



Kirkpatrick & Lockhart Nicholson Graham LLP

# **RESPA REQUIREMENTS**

## **REAL ESTATE SETTLEMENT PROCEDURES ACT**

---

**PREPARED FOR:**

**TRIPLE PLAY CONVENTION**

**ATLANTIC CITY, NEW JERSEY  
December 4, 2007**

---

**PREPARED BY:**

**PHILLIP L. SCHULMAN, ESQUIRE**

**KIRKPATRICK & LOCKHART NICHOLSON GRAHAM LLP**

**1601 K STREET, NW**

**WASHINGTON, DC 20006**

**PHONE: 202.778.9027**

**FACSIMILE: 202.778.9100**

**PSCHULMAN@KLNG.COM**

**WEBSITE: WWW.KLNG.COM**

©2005 KIRKPATRICK & LOCKHART NICHOLSON GRAHAM LLP

## I. HISTORY / PURPOSE

### A. Enacted in 1974 as a consumer disclosure and anti-kickback statute

1. **12 U.S.C. §§ 2601 et seq.**
2. **HUD is responsible for enforcement**
  - a. Regulation X [24 C.F.R. Part 3500]
  - b. Policy Statements
  - c. Informal Advisory Opinions

### B. Primary Purposes – Section 2 [12 U.S.C. § 2601(b)]

1. **Full Disclosure** – Provide effective advance disclosure to homebuyers and sellers of settlement costs.
2. **Anti-Kickback** – Eliminate abusive practices such as kickbacks and referral fees that drive up the costs of products to consumers.
3. **Reduction in Escrow** – Reduce the amounts homebuyers must place in escrow accounts established to insure the payment of real estate taxes and insurance.
4. **Recordkeeping** – Reform and modernize local recordkeeping and land title information.

### C. Basic Provisions of the Statute

#### 1. **Section 3 = Definitions**

[12 U.S.C. § 2602, 24 C.F.R. § 3500.2]

#### 2. **Section 4 = HUD-1 Settlement Statement**

The “person conducting the settlement” must provide the borrower with a HUD-1 Settlement Statement at or before closing that clearly itemizes all charges imposed on the borrower and seller in connection with the settlement.

[12 U.S.C. § 2603, 24 C.F.R. §§ 3500.8, 3500.9, 3500.10 and Appendix A]

**3. Section 5 = Good Faith Estimates and Special Information Booklets**

Lenders must provide a Good Faith Estimate “of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement” and HUD's Special Information Booklet to borrowers within 3 days of loan application.

[12 U.S.C. § 2604, 24 C.F.R. § 3500.7 and Appendix C]

**4. Section 6 = Transfers of Servicing**

Lenders must disclose at the time of application that the loan servicing may be transferred. When servicing will be transferred, both the originating lender and the new servicing lender must notify the borrower within 15 calendar days before the effective date of an actual transfer (i.e., the date on which the mortgage payment is first due to the new servicer).

[12 U.S.C. § 2605, 24 C.F.R. § 3500.21]

**5. Section 7 = Exempted Transactions**

RESPA does not apply to certain types of transactions, including: (i) transactions that are primarily for business, commercial, or agricultural purposes; (ii) government or governmental agencies or instrumentalities; (iii) temporary financing; and (iv) secondary market transactions.

[12 U.S.C. § 2606, 24 C.F.R. § 3500.5]

**6. Section 8 = Kickbacks and Referral Fees**

RESPA prohibits payments in return for referrals and the splitting of unearned fees, except in certain limited circumstances set forth in the statute and regulations. The penalties for a violation include a fine of up to \$10,000, imprisonment for up to one year, or both, as well as treble damages (i.e., three times the amount of the charge for the settlement service involved in the violation).

[12 U.S.C. § 2607, 24 C.F.R. §§ 3500.14, 3500.15]

**7. Section 9 = Required Use of Title Companies**

A seller may not require a consumer to purchase title insurance from a particular title company as a condition of sale.

[12 U.S.C. § 2608, 24 C.F.R. § 3500.16]

**8. Section 10 = Escrow Accounts**

RESPA regulates how much a lender may require a borrower to deposit into escrow and requires certain notices and the provision of escrow account statements. An Initial Escrow Account Statement, which must contain certain information, must be provided within 45 days of settlement or within 45 days of the date of the establishment of the escrow, whichever comes first. The initial statement may be furnished at closing and incorporated into the HUD-1 Settlement Statement. A new Initial Escrow Account Statement must be delivered to the borrower by a transferee servicer within 60 days of the effective date of a transfer of servicing if the transferee servicer changes the monthly payment amount or accounting method. Subject to certain exceptions, servicers must also give borrowers Annual Escrow Account Statements, which must contain certain information, for each escrow account within 30 days after the conclusion of the escrow computation year.

[12 U.S.C. § 2609, 24 C.F.R. § 3500.17]

**9. Section 11 = Borrower Identity**

Lenders must obtain certain information regarding borrower identity.

[12 U.S.C. § 2610]

**10. Section 12 = Prohibited Fees**

Fees in connection with the provision of HUD-1 Settlement Statements, escrow account statements, and TILA statements may not be charged.

