the ownership and financial interest between the referring party and each settlement service provider being referred. The disclosure statement must also give an estimated price or range of prices generally charged by the affiliated settlement service providers. The disclosures must be on a separate piece of paper and be given no later than the time of the referral.

A copy of the mandatory AfBAD format can be found on page 12 of this *Update* or on HUD website at portal.hud.gov/hudportal/HUD?src=/program_offices/housing/ramh/res/resappd.

An AfBAD must be given to avoid RESPA liability, and it also serves to fulfill the disclosure requirements for referrals made under Wis. Admin. Code § REEB 24.05(3).

2. Use of Affiliated Provider Not Required

Second, there can be no required use. In other words, the person being referred must not be required to use the affiliated settlement service business. The consumer's use of the affiliated business may not be required as a condition to the availability of the property or any other settlement service for which the consumer will pay. The sale of a property, for instance, cannot be tied to a party’s use of a particular settlement service provider. The exceptions to this rule are that a lender may require a party to pay for the services of a specific attorney, credit reporting agency or appraiser, and that an attorney may require the use of a particular title insurance company.

3. No Compensation Other than Return on Ownership

The only thing of value that can be received from the AfBA is a return on the ownership interest or franchise relationship between the affiliated providers. Bona fide dividends or capital or equity distributions made for ordinary business purposes and related to ownership interest or franchise relationship, and not based on the number of referrals made, meet these criteria. Thus, even if the first two requirements are met, any payments between or among the affiliated companies must be for services rendered or must constitute a return on ownership interest. No outright referrals or referrals disguised as fees are allowed.

- A return on an ownership interest does not include any payment calculated in a way that has no apparent business motive other than distinguishing among payment recipients based on the amount of their actual, estimated or anticipated referrals.
- A return on franchise relationship may be a payment to or from a franchisee, but it does not include any payment that is not based on the franchise agreement, nor any payment that varies according to the number or amount of referrals by the franchisor or franchisee, or that is based on a franchise agreement that has been adjusted on the basis of a previous number or amount of referrals by the franchiser or franchisees. A franchise agreement

may not be constructed to insulate against kickbacks or referral fees.

- The mere labeling of a thing of value, nor the fact that it may be calculated pursuant to a corporate or partnership organizational document or a franchise agreement, will not determine whether or not it is a bona fide return on an ownership interest or franchise relationship.

Any disclosure statements or other documents implementing these requirements must be retained for five years after date of execution.

Accordingly, a real estate broker who has an interest in a title company can refer a customer to that entity and not violate RESPA, but only if (1) the broker provides the required AfBAD form, (2) the customer is not required to use the affiliated title company's services, and (3) nothing of value, other than a possible return on an ownership interest or franchise relationship, is paid to or received by the broker in return for the referral.

A RESPA compliance specialist has advised that if an employee receives a referral fee for referring business to the employer, there is no violation of § 8 of RESPA. If, however, there are two entitles involved, then there likely is a violation.

For example, if a real estate company has an affiliated title company that charges its agents a transaction fee, and the company waives the transaction fee if the parties are referred to the affiliated title company, the waiver of the transaction fee would appear to be a "thing of value." The giving and receiving of a "thing of value" in return for the referrals makes the described practice a RESPA violation. Similarly, if a salaried manager (an employee) is paid a bonus that is dependent upon the volume of referrals made by the manager's agents to an affiliated title company or mortgage company, the bonus is a thing of value and appears to be another § 8 RESPA violation. Section 8 of RESPA expressly prohibits giving positive incentives — "things of value" — for the referral of settlement service business.

REALTOR® Practice Tip

The things that can get brokers into trouble under RESPA include:

- Accepting anything of value for the referral of closing service business.
- Accepting marketing help or ad space from a settlement service provider without paying the broker's fair, proportionate share.
- Having ownership interest in a settlement service company and referring business to it without proper AfBAD disclosure.
- Participating in any marketing or settlement service that results in charges to the consumer that are not normal or for services not of real value.

For further discussion see the November 2006 *Legal Update*, "RESPA and the Real Estate Broker," at www.wra.org/LU0611.

RESPA Violations: Land Brokerages and Other Settlement Service Providers in CFPB Hot Water

The Consumer Financial Protection Bureau (CFPB) has been active in enforcing RESPA's anti-kickback provisions. Its goal is to protect consumers and honest businesses and deter individuals from engaging in illegal activity. Government agencies, including the CFPB, appear to be wary of AfBAs in particular. Another recent trend appears to be settlement service providers who use insurance payments to camouflage kickbacks. Other possibly unlawful techniques have also received scrutiny, as in one case where a "marketing fee" paid to the lender by an overnight express delivery vendor may have been a kickback for using the delivery service.

