CFPB Enforcement Targets RESPA Violations, AfBAs

Title and Settlement Companies Reminded of Importance to Comply with RESPA

Between 2003 and 2011, the U.S. Department of Housing and Urban Development announced 13 settlement agreements with providers who were alleged to have operated or invested in "sham" affiliated business arrangements.

In July 2011, the Consumer Financial Protection Bureau (CFPB) took over enforcement of the Real Estate Settlement Procedures Act from HUD. Over the past two years, the CFPB has racked up 11 RESPA settlements and lawsuits.

Attorneys with the law firm Morrison & Foerster said that now more than ever, RESPA compliance matters.

"The risk of detection of even minor or technical errors is higher now than it has been over the last few years, because the new "cop on the beat"—the CFPB—is out in full force," wrote Angela Klein and Donald Lampe in a blog post for the law firm.

The CFPB commenced its RESPA enforcement in April 2013 when it announced enforcement actions against four mortgage insurers for alleged kickbacks to lenders in exchange for business. The CFPB ordered Genworth Mortgage Insurance, Mortgage Guaranty Insurance Corp., Radian Guaranty Inc. and United Guaranty Corp. to pay $15.4 million in penalties. The mortgage insurers had entered into captive reinsurance arrangements with the lenders' subsidiaries. The CFPB alleged the arrangements violated RESPA as this allowed the insurance firms to provide additional money to the lender.

The CFPB eye then turned to the settlement services industry, announcing a consent order against Paul Taylor Homes Limited, Paul Taylor Corp., the general partner of the home builder, and Paul Taylor, the president of Paul Taylor Corp., for allegedly accepting fees in return for the referral of settlement service business to two affiliated mortgage companies partially owned by Paul Taylor.

While Taylor and his companies never admitted to the findings, the CFPB alleged that Taylor and Benchmark Bank created an affiliated business arrangement in 1999 designed to originate mortgage loans to the home builder's customers. Even with initial capitalization of $50,000, the CFPB alleged the affiliated business:

1. conducted no origination business outside of the referrals from Taylor and the home builder
2. did not advertise itself to the public
3. did not perform essential origination services and relied on Benchmark Bank to process, underwrite, close, and fund mortgage loans
4. did not maintain its own office space
5. did not have its own employees

As part of the settlement, Taylor agreed to refrain from engaging in the settlement service business, other than the sale of homes, or maintaining an ownership interest in any entity that provides settlement services for a five-year period.

According to Phil Schulman of the law firm K&L Gates, this consent order reflects the CFPB's focus on the same factors for bona fide affiliated businesses that HUD used to evaluate and enforce Section 8 requirements. For those who operate or are an investor in an AfBA that does not conduct day-to-day business as a separate, stand-alone entity, now is the time to evaluate business operations

according to RESPA requirements and HUD guidance in order to avoid an inquiry from the CFPB.

40-year-old Law Firm Targeted

In October 2013, the bureau filed a federal lawsuit against a law firm in Louisville, Ky. The firm, run by J. David Borders and his two sons, provides real estate closing services. The bureau claims the firm illegally paid for referrals from real estate and mortgage broker companies through a network of shell companies. The firm denies the charges, and has argued in court documents that its affiliate arrangements met the law's disclosure requirements. The case is still pending.

The CFPB alleges that Louisville law firm Borders & Borders PLC, and its principals, Harry Borders, John Borders, Jr., and J. David Borders, violated the Real Estate Settlement Procedures Act (RESPA) by operating a network of affiliated companies to pay kickbacks for referrals of mortgage settlement business.

According to the CFPB's complaint, Borders & Borders operated nine joint ventures with the owners and managers of local real estate and mortgage broker companies, and allegedly used the joint ownership to disguise illegal kickbacks as legitimate profit sharing.

The CFPB said the joint ventures were not bona fide entities and did not have their own office space, email addresses or phone numbers. In addition, all nine companies shared an independent contractor who was also an employee of Borders & Borders. Each company only issued title insurance policies for homebuyers that had been referred to and by Borders & Borders, and did no advertising to attract other business. The companies performed no substantive title work, all of which was instead performed by the staff at Borders & Borders. The CFPB believes the entire arrangement served no significant business purpose beyond acting as a conduit for kickbacks in exchange for referrals.

The bureau alleged the firm violated RESPA Section 8 by using a network of sham affiliated business arrangements to pay kickbacks for real estate settlement business referrals. A month after the bureau filed the complaint, the Sixth Circuit issued its decision in *Carter v. Welles- Bowen Realty, Inc.*, striking down the HUD-created policy regarding the 10 elements of a lawful AfBA (*See page 13*). The CFPB is pushing ahead in Borders, though, arguing that in any event, the Borders AfBA disclosure did not comply with RESPA and Reg. X.