[12 U.S.C. § 2611, 24 C.F.R. § 3500.12]

**11. Sections 13 – 15**

These sections were repealed

**12. Section 16 = Jurisdiction of Courts**

Actions under RESPA may be brought in any court in the jurisdiction where the property is located or where the violation is alleged to have occurred. There is a three year statute of limitations in connection with violations of the servicing and escrow statement requirements, and a one-year statute of limitations for violations of the anti-kickback and required use provisions, except that the government may always bring an action within three years of the occurrence of the violation.

[12 U.S.C. § 2614]

**13. Section 17 = Validity of Contracts and Liens**

RESPA does not affect the validity of a sales contract or any loan, loan agreement, mortgage, or lien in connection with the mortgage loan.

[12 U.S.C. § 2615, 24 C.F.R. § 3500.18]

**14. Section 18 = Relation to State Laws**

RESPA does not preempt state laws except to the extent a state law is inconsistent with RESPA. HUD is authorized to determine whether any inconsistencies exist, but an inconsistency may be determined to exist only if the state law affords less protection to the consumer than RESPA.

[12 U.S.C. § 2616, 24 C.F.R. § 3500.13]

**15. Section 19 = HUD Enforcement**

HUD may prescribe rules and regulations, investigate industry practices, hold hearings, and subpoena information and documentation.

[12 U.S.C. § 2617, 24 C.F.R. § 3500.19]

**D. Penalties for Violations of RESPA**

**1. Violation of the Section 8 Anti-Kickback Provisions**

[12 U.S.C. § 2607(d)]

- a. Civil and criminal penalties
- b. Imprisonment for up to one year
- c. A fine up to \$10,000
- d. Both imprisonment and a fine
- e. Treble Damages

**2. Violation of the Section 6 Servicing Transfer Provisions**

[12 U.S.C. § 2605]

- a. Actual Damages
- b. Attorney's Fees

- c. If a pattern or practice of non-compliance exists, additional damages of up to \$1,000 per claim are available.
- d. Class Action Suits – Damages may not exceed the lesser of \$500,000 or one percent of the net worth of the servicer.
- e. Escape Clause – A servicer may avoid liability if, within 60 calendar days after discovering an error and prior to commencement of a lawsuit or receipt of written notice from the borrower, the servicer notifies the borrower of the error and makes any necessary corrections to the borrower's account.

**3. Violation of the Section 10 Escrow Account Statement Provisions**

[12 U.S.C. § 2609]

- a. Strict Liability Standard
- b. Unintentional Violations – Civil money penalties of \$50 for each failure to submit an Initial Escrow Account Statement, up to \$100,000 over any 12-month period.
- c. Intentional Violations – Civil money penalties of \$100 for each failure to submit an Initial Escrow Account Statement, with no maximum.

**4. Other Sanctions**

- a. State Attorneys General and State Insurance Commissioners May Sanction Violators [12 U.S.C. §§ 2607(d), 2614, 2617]
  - i. Seek a court order to enjoin business activities
  - ii. Require restitution to the borrower
  - iii. Require a return of profits made from the unauthorized activity
- b. HUD May Sanction Violators in the Case of Government Insured or Guaranteed Loans. [The National Housing Act, FHA Rules]
  - i. Debarment of real estate agents/brokers, mortgage brokers/lenders, title agents/companies, etc. . . . from participation in government loan programs
  - ii. Civil money penalties

- iii. Withdrawal of FHA approval
- c. Private actions brought by consumers, including class actions  
[12 U.S.C. § 2607(d)]
  - i. Treble damages (i.e., three times the amount of the charge paid for the settlement service at issue)
  - ii. Court costs and reasonable attorney's fees

## II. ANTI-KICKBACK PROVISIONS

### A. These Provisions Raise the Most Concerns and are the Cause of Most Enforcement Actions Under RESPA

#### 1. Cites

- a. Sections 8(a) and 8(b) – 12 U.S.C. § 2607(a), (b)
- b. Regulation X – 24 C.F.R. § 3500.14

2. **Presumption of Guilt** – Whenever one party makes a payment to another party in a position to refer it settlement service business, the presumption is that the payment is in return for the referral of business.

### B. Section 8(a) – Prohibition Against Referral Fees

“No 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 apart of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.” [12 U.S.C. § 2607(a)]

There are 4 elements to a Section 8(a) violation:

#### 1. ***A settlement service involving a federally related mortgage loan***

##### a. Settlement Service

- i. Broadly defined in RESPA [12 U.S.C. § 2602(3)]

“any services provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit

reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement.”

- ii. Expanded Definition in Regulation X [24 C.F.R. § 3500.2(b)]
- Origination of a federally related mortgage loan
  - Services rendered by a mortgage broker
  - Services related to origination, processing, or funding of a federally related mortgage loan
  - Title services
  - Services rendered by an attorney
  - Document preparation, including notarization, delivery, and recordation
  - Rendering credit reports and appraisals
  - Rendering inspections
  - Settlement or closing
  - Services involving hazard, flood, or other casualty insurance or homeowners' warranties
  - Services involving mortgage life, disability, or similar insurance designed to pay a mortgage upon disability or death of a mortgagor if required by the lender as a condition of the loan
  - Services involving real property taxes or other assessments or charges on real property
  - Real estate broker or agent services
  - “Provision of any other services for which a settlement service provider requires a borrower or seller to pay”

- b. Federally Related Mortgage Loan [12 U.S.C. § 2602(1), 24 C.F.R. 3500.2] = A loan secured by a first or subordinate lien

on a one-to-four family residential dwelling (including manufactured homes) that is:

- i. made in whole or in part by a lender regulated by, or whose deposits or accounts are insured by, an agency of the federal government;
- ii. made in whole or in part or insured, guaranteed, supplemented or assisted in any way by an officer or agency of the federal government or in connection with a HUD program or other government-administered housing program;
- iii. intended to be sold to Fannie Mae, Freddie Mac, or Ginnie Mae; or
- iv. made by a creditor that makes or invests in residential real estate loans aggregating over \$1 million per year.