Good practice pointers and lessons can be learned from the CFPB enforcement actions.

RealtySouth: Consumers Cannot be Required to Use Affiliated Title and Closing Company

The CFPB determined in an administrative proceeding that RealtySouth, a large Alabama real estate broker, failed to comply with the RESPA by improperly referring customers to its affiliated settlement service companies. RealtySouth gave consumers inadequate disclosures that did not properly explain their rights to choose service providers during the homebuying process.

Section 8(a) of RESPA prohibits giving or accepting a fee, kickback or thing of value for business referrals to settlement services for federally-related mortgage loans. A thing of value includes increased equity in a parent or subsidiary entity. However, § 8(c)(4) of RESPA provides a safe harbor for affiliated settlement service businesses. Referrals to affiliated businesses are permitted but only if: (1) the consumer is provided a written Affiliated Business Arrangement Disclosure (AfBAD) in the format specified by federal law, setting forth the affiliated nature of the businesses and a written estimate of the charge or charges generally made by the company to which the client is referred; (2) the client is not required to use the affiliated business; and (3) the only thing of value received under the arrangement are returns on ownership interest.

RESPA requires that the AfBAD be set forth on a separate sheet of paper, provided to the client either at or before the time of referral, and include:

1. Identification of the consumer and the entity making the referral, the property address, and the date.
2. A description of the business relationship between the referring entity and the company to which the client is being referred.
3. A signature line for the client to sign acknowledging their understanding.
4. The estimated charge or charges for the settlement service.
5. A clear statement that the client is not required to use the affiliated company, and an explanation that the client has other choices in settlement service providers.

RESPA Appendix D to Part 1024 sets forth a model AfBAD that contains specific language and typography for the AfBAD, including the following language:

> Set forth below is the estimated charge or range of charges for the settlement services listed. You are NOT required to use the listed provider(s) as a condition for [settlement of your loan on] [or] [purchase, sale, or refinance of] the subject property. THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES.

CFPB found that RealtySouth's referral activities had violated RESPA by:

- Strongly encouraging its agents (and in some cases requiring them) to use affiliated companies.
- Using a preprinted purchase contract over a period of one year that explicitly stated that an affiliated company would provide title and closing services.
- Later changing the language in the preprinted purchase contract regarding title and closing services, but continuing to steer parties to affiliated companies by requiring them to check one of two boxes for title services, either an affiliated company or "Other".
- Providing customers with an AfBAD that did not comply with RESPA. The RealtySouth statement did not use the format of Appendix D. Specifically, it (a) did not use capital letters or other means of emphasizing to customers that they could obtain similar services from other providers and that they were free to shop around, (b) incorporated the disclosure language into a list of descriptions of affiliated companies, and (c) included marketing language emphasizing the benefit and value of affiliated companies.

The CFPB ordered RealtySouth to emphasize to its salespeople that they cannot require the use of any affiliate in real estate transactions, to provide disclosure statements in the format provided in RESPA Appendix D, and to stop making any marketing statements that materially interfere with the required disclosures. RealtySouth was ordered to pay a civil penalty of $500,000.

In the Matter of: JRPBW Realty, Inc., doing business as RealtySouth; TitleSouth, LLC, File No. 2014-CFPB-0005 (May 28, 2014). Read the full consent order at files.consumerfinance.gov/f/201405_cfpb_consent-order_realty-south-and-title-south.pdf.

REALTOR® Practice Tip

REALTORS® would be wise to not stray from the RESPA Appendix D language and format for the AfBAD and never bury mandatory disclosures within other material, especially marketing material proclaiming the superiority of affiliated providers.

Stonebridge Title Services Inc.: Illegal Title Insurance Referral Fees

On June 12, 2014, the CFPB ordered a New Jersey company, Stonebridge Title Services Inc., to pay a civil penalty of $30,000 for paying illegal kickbacks for referrals. The bureau charged that from 2008-2013, Stonebridge paid commissions to more than 20 independent salespeople who referred title insurance business to Stonebridge. Stonebridge solicited people to provide it with referrals of title insurance business, offering to pay commissions of up to 40% of the title insurance premiums Stonebridge itself received. In particular, Stonebridge sought independent salespeople who could solicit title insurance business for Stonebridge. These independent salespeople had or developed relationships with entities, typically law firms, and referred these entities to Stonebridge for title insurance and related services on behalf of consumers. These practices violated § 8 of the RESPA, which prohibits kickbacks and payment of unearned fees in the context of residential real estate transactions.

Paying commissions for referrals is allowed under RESPA if the recipient of the payment is an employee of the company that is paying the referral. In this case, although the individuals received W-2 tax forms, the bureau's investigation determined that these individuals were independent contractors and not bona fide employees.