In its reply to the lawsuit, the firm doesn't dispute the existence of the joint ventures or the fact that Borders principals were part owners, but it denies that the arrangement was illegal.

"We are a family-owned firm that has been in business for over 40 years, and we would not and did not violate (the Real Estate Settlement Procedures Act)," the law firm said in a statement. "This case concerns a number of agencies that were affiliated with our firm several years ago. The title agencies were 'affiliated business arrangements' that are expressly allowed by RESPA."

Insufficient Disclosures

Inadequate AfBA disclosures were the impetus for the settlement the CFPB reached in May with RealtySouth, the largest real estate firm in Alabama. The bureau accused RealtySouth of violating Section 8(a) of RESPA because the company's AfBA disclosure did not use capital letters and did not properly highlight the consumers' right to shop around. The CFPB also alleged that the "required language was buried in a section of text that also made marketing claims about the company's prices." The CFPB also said RealtySouth's preprinted purchase contracts either explicitly directed or suggested that title and closing services be conducted by its affiliate, TitleSouth.

The CFPB said RealtySouth's disclosure did not follow the format provided in the Affiliated Disclosure Statement set forth in Appendix D.

In addition to modifying its disclosure and ensuring that its training materials emphasize that its agents cannot require the use of affiliates, RealtySouth paid a $500,000 civil penalty. HUD referred this case to the CFPB.

The message with this settlement is to use the correct disclosures. Schulman said the settlement makes it clear that the CFPB does not want disclosures to serve as marketing pieces for the affiliate.

"Nor may a company alter the important language in the disclosure that informs consumers that they are not required to use the affiliate and may shop around to make sure they secure the best pricing for the service," he added.

Schulman also said the settlement is important because it touches on required use. A company or individual that owns more than a 1 percent interest in an affiliated settlement service provider may not require the use of that affiliated entity. Prior to the CFPB investigation, RealtySouth modified its purchase sales agreement to eliminate the required use of an affiliate. According

to Schulman,though, the infraction served as a basis for the significant fine paid by the company.

"The bottom line is that companies that own affiliated title agencies should never require their use and should stick closely to the affiliated business disclosure statement set forth in Appendix D of the RESPA regulations," Schulman said.

RESPA Primer

Settlement Impact on Commissioned Employees

Weeks after settling with RealtySouth, the CFPB ordered New Jersey-based Stonebridge Title Services Inc. to pay $30,000 for paying illegal kickbacks for referrals. Stonebridge allegedly paid commissions to more than 20 independent salespeople who referred title insurance business to the company. Stonebridge solicited people to provide it with referrals of title insurance business, offering to pay commissions of up to 40 percent of the title insurance premiums Stonebridge itself received, according to the CFPB. The case also was referred to the CFPB by HUD.

Many ALTA members have asked what impact this settlement will have on title companies that have commissioned staff. Schulman said that Section 8(a) of RESPA is clear about not giving or receiving a thing of value for the referral of settlement service business.

There is, however, an exception for payments made by an employer to a bona fide employee. Per-transaction payments to an independent contractor are not permitted. 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 Stonebridge, the CFPB declared that a rose by any other name is not an employee," Schulman said.

ALTA members can glean from the settlement that the CFPB will look beyond labels to assure that sales agents are bona fide employees. That means the sales agents must meet the IRS test for determining employment. That test primarily looks to whether the individual is under the supervision and control of the employer. Indications proving employment include: having the employee report to management; use of the employer's equipment and work space; receipt of a W-2 form; attending staff meetings and receiving benefits—to name a few.

"The lesson learned here is that individuals receiving per-transaction payments for the referral of settlement service business must be bona fide employees, not independent contractors labeled as 'employees.'" Schulman said.

Marx Sterbcow, managing attorney of the law firm Sterbcow Law Group, said that anyone who is paid in a transaction should perform some core functions.

"You have to justify you are doing work for the money received," he said. "If a company is using W-2 employees, it's a good idea to utilize a transaction software system so employees can go in and check off the functions that they performed. Documentation for every transaction is vital in this environment."

Analyzing the consent order, Sterbcow said the CFPB is sending some interesting messages. In the consent order, the CFPB said Stonebridge's independent salespeople developed relationships with law firms. Sterbcow noted that if the CFPB identified the law firms there could be the potential for a class-action lawsuit. Additionally, Sterbcow hoped for some additional detail from the CFPB beyond just saying law firm.

"It would have been helpful to the industry if the CFPB specified who these people were and the job functions performed," he said.

Sterbcow also found it interesting that the consent order mentioned that Stonebridge received premiums from consumers when purchasing policies and then remitted a percentage of the premiums to the underwriter.

"From a national perspective, this was a huge shot fired across the industry's bow," Sterbcow said. "Underwriters had better start policing their agents to ensure they are not doing this." ■