**2. A referral of business incident to or part of a settlement service pursuant to an *agreement or understanding***

a. Referral [24 C.F.R. § 3500.14(f)]

“A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business. A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use . . . a particular provider of a settlement service or business incident thereto.”

b. Agreement or understanding [24 C.F.R. § 3500.14(e)]

“An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by 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.”

**3. Payment or receipt of a fee or *thing of value***

- a. Statutory Definition [12 U.S.C. § 2602(2)] – “any payment, advance, funds, loan, service, or other consideration.”
- b. Regulatory Definition [24 C.F.R. § 3500.14(d)] – “monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies 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 person's expenses, or reduction in credit against an existing obligation. The term 'payment' is used . . . as synonymous with the giving or receiving of any 'thing of value' and does not require transfer of money.”

**4. A payment *in consideration for the referral of business rather than for goods or facilities furnished or services performed***

As described below, RESPA expressly accepts from the Section 8 prohibitions reasonable payments made in return for goods or facilities actually furnished or services actually performed.

**C. Section 8(b) – Prohibition Against Splitting Unearned Fees**

- 1. **The same elements as Section 8(a), except the third element regarding payment or receipt of a fee or thing of value.**
- 2. **According to the statutory language, there must be an actual split of an unearned fee between two or more parties.**
  - a. Statutory Provision – “No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.” [12 U.S.C. § 2607(b)]
  - b. Effect – The proscribed act is splitting an unearned fee between one who performs a service and one who provides a referral.
  - c. Legislative History – Supports the statutory language.

[Senate Report No. 93-866, 93<sup>rd</sup> Cong., 2d Session (May 22, 1974), H.R. Rep. No. 93-1777, at 7 (1974), 120 Cong.

Rec. 6586 (March 13, 1974), 120 Cong. Rec. 29442-43  
(Aug. 20, 1974)]

- i. Senate Reports state that RESPA was not intended as a rate-setting statute and that the federal government may not set rates merely because there are abuses or problems in certain areas of the country.
- ii. Prior to enacting RESPA, Congress rejected several proposals to regulate settlement charges
- iii. Senator Bill Brock (R. Tenn.), who introduced Section 8(b) to the Senate, pronounced that this section was intended to “prohibit any fee-splitting among persons who render settlement services unless the fee is paid in return for services actually rendered.”
- iv. House Representatives similarly emphasized that Section 8(b) was intended to deal only with fee-splitting arrangements, and that it does not authorize actions or suits based on a homebuyer's belief that a charge exceeded the reasonable value of services rendered.

**3. HUD takes a different position; namely, that a split between two or more parties is not necessary and that the mere receipt of an unearned, excessive, or duplicative fee is sufficient for a Section 8(b) violation**

- a. Congress did not define “portion, split, or percentage”
- b. Congress authorized HUD to “prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary.” [12 U.S.C. § 2617(a)]
- c. HUD implemented regulations indicating that a split is not required under Section 8(b) [24 C.F.R. § 3500.14(c), g(3)]

“A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section . . . . When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are

actual, necessary and distinct from the primary services provided by such person.”

This provision prohibits:

- i. Receipt of a fee where no services are performed
- ii. Receipt of an excessive fee (i.e., a payment that is not commensurate with the value of actual goods or services provided)
- iii. Multiple payments in the same transaction where the settlement service provider does not perform additional services to justify the fee

**4. The federal Circuit Courts that have addressed the Section 8(b) issue are split in their interpretation of the statutory language and the deference granted to HUD. The 4<sup>th</sup>, 7<sup>th</sup>, and 8<sup>th</sup> Circuits have found that there must be a split of the unearned portion of a fee between two or more parties in order for a Section 8(b) violation to occur.**

- a. Echevarria v. Chicago Title & Trust Company [256 F.3d 623 (7<sup>th</sup> Cir. 2001)] – Plaintiffs alleged that the title company had charged them more money than was required to record a deed and retained the difference. The 7<sup>th</sup> Circuit found that the title company had not violated Section 8(b) because it had not shared the excessive fees with any other party and a mere mark-up charged by a third-party vendor does not constitute a RESPA violation.
- b. Boulware v. Crossland Mortgage Corporation [291 F.3d 261 (4<sup>th</sup> Cir. 2002)] – This was a class action in which consumers alleged that the mortgage lender charged them \$65 for credit reports that cost \$15 or less and retained the difference. The 4<sup>th</sup> Circuit held that the mortgage company's mark-up was permissible because Section 8(b) is not a price control provision and does not apply to overcharges or the marking up of third parties' fees.
- c. Krzalic v. Republic Title Company [314 F.3d 875 (7<sup>th</sup> Cir. 2002), *cert. denied*, 123 S. Ct. 2641 (2003)] – Class action plaintiffs alleged that Republic Title Company had charged them \$50 for recording their mortgages but paid the county recorder only \$36 and retained the \$14 difference. The 7<sup>th</sup> Circuit found in favor of the title company and held that RESPA is not a price control statute, that there was no kickback, and that Section 8(b) does not prohibit markups that are not split between two or more parties. The judge in

this case went so far as to state that HUD's view is "contorted" and "silly."