In the Matter of: Stonebridge Title Services Inc., File No. 2014-CFPB-0006 (June 12, 2014). Read the full consent order at files.consumerfinance.gov/f/201406_cfpb_consent-order_stonebridge-title-services.pdf.

REALTOR® Practice Tip

RESPA § 8(a) prohibits paying or receiving referral fees or another thing of value pursuant to an agreement for the referral of real estate settlement services in relation to a federally related mortgage loan, clearly including the payment of referral fees for title insurance business.

Borders & Borders PLC: Paying Illegal Real Estate Kickbacks

The CFPB filed a complaint against the Kentucky-based law firm of Borders & Borders PLC in October 2013 in federal district court, alleging that the firm violated RESPA by using a network of sham affiliated business arrangements (AfBAs) to pay kickbacks for referrals of real estate settlement business. Borders is a law firm in Louisville, Kentucky that conducts real estate closings and issues title insurance in an agency capacity for at least three title insurance companies.

The CFPB alleged that Borders violated RESPA by paying kickbacks to real estate and mortgage brokerage companies that referred business to the firm. The kickbacks — paid to owners and managers of local real estate and mortgage brokerage companies who referred business to Borders — were disguised as profit distributions made by nine title insurance companies created and operated by Borders and jointly owned by Borders and the referring entities. According to the bureau, Borders also failed to provide adequate AfBA disclosures to its customers, as required under RESPA and Regulation X.

The CFPB complaint alleges that when a local real estate or mortgage

broker company with a pre-existing arrangement referred a homebuyer to Borders for closing or other settlement services, the law firm would arrange for the title insurance to be issued by the corresponding joint venture. The profits from the joint venture would then be split between the joint venture's owners: Borders and the referring real estate or mortgage broker.

The bureau argued that the complaint adequately alleged facts illustrating that Borders violated RESPA § 8(a). In addition, the CFPB told the court that Borders cannot rely on the AfBA safe harbor contained in § 8(c) because the law firm failed to provide proper disclosures, and the payments the defendants received were not bona fide returns on ownership.

RESPA § 8(a) prohibits the giving or accepting of a thing of value pursuant to an agreement or understanding that real estate settlement service business will be referred. According to the bureau, there was an agreement that the joint venture partners referred customers to Borders for settlement services. Second, a thing of value was provided in the form of purported returns on ownership interests in the joint ventures.

The Borders arrangement did not qualify as an AfBA because the payment claimed to be a return on the ownership interest of the AfBA was not bona fide. Borders created and operated a well-oiled payment-for-referral machine easily understood and frequently utilized by numerous real estate and mortgage brokerage companies, the CFPB said. Borders paid the referring parties with money disguised in accounting ledgers to look like profits generated by title insurance companies co-owned by the referring parties. Instead of paying bona fide returns on ownership interests, the AfBAs were accounting tricks to keep track of referrals and make illegal kickbacks to the referring parties. The companies performed no substantive title work, all of which was instead performed by the staff at Borders. The CFPB believes the entire arrangement served no significant business purpose beyond acting as a conduit for kickbacks in exchange for referrals. The assignment of the title insurance work from Borders to an AfBA involved little more than changing names on paperwork and switching accounting entries in the companies' books, and that the services provided to customers under the names of those different entities were wholly indistinguishable, the CFPB said.

> "RESPA § 8 **prohibits the giving or accepting of a thing of value** pursuant to an agreement or understanding that real estate settlement service business will be referred."

Because the CFPB says the defendants received something other than a return on the ownership interest of the AfBAs, the safe harbor would not apply. In addition, the bureau claimed that the safe harbor does not apply because Borders failed to provide adequate disclosures: disclosures were not always provided to consumers and they were given at closing rather than at the time of the referral. The CFPB also alleged the disclosures failed to disclose ownership percentages, did not have a customer acknowledgment section and modified the language and font contained in the standard AfBA disclosure form.

The court has not yet reached a decision in this case.

Consumer Financial Protection Bureau v. Borders & Borders, PLC; Harry Borders; John Borders, Jr.; and J. David Borders, United States District Court for the Western District of Kentucky (October 24, 2013). Read a copy of the complaint at files.consumerfinance.gov/f/201310_cfpb_complaint_borders.pdf.

NOTE: Borders asked the court to dismiss the case, arguing that the CFPB's complaint relied on the the HUD 10-factor test, which the 6th U.S. Circuit Court of Appeals found unconstitutional in the case of *Carter v. Welles-Bowen Realty Inc*. The bureau insisted it can show that Borders violated RESPA without relying upon the HUD's controversial 10-factor test for determining whether an entity is bona fide stated in the HUD's Statement of Policy 1996-2, Sham Controlled Business Arrangements (see www.respanews.com/Uploads/Public/HUD%20statement%20of%20policy%201996-2%20sham%20AfBAs.pdf).

REALTOR® Practice Tip

REALTORS® should remember that the key to the safe harbor protection of an AfBA requires precisely meeting all three conditions of the exception from the anti-kickback provision of RESPA § 8(a).

Paul Taylor Homes: CFPB Sees Through Sham Mortgage Companies

The CFPB ordered a Texas homebuilder, Paul Taylor, to surrender more than $100,000 he received in kickbacks for referring mortgage origination business to two lenders. He is also prohibited from engaging in future real estate settlement services, including mortgage origination.

Paul Taylor received illegal referral fees through the partnership or joint venture Taylor established and jointly owned with each lender. Each joint venture purported to be a mortgage originator but the CFPB found each one to be a sham designed to allow Taylor to receive the kickbacks. His homebuilding company, Paul Taylor Homes, then referred mortgage origination business to the sham entities. However, the work was actually performed by the lenders. The kickbacks were passed through the sham entities back to Taylor through profit distributions and as a payment through a service agreement.

These distributions were not subject to the "safe harbor" for affiliated business arrangements in 12 U.S.C. § 2607(c)(4) because joint ventures did not constitute bona fide providers of settlement services within the meaning of RESPA and instead were sham-controlled business arrangements as described in U.S. Department of Housing and Urban Development Statement of Policy 1996-2 Regarding Sham Controlled Business Arrangements, 61 Fed. Reg. 29,258 (June 7, 1996) (see www.hud.gov/offices/hsg/ramh/res/res0607c.cfm and pages 7-9 of the November 2006 *Legal Update*, "RESPA and the Real Estate Broker," at www.wra.org/LU0611).

NOTE: the validity of this policy statement has since been called into question in federal courts. The Policy Statement set forth 10 factors, such as adequate capitalization, separate office space and employees, advertising for business, and others, that the HUD would use to determine whether a particular AfBA was a "sham" or "bona fide."

Under the terms of the settlement, Taylor has agreed to pay $118,194.20, the full amount of money he received since early 2010

from the kickback schemes.

In the Matter of: Paul Taylor, Paul Taylor Homes Limited, and Paul Taylor Corp., File No. 2013-CFPB-0001 (May 17, 2013). Read the full consent order at files.consumerfinance.gov/f/291305_cfpb_consent-order-0001.pdf.

REALTOR® Practice Tip

Although HUD's 10-factor test for determining sham AfBAs has been discredited, REALTORS® would be wise to obtain comprehensive legal review of any AfBAs to ensure their validity and legality.

PHH Corporation: Mortgage Insurance Kickbacks

On January 29, 2014, the CFPB initiated an administrative proceeding against New Jersey-based PHH Corporation and its affiliates (PHH), alleging they harmed consumers through a mortgage insurance kickback scheme that started as early as 1995. The PHH affiliates include its residential mortgage origination subsidiaries, PHH Mortgage Corporation and PHH Home Loans LLC, and its wholly owned subsidiaries, Atrium Insurance Corporation and Atrium Reinsurance Corporation.

The CFPB is seeking a civil fine, a permanent injunction to prevent future violations, and victim restitution.

Private mortgage insurance (PMI) is typically required by a lender when a borrower makes a down payment of less than 20 percent for the purchase of a home. The premiums for PMI are usually collected by the lender as part of the borrower's monthly mortgage payment. PMI protects the lender in the event the borrower defaults on the loan – if a borrower defaults and foreclosure proceeds do not fully pay off the loan amount, PMI covers some or all of the lender's loss. Generally the lender selects the mortgage insurer because it protects the lender against the risk of default, while the borrower pays the insurance premium every month in addition to the mortgage payment. PMI can be harmful when illegal kickbacks inflate its cost. This may increase the burden on homebuyers who are already stretched thin.

PMI providers reduce their exposure on the loans they insure by transferring part of the risk to a reinsurer that assumes the transferred risk in return for a share of the premiums collected. "Reinsurance" is simply insurance for insurance companies. Many insurance companies purchase reinsurance in order to cover their own risk of unexpectedly high losses. When a mortgage lender sets up a subsidiary company to provide reinsurance to the mortgage insurers, it becomes a "captive" arrangement. It is "captive" because the lender both originates the loan and, through its own subsidiary, provides the reinsurance.