- d. Haug v. Bank of America [317 F.3d 832 (8<sup>th</sup> Cir. 2003)] – Plaintiffs alleged that the lender charged them \$50 for a credit report that cost the bank only \$15, \$300 for an appraisal that cost the bank significantly less, and \$25 for document delivery fees that cost less. The 8<sup>th</sup> Circuit held that there was no violation because at least two parties must share an unearned fee for a violation to occur.

**Numerous other federal courts have rendered similar decisions:**

Mercado v. Calamet Fed. Sav. & Loan Assoc., 763 F.2d 269 (7<sup>th</sup> Cir. 1985).

Durr v. Intercounty Title Co. of Illinois, 14 F.3d 1183 (7<sup>th</sup> Cir. 1994), cert. denied, 513 U.S. 811 (1994).

Willis v. Quality Mortgage USA, Inc., 5 F. Supp. 2d 1306 (D. Al. 1998).

Duggan v. Independent Mortgage Corp., 670 F. Supp. 652 (E.D. Va. 1987).

Callahan v. Commonwealth Land Title Ins. Co., Civil Action Nos. 88-7656, 88-8319, 1990 U.S. Dist. LEXIS 14524 (E.D. Pa. 1990).

Bloom v. Martin, 865 F. Supp. 1377 (N.D. Ca. 1994).

Campbell v. Machias Sav. Bank, 865 F. Supp. 26 (D. Me. 1994).

Barbosa v. Targe Mortgage Corp., 968 F. Supp. 1548 (S.D. Fla. 1997).

Christakos v. Intercounty Title Co., 196 F.R.D. 496 (N.D. Ill. 2000).

5. **HUD Policy Statement – After the 7<sup>th</sup> Circuit decision in Echevarria, and despite numerous prior federal cases that came to the same conclusion as the 7<sup>th</sup> Circuit, HUD issued a Policy Statement in October 2001 reiterating its position that no split is required, as stated in Regulation X.**  
[RESPA Statement of Policy 2001-1 (October 18, 2001)]

- a. HUD stated that the 7<sup>th</sup> Circuit misapplied Section 8(b) in Echevarria
- b. HUD set forth 3 scenarios under which a Section 8(b) violation would occur:
  - i. Two or more persons split a fee and part or all of one person's share is unearned.
  - ii. One person marks up the cost of goods or services provided by a third party and keeps the difference without providing any goods or services to justify the additional charge (i.e., a lender charges a consumer more for an appraisal report than the appraiser charges the lender and keeps the difference). HUD stated that "a settlement-service provider may not

mark up the cost of another provider's services without providing additional settlement services; such payment must be for services that are actual, necessary and distinct services provided to justify the charge[.]”

- iii. One person charges a fee for no, nominal or duplicative work, or a fee that exceeds the value of goods or services provided. In addition, HUD provided that “a single service provider cannot serve in two capacities, e.g., a title agent and closing attorney, and be paid twice for the same service. The fee the service provider would be receiving in this case is duplicative . . . and not necessary and distinct[.]”

**6. Since HUD issued RESPA Statement of Policy 2001-1, the 11<sup>th</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> Circuits have sided with the Department and reasoned that a split in the unearned portion of a fee between two or more parties is not required to constitute a Section 8(b) violation.**

- a. Sosa v. Chase Manhattan Mortgage Corporation [No. 02-13930, D.C. Docket No. 02-20285-CV-PAS, 2003 U.S. App. LEXIS 21759 (11<sup>th</sup> Cir. 2003)]
  - i. *Facts* – Plaintiffs alleged that Chase charged a \$50 fee for messenger or courier services and retained a portion of the fee without performing the actual deliveries.
  - ii. *Procedural History* – The District Court for the Southern District of Florida granted Chase's motion to dismiss, holding that Chase would have had to share its portion of the \$50 with a third party to violate Section 8(b) and that any other reading would mean the borrowers violated Section 8(b) as well (“No person shall give and no person shall accept . . .”).
  - iii. *Holding* – The 11<sup>th</sup> Circuit affirmed the decision to dismiss the complaint, but on different grounds.
  - iv. *Reasoning*
    - (1) A single party can violate Section 8(b).
    - (2) The word “and” in the statute connects two phrases (i.e., “no person shall give” and “no person shall accept”), thereby creating two separate prohibitions.