A CFPB investigation showed that when PHH originated mortgages, it referred consumers to mortgage insurers with which it partnered. In exchange for this referral, these insurers purchased "reinsurance" from PHH's subsidiaries. PHH apparently took the reinsurance fees as kickbacks, in violation of RESPA. The CFPB alleges that because of PHH's scheme, consumers ended up paying more in mortgage insurance premiums.

The CFPB alleges that PHH manipulated its allocation of mortgage insurance business to maximize kickback reinsurance payments for itself. Over the approximately 15-year scheme, the CFPB alleges that PHH set up a system whereby it received as much as 40 percent of the premiums that consumers paid to mortgage insurers, collecting hundreds of millions of dollars in kickbacks. In some cases, PHH charged more money for loans to consumers who did not buy mortgage insurance from one of its kickback partners. In general, they charged these consumers additional percentage points on their loans; and PHH pressured mortgage insurers to "purchase" its reinsurance with the understanding or agreement that the insurers would then receive borrower referrals from PHH. PHH continued to steer business to its mortgage insurance partners even when it knew the prices its partners charged were higher than competitors' prices.

This CFPB administrative law case is ongoing and has not reached resolution.

In the Matter of: PHH CORPORATION, PHH MORTGAGE CORPORATION, PHH HOME LOANS, LLC, ATRIUM INSURANCE CORPORATION, AND ATRIUM REINSURANCE CORPORATION, File No. 2014-CFPB-0002 (January 29, 2014). Read the CFPB administrative proceedings and documents filed to date at www.consumerfinance.gov/administrativeadjudication/2014-cfpb-0002/.

REALTOR® Practice Tip

The solicitation and acceptance of kickbacks and unearned fees in exchange for referrals of settlement service business violates RESPA, whether it is a complex scheme like the alleged PHH reinsurance network or the simple act, for example, of a lender compensating a broker for referring buyers seeking financing.

RESPA Legal Hotline Questions and Answers

Home warranties under RESPA

The broker received conflicting statements from two different home warranty companies (HWC). One company said they no longer can pay the broker's company a $60.00 service fee based on the HUD's RESPA ruling and the other said they not only can, but they do. Both companies require the broker's agents/company to provide services, which include giving out the brochure, filling out the application, and collecting or making sure it is on the HUD settlement statement. Can the broker collect fees from the HWCs for services rendered?

The following is taken from the RESPA: Home Warranty Companies' Payments to Real Estate Brokers and Agents Interpretative rule, Docket No. FR–5425–IA–01 (June 25, 2010, 75 F.R. 36272):

> In some circumstances, marketing services performed on behalf of an HWC are not compensable services. In particular, a real estate broker or agent is in a unique position to refer settlement service business and through marketing can affirmatively influence a homebuyer's or seller's selection of an HWC. As a real estate broker and agent hold positions of influence in the real estate transaction, a homebuyer or seller is more likely to accept the broker's or agent's promotion or recommendation of a settlement service provider. Therefore, marketing performed by a real estate broker or agent on behalf of an HWC to sell a homeowner warranty to particular homebuyers or sellers is a 'referral' to a settlement

service provider.

Section 8(c) of RESPA and HUD's regulations allow payment of bona fide compensation for services actually performed. (See 24 CFR 3500.14(g)(1)(iv).) HUD's regulations also allow persons in a position to refer settlement service business to receive payments for providing additional compensable services as part of a transaction. (See 24 CFR 3500.14(g)(3).) Services performed by real estate brokers and agents on behalf of HWCs would be compensable as additional settlement services only if the services are actual, necessary and distinct from the primary services provided by the real estate broker or agent. Further, the real estate broker or agent may accept, and an HWC may pay to the broker or agent, a portion of the charge for the homeowner warranty only for services that are not nominal and for which there is not a duplicative charge. (See 24 CFR 3500.14(c).) HUD looks at the actual services provided to determine in a particular case whether compensable services have been performed by the real estate broker or agent. For example, conducting actual inspections of the items to be covered by the warranty to identify pre-existing conditions that could affect home warranty coverage, recording serial numbers of the items to be covered, documenting the condition of the covered items by taking pictures and reporting to the HWC regarding inspections may be compensable services.

This rule has been challenged by NAR, which has been pushing for legislation clarifying that home warranties are not a settlement service under RESPA, but at the moment, the rule stands as the applicable guidance on the subject. The broker can confer with his company's attorney, evaluate the relative risks and rewards, and determine the best course for the company at this time.

See the entire HUD interpretative rule at www.hud.gov/offices/hsg/ramh/res/homewar625.pdf and the subsequent HUD response to comments and questions at portal.hud.gov/hudportal/documents/huddoc?id=DOC_14576.pdf.