- It is illegal to give a portion of a charge, even if there is no culpable acceptor, or to receive one, even if there is no culpable giver.
  - A consumer could not be a culpable giver of an unearned fee because a consumer always intends to pay a fee for services that are actually rendered.
- (3) Requiring a split between two parties would be irrational because one should be guilty if one attempts to give a kickback, even if the other entity refuses to accept it. *This would seem to read into RESPA a prohibition against “attempted kickbacks” that does not currently exist in the statute.*
- (4) The court still found in favor of Chase.
- The plaintiffs did not allege that the portion of the fee retained by Chase was not in return for services actually performed.
  - Chase performed services insofar as it performed deliveries through its agents by arranging for third-party contractors to do so.
- a. Kruse v. Wells Fargo Home Mortgage, Inc. [2004 U.S. App. LEXIS 19047; 383 F.3d 49 (2d Cir. 2004)]
- i. *Facts* – In addition to alleging that Wells Fargo charged excessive underwriting fees, the plaintiffs alleged that Wells Fargo paid third parties to perform tax services, flood certification, and document preparation, and charged plaintiffs in excess of the amounts paid to the third parties without performing further services. For example, the plaintiffs alleged that Wells Fargo paid \$20-\$50 to a third party for document preparation and charged the plaintiffs \$150-\$300 without performing additional services.
  - ii. *Procedural History* – Relying on the decisions of the 7<sup>th</sup>, 8<sup>th</sup>, and 4<sup>th</sup> Circuits, the District Court for the Eastern District of New York found no violation of RESPA and dismissed the plaintiff’s complaint.
  - iii. *Holding* – The 2<sup>nd</sup> Circuit affirmed in part the decision to dismiss the complaint by holding that Section 8(b) of RESPA does not apply to overcharges. The 2<sup>nd</sup> Circuit also reversed and remanded the decision in part to permit the District

Court to determine whether Wells Fargo performed additional services to justify the mark ups.

iv. *Reasoning*

- (1) The court found the statutory language of Section 8(b) to be ambiguous as applied to mark-ups, and, thus, deferred to HUD's interpretation in Statement of Policy 2001-01.
- (2) The court remanded the case to the District Court to determine, using HUD's Policy Statement, whether Wells Fargo charged fees for third party services without performing additional services.

b. Santiago v. GMAC Mortgage Group, Inc. [No. 03-4273; 417 F.3d 384 (3d Cir. 2005)]

- i. *Facts* – In addition to alleging that GMAC overcharged plaintiffs for a funding fee, the plaintiffs alleged that GMAC charged more for tax service and flood certification services than that paid to the tax service and flood certification vendors.
- ii. *Procedural History* – The District Court for the Eastern District of Pennsylvania dismissed the case and found that Section 8(b) was intended to prohibit kickbacks and referral fees and does not include a cause of action for overcharges and mark-ups.
- iii. *Holding* – The 3<sup>rd</sup> Circuit affirmed the District Court's decision that Section 8(b) does not include a cause of action for overcharges, but remanded the case to the District Court to decide the mark-up claim under Section 8(b) of RESPA.
- iv. *Reasoning*
  - (1) The court reasoned that the statutory text of Section 8(b) provides a cause of action for mark-ups. The court noted that the title of Section 8(a) is "Business referrals," and prohibits the acceptance of "any fee, kickback or thing of value," while Section 8(b) is titled "Splitting charges," and prohibits the acceptance of "any portion, split, or percentage of any charge." The court, therefore, rejected the argument that Section 8(b) applies only to kickbacks because the term "kickback" is not used in Section 8(b). The court stated that this use of language in Section 8(a) suggests that Section 8(b) is meant to provide for a situation other than kickbacks.

- (2) Although the court relied on the statutory language and did not defer to HUD's Policy Statement, in remanding the case to the District Court, the court noted that the District Court should consider certain factors imposed by HUD. These factors include the issues of whether any ancillary services performed by GMAC were nominal, whether the amount of any markup had to be reasonable in light of the additional services provided, or whether these extra services were already included in some other settlement service charge paid by the borrower.

**Other federal courts have rendered similar decisions:**

- a. Briggs v. Countrywide Funding Corporation [931 F. Supp. 1545 (M.D. Ala. 1996)] – The court stated that because RESPA does not define “kickback” or “split,” it is not irrational for HUD to deem the payment of an unearned or duplicative fee to be a kickback under RESPA.
- b. McCullough v. Great Western Bank [No. C97-1422WD, 1998 U.S. Dist. LEXIS 8226 (W.D. Wa. 1998)] – The court criticized 7<sup>th</sup> Circuit cases for requiring the existence of a split.
- c. DeLeon v. Beneficial Construction Co. [55 F. Supp. 2d 819 (N.D. Ill. 1999)] – The court held that Section 8(b) could be violated where a mortgage broker charged for services that it did not render.

**7. The Future of Section 8(b)**

- a. It is hard to predict how Section 8(b) will be applied.
  - i. The 4<sup>th</sup>, 7<sup>th</sup> and 8<sup>th</sup> Circuits claim that a split between two or more parties is required to violate Section 8(b).
  - ii. The 11<sup>th</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> Circuits and HUD claim that a single party can violate Section 8(b).
  - iii. Despite the statutory language, settlement service providers remain vulnerable in the 11<sup>th</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> Circuits and in jurisdictions that have not yet addressed the issue, as well as remain vulnerable to HUD in administrative enforcement actions.
- b. HUD has evidenced its willingness to enforce its interpretation of Section 8(b).