Transaction fee or administrative fee

In light of the 2012 Supreme Court decision in Freeman v. Quicken Loans, is it legal for a broker company to do the following:

1. ***Charge a client a commission of "x" percent AND a transaction fee of $____hundred dollars (assume it is $300)?***
2. ***Keep the transaction fee of $300 in-house and split the fee with an agent and not split with a cooperating broker or other business entity?***
3. ***The decision appears to clearly prohibit splitting the fee with another person. Is that interpreted to be an "outside" person or does that prohibit the broker from splitting with a licensee within the company?***

On May 24, 2012, the United States Supreme Court held unanimously in *Freeman v. Quicken Loans, Inc*. that there must be splitting of a settlement service fee with a third party before there can be a violation of the RESPA § 8(b) unearned fee rule. This holding rejects a longstanding HUD policy that interpreted the law to include a flat ban on unearned fees.

Suits alleging a violation of § 8(b) of RESPA have been brought against real estate brokerages that charge consumers a separate fee as well as a percentage-based commission. In the 2009 decision in *Busby v. JRHBW Realty, Inc. d/b/a Realty South*, the Eleventh Circuit Court of Appeals found that a fully disclosed administrative brokerage commission paid by a buyer violated § 8(b) of RESPA because it was not sufficiently related to any specific service performed for the buyer's benefit and could not be justified by the entire array of services provided to the buyer. However, in light of the unanimous *Freeman* ruling, such fees do not violate § 8(b) of RESPA unless the broker who is paid the fee splits it and pays a portion of it to a third person outside of the brokerage firm who provides no services in exchange for the fee.

1. The negotiation of commission between a seller and listing broker is determined on a case-by-case basis. Given the *Freeman* decision, commissions may be based on a percentage (%) of gross sale price in addition to a separate transaction or administration fee, provided the fee is not split with a third party.
2. In terms of cooperative commission, this too must be negotiated on a case-by-case basis. For example, MLS offers of compensation are either a percentage (%) of the gross sale price or a specific dollar amount. The amount offered in the MLS is wholly independent of what commission is paid by the seller to the listing broker. If, however, the broker creates an offer of compensation outside the MLS paradigm or modifies the MLS offer of compensation by agreement with an MLS participant, the payment could be based upon a percentage (%) of what the seller pays the listing broker. Arguably in such a scenario, a portion of the transaction or administrative fee could be split outside the brokerage firm but may raise questions, depending upon what the fee was for and if the cooperating broker has a hand in earning it. The broker may have private legal counsel review the broker's commission structure in light of the *Freeman* decision.
3. The NAR interpretation of the *Freeman* decision is that payment cannot be split with a third person who is outside the brokerage firm.

The decision is available at www.supremecourt.gov/opinions/11pdf/10-1042.pdf. For additional information, read speakingofrealestate.blogs.realtor.org/2012/05/24/supreme-court-rules-fee-split-required-for-respa-violation and www.realtor.org//legal-case-summaries/freeman-v-quicken-loans-inc-supreme-court-rules-fee-split-required-for-respa-violation (login required).

Steering to a particular title company

When acting as a buyer's agent, a company is writing in the offer that the buyer wants their lender policy and the seller's title policy from the same company. The offer says the buyers "wish" a certain named title company. Can this be done in this manner? The buyer's agent works for a company that owns the title company.

Section 9 of RESPA does not allow a seller (or the seller's agent) to require a buyer, as a condition of buying the property, to purchase the owner's title insurance from any particular title company. A buyer may, however, ask the seller to provide title insurance from a specific title company. Arguably the use of the word "wish" is perhaps not the best word choice. Each offer is presented to the seller, and the broker may discuss the advantages and disadvantages thereof. Prior to accepting such an offer, the seller may investigate the costs and services offered

by the named title company and others before deciding whether to accept or counter the buyer's offer.

Real estate brokers and agents are permitted to own an interest in a settlement service company, such as a mortgage brokerage or title company. They must, however, comply with the RESPA Affiliated Business Arrangement (AfBA) rules when referring parties to the affiliated business in a real estate transaction. This is necessary to avoid having the referral be considered an illegal kickback or unearned fee under RESPA. The buyer's agent or broker must provide the AfBAD statement in compliance with RESPA format and requirements; cannot require the buyer/client to use the affiliated company as a condition for the home sale transaction; and must not receive any payments from the company other than a return on its ownership interest in the company.

After proper disclosures are made, the buyer may draft the offer to state that a specific title company will prepare the owners' policy of title insurance. The seller may disagree and counter or reject the offer, but cannot demand the use of a specific title company that it prefers.

Buyer choosing a title company

The broker knows the buyer can choose the title insurance company, but the listing agent is insisting that the seller shall choose. Where is the statute that says the buyer may choose the title company?

The seller's obligation to provide clear title is contained in the title evidence provisions at lines 326-359 of the WB-11 Residential Offer to Purchase. Under these provisions, the seller is required to give evidence of title in the form of an owner's policy and pay the costs thereof. The title evidence must show merchantable title to the property, subject to liens that will be paid out of proceeds, and standard title insurance requirements and exceptions. Unless the offer dictates a specific title company, the seller may choose.

The WRA has in the past contacted the RESPA office at the HUD and asked whether a buyer would lose his right to choose the title insurance company if he drafts the purchase contract without specifying a title insurer but later says that he wants to choose one. The HUD did not provide a definitive answer, but did cite § 9 of RESPA, which does not allow a seller of a property (or its agent) to require a buyer, as a condition of selling the property, to purchase owner's title insurance from any particular title company. To avoid any ambiguity or dispute regarding the issue, a buyer who wants the seller to provide title evidence from a certain company should draft the offer accordingly. If the offer remains silent, the RESPA prohibitions of making the offer conditioned upon the use of a certain title company appear not to apply, thereby allowing the seller to choose.

Under RESPA, the seller cannot condition the sale of the property on the use of a specific title company, but a buyer may request that a specific title company furnish the owner's title insurance policy. The seller may disagree and counter or reject the offer, but essentially cannot demand the use of a specific title company that it prefers. The broker may wish to contact private legal counsel to make sure that this transaction conforms to office policy and applicable law.

"The seller may disagree and **counter or reject the offer,** but essentially cannot demand the use of a specific title company that it prefers. The broker may wish to contact private legal counsel to make sure that this transaction conforms to office policy and applicable law."

Referrals of non-settlement services

A local home painting business wants to pay a referral fee to agents who refer painting business to the company. Is this legal?

Under RESPA, painters generally are not settlement service providers so this particular type of referral is not subject to RESPA, provided the painting is not rendered as part of the closing and not paid for on the closing statement.

Wis. Admin. Code § REEB 24.05(1)(b) provides, " A licensee acting as an agent in a real estate or business opportunity transaction may not recommend or suggest to a party to the transaction the services of another individual or entity from which the licensee may receive compensation for a referral or in which the licensee has an interest, unless the licensee, prior to or at the time of the referral, discloses to the party in writing the fact that he or she may receive compensation for the referral or that he or she has an interest in the individual or entity providing the services. This paragraph does not apply when the licensee makes a referral to another licensee for real estate services under s. 452.19, Stats."

If this referral to the painter is made in the context of a transaction, then the broker must follow this rule and disclose in writing that he will receive a fee from the painter. If the broker is not acting as an agent and the referral occurs outside of a transaction, then it is not subject to license law. It may be prudent, however, to disclose the referral fee in all cases to avoid any possibility that a transaction may later occur with the party. A disclosure made outside of a transaction need not be in writing, but an email or other writing would be recommended.

Distributing lender financing information

A builder/broker is building and selling homes in a local community. A local bank put together a flier detailing the payments and other information for purchase money loans under various available loan programs. This is intended for use as a sales piece, but the bank said that they couldn't put their name on it due to RESPA restrictions. May the builder/broker use the flier as a handout?

The NAR Frequently Asked RESPA Questions provide the following insight into this issue, online at www.realtor.org/LetterLw.nsf/pages/0305respaQ&A (login required):

> "11. Can brokers and agents accept from lenders and distribute to prospective buyers flyers containing financing information? For instance, at an open house, may a lender provide flyers that offer closing cost calculations for various down payment scenarios, to be distributed by brokers and agents?"
>
> "Distribution of such flyers provided by lenders does not violate RESPA. The information gathered is consistent with the real estate agent's responsibilities to his or her client to facilitate the sale of the property

and no separate benefit flows to the agent from the lender. The agent may not, however, accept from lenders flyers which also promote the listed property, since that would result in the lender bearing a portion of the agent's advertising expenses, which are the agent's responsibility."

Joint advertising

If a lender and a real estate agent develop an ad together and both pay for the ad, does this violate RESPA?

If the bank wanted to run the ad for both the bank and a real estate broker, and only the bank paid for the ad, that would be considered a RESPA violation in the form of an illegal kickback. However, if the broker and the bank shared the cost of the ad proportionately, then it would not be a RESPA violation.

Liability for advertising cost kickback

A broker's agents were jointly advertising with a lender. The agents were not contributing anything towards the cost of the advertisement. The broker understands that this could be a RESPA violation. Would the agents or just the lenders be culpable under RESPA? Would the broker be culpable if the broker knew and did not stop the practice?