- i. HUD issued a Press Release on October 2, 2003 announcing various settlement agreements and stating HUD's willingness to enforce its view.
- ii. HUD entered into a Settlement Agreement with Allied Home Mortgage Capital Corporation, which had marked up the cost of credit reports to borrowers. Under the Settlement Agreement, Allied agreed to:
  - (1) pay \$370,000 to HUD;
  - (2) refrain from marking up the costs for credit reports or any other third-party settlement services;
  - (3) audit the closing practices of its branch offices annually;
  - (4) take action against employees who are responsible for markups in the future; and
  - (5) repay borrowers any excess charge in a timely manner.
- c. This issue arises frequently for our clients in the context of bundled services.

Vendor management companies that arrange for third-party services typically mark up the individual vendors' fees and retain the additional amounts. For example, a company may arrange for the credit report, appraisal report, flood certification, and other items and aggregate all the costs into one bundled fee to the consumer. If the vendor management company charges more for each fee than the vendor, HUD would say there is a violation of Section 8(b). In order to justify the increased charges, the vendor management company must perform services. The typical services performed include:

- establishing and maintaining a network of vendors;
- investigating the network vendors' credentials and reputations;
- ensuring that network vendors are properly licensed or certified;
- ensuring that network vendors maintain required insurance;

- arranging for network vendors' services in individual transactions;
- mediating disputes between consumers and network vendors; and
- warranting network vendors' services to consumers.

### III. EXCEPTIONS TO THE ANTI-KICKBACK PROVISIONS

#### A. Exceptions to Anti-kickback Prohibitions

The prohibitions against kickbacks and referral fees set forth in RESPA and Regulation X are subject to various statutory and regulatory exceptions.

##### 1. **Payments to an attorney for services actually rendered**

“Nothing in [Section 8] shall be construed as prohibiting the payment of a fee to attorneys at law for services actually rendered.” [12 U.S.C. § 2607(c)(1)(a). See also 24 C.F.R. § 3500.14(g)(1)(i)]

##### 2. **Payments by a title company to its duly appointed title agent for services performed in the issuance of a title policy**

“Nothing in [Section 8] shall be construed as prohibiting the payment of a fee by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance.” [12 U.S.C. § 2607(c)(1)(B). See also 24 C.F.R. § 3500.14(g)(1)(ii)]

##### 3. **Payments by a lender to its duly appointed agent for services performed in the making of a loan**

“Nothing in [Section 8] shall be construed as prohibiting the payment of a fee by a lender to its duly appointed agent for services actually performed in the making of a loan.” [12 U.S.C. § 2607(c)(1)(C). See also 24 C.F.R. § 3500.14(g)(1)(iii)]

This exemption is unclear and there is little explication provided in the statute, regulations, or legislative history regarding the meaning of this exemption.

##### 4. **Cooperative Agreements between listing and selling realtors**

“Nothing in [Section 8] shall be construed as prohibiting payments pursuant to cooperative brokerage and referral arrangements or

agreements between real estate agents and brokers.” [12 U.S.C. § 2607(c)(3). See also 24 C.F.R. § 3500.14(g)(1)(v)]

The regulation citing this exemption states that “[t]he statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.” [24 C.F.R. § 3500.14(g)(1)(v)]

According to numerous informal opinion letters issued by HUD, to be acting in a real estate brokerage capacity, each of the parties arguably must be licensed or authorized to act as a real estate broker. Additionally, the person or entity must be acting as a real estate broker, not a mortgage broker, to qualify for the exemption even though the state may license mortgage brokers under its real estate law. The general prohibition against referral fees and fee splitting attaches even if state law permits the payment of “finder fees.”

#### **5. Payments by an employer to its employees**

“Section 8 of RESPA permits an employer’s payment to its own employees for any referral activities.” [24 C.F.R. § 3500.14(g)(vii)]

The employee must be a bona fide employee of the employer. HUD’s position is that the employee must be an actual W-2 employee, and not an independent contractor.

The employer must pay the referral fee to the employee. The referred party may not pay the employee or reimburse the employer for the employee’s referral.

#### **6. Payments for services actually rendered or goods actually provided**

“Nothing in [Section 8] 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.” [12 U.S.C. § 2607(c)(2). See also 24 C.F.R. § 3500.14(g)(1)(iv)]

Two-part test.

- a. Actual goods, facilities, or services must be provided.
- b. The compensation paid must be reasonably related to the value of the good or facility furnished or the service performed.

“The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. ... High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities, or services.” [24 C.F.R. § 3500.14(g)(2)]

## **7. Payments among affiliated business arrangements**

“Nothing in [Section 8] shall be construed as prohibiting affiliated business arrangements.” [12 U.S.C. § 2607(c)(4). See also 24 C.F.R. § 3500.15]

## **B. The Affiliated Business Exception (“AfBA”)**

### **1. Background**

- a. The Affiliated Business Arrangement (“AfBA”) exception in Section 8(c)(4) permits payments of a return on ownership interest in an AfBA to AfBA owners, provided that a Safe Harbor Test is met.
- a. Absent the exception in Section 8(c)(4) for AfBAs, under a strict Section 8 analysis, even the payment of a dividend or other return of capital to an affiliate from which the referral originated could constitute a violation of Section 8.
- b. Congress amended RESPA in 1983 to clarify that Section 8 should not be construed to prohibit affiliated business arrangements and ownership returns received as a result of referrals to affiliated entities, provided that the conditions of a safe harbor test are satisfied.
- c. 1992 RESPA Regulations Give Distinct Advantages to AfBAs
  1. An employer may pay an employee for any referral activities (including referrals to the affiliated title agency).
  2. Discounts or rebates to consumers to entice them to use AfBA are permitted (but still must satisfy other applicable legal requirements).

- d. Example – Lender and title company form joint venture title agency = AfBA

## 2. Definition of Affiliated Business Arrangement

- a. “Affiliated Business Arrangement” – defined in RESPA [12 U.S.C. § 2602(7)]

“an arrangement in which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selections of that provider.”

- b. Element A of the AfBA Definition – Persons in a position to refer settlement service business

Covers a “person in a position to refer settlement service business,” or an “associate” of such person, who has either an “affiliate relationship” with, or a “direct or beneficial ownership interest” of more than one percent in a provider of settlement services.

- i. “Person in a position to refer settlement service business” – defined in Regulation X [24 C.F.R. § 2500.15(c)(9)]

“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 services.”

- ii. “Associate” – defined in RESPA [12 U.S.C. § 2602(8)]

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

(A) a spouse, parent, or child of such person;

(B) a corporation or business entity that controls, is controlled by, or is under common control with such person;

(C) an employer, officer, director, partner, franchiser, or franchisee of such person; or

(D) anyone who has an agreement, arrangement, or understanding with such person, the purpose or substantial effect of which is to enable the person in a position to refer settlement business to benefit financially from the referrals of such business.”

- iii. “Affiliate relationship” – defined in Regulation X [24 C.F.R. § 2500.15(c)(2)]

“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.”

- iv. “Direct ownership” – defined in Regulation X [24 C.F.R. § 3500.15(5)]

“the holding of legal title to an interest in a provider of settlement service except where title is being held for the beneficial owner.”

- v. “Beneficial ownership” – defined in Regulation X [24 C.F.R. § 3500.15(3)]

“the effective ownership of an interest in a provider of settlement services 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.”

- c. Element B of the AfBA Definition - Persons who refer settlement service business

Covers a person, or the “associate” of such person, who refers settlement service business (i.e., “affirmatively influences” the selection of the settlement service provider). This is a factual issue that can depend on the nature of the relationship between the referring party and the consumer.

### 3. Safe Harbor Test

- a. Referrer of business to title agency must disclose affiliation.

- i. The referring party must give the consumer a written disclosure on a separate piece of paper no later than the time of referral or, if the lender requires the use of a particular provider, at the time of application. [12 U.S.C. § 2607(c)(4)(A); 24 C.F.R. § 3500.15(b)(1)]ii.
  - ii. HUD provides a form for the AfBA Disclosure in Appendix D to Regulation X. The AfBA Disclosure must state:
    - The nature of the relationship between the referring party and the affiliate,
    - That the referring party may receive a financial benefit from the referral, and
    - That the consumer is not required to use the referred settlement service provider.
  - iii. The model AfBA Disclosure form promulgated by HUD includes a signature line for the referred consumer.
  - iv. Special rules for telephonic and electronic referrals and referrals made by lenders are set forth in Section 8(c)(4)(A).
- b. Referrer of business to title agency must **disclose costs** to consumer.
- i. “Nothing in [Section 8] shall be construed as prohibiting affiliated business arrangements so long as a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided with a written estimate of the charge or range of charges generally made by the provider to which the person is referred.” [12 U.S.C. § 2607(c)(4)(A). See also 24 C.F.R. § 3500.15(b)(1)]
- c. Referrer of business to title agency must explain that consumer is **not required to use** affiliated entity.
- i. “Nothing in [Section 8] shall be construed as prohibiting affiliated business arrangements so long as ... such person is not required to use any particular provider of settlement services.” [12 U.S.C. § 2607(c)(4)(B). See also 24 C.F.R. § 3500.15(b)(2)]

- ii. Exception for certain required settlement service providers – “[t]he following shall not be considered a violation of [Section 8(c)(4)(B)]:
- Any arrangement that requires a buyer, borrower, or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender’s interest in a real estate transaction, or
  - Any arrangement where an attorney or law firm represents a client in a real estate transaction and issues or arranges for the issuance of a policy of title insurance in the transaction directly as agent or through a separate corporate title insurance agency that may be established by that attorney or law firm and operated as an adjunct to his or its law practice.” [12 U.S.C. § 2607(c)]

d. Only thing of value that may be transferred among affiliates is a return on ownership interest.

- i. “Nothing in [Section 8] shall be construed as prohibiting affiliated business arrangements so long as ... the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship.” [12 U.S.C. § 2607(c)(4)(C). See also 24 C.F.R. § 3500.15(b)(3)]
- ii. The parent owners of the affiliated business entity may not receive any compensation other than a return on their respective ownership interests.
- iii. HUD prefers that each owner or participant in the AfBA entity make an investment of capital rather than a loan to the AfBA entity.
- iv. Any receipts based on ownership interest should be based on the fair value contributions of the participants in the AfBA entity rather than on expected referrals.