RESPA forbids paying someone for the mere referral of business. This means no "gifts" or fees to individuals that refer business to settlement service providers. For instance, it is illegal for a mortgage brokerage firm to pay $200 per loan to real estate agents who steer homebuyers its direction.

Under RESPA, no person may give or receive fees or kickbacks for referral of settlement services, or give or receive a split or percentage of settlement charges other than for services actually provided. Receiving compensation simply for referring a buyer or borrower to a settlement service provider is prohibited, as is splitting any settlement charge when no actual services were performed to earn the payment.

The employing broker is responsible for the real estate-related actions of the broker's agents regardless of whether the broker had knowledge of the actions. A broker who knew of an agent's illegal actions and who did not stop them may face more significant consequences from the REEB than a broker who did not know of the agent's actions. A broker is required to have adequate supervision of all licensees, regardless of the office location or office configuration model used by the company. Companies must ensure that agents have reasonable access to a supervising broker to consult on real estate practice issues. Under this proposal, it would not be proper to leave agents "on their own" without any ability to consult with their supervisor. Obviously "reasonable access" is a broad term, but it clearly means that agents must have someone to turn to when they need answers to practice questions.

Convention sponsorship

Would a bank sponsoring an agent for the WRA Fall Convention and continuing education sessions be a violation of § 8 of RESPA?

It depends on whether some of the expenses an agent would otherwise bear are defrayed by the affiliate member. Individual sponsorship of CE may be a RESPA violation because members normally have to pay a fee to attend such programs. CE credits are necessary for agents to maintain their licenses, and agents normally have to pay for CE. Paying for CE credits offered to real estate agents by a settlement service provider may be seen as a thing of value in exchange for the referral of settlement service business.

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RESPA does allow settlement service providers to conduct normal promotional and educational activities that are not conditioned upon the referral of settlement service business and do not involve the defraying of expenses otherwise incurred by persons in a position to refer settlement service business. Thus the bank may offer free education to the agents so long as it is not a required continuing education class.

See the NAR RESPA FAQ at www.realtor.org/LetterLw.nsf/pages/0305respaQ&A (login required).

RESPA resources

- NAR Real Estate Settlement Procedures Act (RESPA) page: www.realtor.org/topics/real-estate-settlement-procedures-act-respa
- NAR RESPA FAQ: www.realtor.org/topics/real-estate-settlement-procedures-act-respa/respa-faq
- NAR Letter of the Law RESPA FAQ: www.realtor.org/LetterLw.nsf/pages/0305respaQ&A (login required)
- November 2006 *Legal Update*, "RESPA and the Real Estate Broker:" www.wra.org/LU0611
- HUD FAQs About RESPA for Industry: respanews.com/Uploads/Public/HUD_FAQs_General.pdf
- January 2011: HUD's Home Warranty Marketing Rules (NAR podcast): www.realtor.org/audio/january-2011-huds-home-warranty-marketing-rules

Watch the Legal Update Video Online:



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Affiliated Business Disclosure Statement Format

To:
From:
Property:
Date:

This is to give you notice that [referring party] has a business relationship with [settlement services providers(s)]. [Describe the nature of the relationship between the referring party and the providers(s), including percentage of ownership interest, if applicable.] Because of this relationship, this referral may provide [referring party] a financial or other benefit.

[A.] Set forth below is the estimated charge or range of charges for the settlement services listed. You are NOT required to use the listed provider(s) as a condition for [settlement of your loan on] [or] [purchase, sale, or refinance of] the subject property. THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES.

[provider and settlement service] [charge or range of charges]

_____

_____

[B.] Set forth below is the estimated charge or range of charges for the settlement services of an attorney, credit reporting agency, or real estate appraiser that we, as your lender, will require you to use, as a condition of your loan on this property, to represent our interests in the transaction.

[provider and settlement service][charge or range of charges]

_____

_____

ACKNOWLEDGMENT

I/we have read this disclosure form, and understand that [referring party] is referring me/us to purchase the above-described settlement service(s) and may receive a financial or other benefit as the result of this referral.

.....[signature]

[INSTRUCTIONS TO PREPARER:] [Use paragraph A for referrals other than those by a lender to an attorney, a credit reporting agency, or a real estate appraiser that a lender is requiring a borrower to use to represent the lender's interests in the transaction. Use paragraph B for those referrals to an attorney, credit reporting agency, or real estate appraiser that a lender is requiring a borrower to use to represent the lender's interests in the transaction. When applicable, use both paragraphs. Specific timing rules for delivery of the affiliated business disclosure statement are set forth in 24 CFR 3500.15(b)(1) of Regulation X.] These INSTRUCTIONS TO PREPARERS should not appear on the statement.

[61 FR 58477, Nov 15, 1996]

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