“A return on an ownership interest does not include any payment which varies according to the relative amounts of referrals by the different recipients of similar payments.” [24 C.F.R. § 3500.15(b)(3)(ii)(B)]

- v. Finally, there may not be a provision for adjustments to the ownership interest in the AfBA entity based on the amount of any business referred.

“A return on an ownership interest does not include a payment based on an ownership, partnership, or joint venture share which has been adjusted on the basis of previous relative referrals by recipients of similar payments.” [24 C.F.R. § 3500.15(b)(3)(ii)(C)]

#### 4. Elements of a Lawful AfBA – 1996 AfBA Policy Statement

a. Issued in response to “sham” AfBAs established merely as a means to funnel money to a party who otherwise could not receive fees for the referral of settlement service business.

i. E.g., AfBA between a real estate agent and lender.

- The AfBA has no employees, no capital contribution by the real estate agent, and subcontracts all lending services back to the lender partner.
- The real estate agent receives a return on the ownership interest, but from an entity that provides no services.
- AfBA is a shell that facilitates the lender’s payment to the real estate agent through the shell when such a payment would otherwise be prohibited.

b. HUD weighs ten factors to determine if an AfBA is *Bona Fide* provider of settlement services.

i. Need not meet all ten to be lawful.

ii. No one particular factor will be determinative.

c. Ten Factors Enunciated By HUD

1. Does the new entity have sufficient initial capital and net worth, typical in the industry, to conduct the settlement service business for which it was created, or is it undercapitalized to do the work it purports to provide?

2. Is the new entity staffed with its own employees to perform the services it provides, or does the new entity have “loaned” employees of one of the parent providers?

3. Does the new entity manage its own business affairs, or is an entity that helped create the new entity and that is running the new entity for the parent provider making the referrals?

4. Does the new entity have an office for business which is separate from one of the parent providers? If the new entity is located at the same business address as one of the parent providers, does the new entity pay a general market value rent for the facilities actually furnished?
5. Is the new entity providing substantial services, *i.e.*, the essential functions of the real estate settlement service, for which the entity receives a fee? Does it incur the risks and receive the rewards of any comparable enterprise operating in the marketplace?
6. Does the new entity perform all of the substantial services itself, or does it contract out part of the work? If it contracts some of the work, how much of that work is contracted out?
7. If the new entity contracts out some of its essential functions, does it contract services from an independent third party, or are the services contracted from a parent, affiliated provider or an entity that helped to create the controlled entity? If the new entity contracts out work to a parent, affiliated provider or an entity that helped create it, does the new entity provide any functions that are of value to the settlement process?
8. If the new entity contracts out work to another party, is the party performing any contracted services receiving a payment for services or facilities provided that bears a reasonable relationship to the value of the services or goods received, or is the contractor providing services or goods at a charge such that the new entity is receiving a “thing of value” for referring settlement service business to the party performing the services?
9. Is the new entity actively competing in the marketplace for business? Does the new entity receive or attempt to obtain business from settlement service providers other than one of the settlement service providers that created the new entity?
10. Is the new entity sending business exclusively to one of the settlement service providers that created it, or does the new entity send business to a number of entities, which may include one of the providers that created it?

## IV.

## EXAMPLES

### A. Marketing Agreements / Desk Rentals

1. HUD has expressed concern with situations where one settlement service provider pays another for marketing services and/or the rental of office or desk space.

E.g., A mortgage lender pays a real estate broker for marketing the lender's services.

E.g., A mortgage lender enters into a lease or sublease agreement with a real estate broker for the use of office space.

The concern is that the payment for marketing or office space is actually a payment by the lender to the real estate broker for referrals in violation of Section 8(a).

2. HUD is currently investigating a number of different entities' marketing and rental arrangements.
3. There are a number of HUD investigations underway regarding desk rentals. The concern is that the rental payment is greater than the value of the space in order to compensate the broker for referrals.

### B. Refer a Friend / Gifts

1. HUD has expressed concern with situations where a settlement service provider furnishes gifts to customers or other settlement service providers in return for referrals in violation of Section 8(a).

**2. HUD has investigated numerous entities for providing gifts in return for referrals.**

a. A Branch Manager of Integrity Home Funding, LLC – Refer a Friend Program

Former clients that sent referrals to the Branch Manager of the lender were entered into a raffle to receive tickets to sporting events, theater productions, and other prizes. There was one winner per month. HUD determined that the mere chance to win a prize, as well as the receipt of an actual prize, constituted a thing of value in return for referrals. A settlement agreement was executed in February 2004 under which the Branch Manager paid \$1,500 to HUD and notified his customers of the Settlement Agreement.

b. Virtual Tour Cases

HUD entered into a number of settlement agreements after determining that title companies' provision of virtual tours free of charge to real estate agents constituted a thing of value in return for the agents' referrals. HUD entered into agreements with 7 title companies (Chicago Title, Fidelity National Title, Stewart Title of Austin, Austin Title, First American, Gracy Title, and Heritage Title) and a real estate broker (Coldwell Banker). Payments under the settlement agreements ranged from \$1,200 to \$44,000.

**C. Taking Loan Applications**

**1. HUD takes the position that the mere completion of a loan application does not constitute a service for which one may be paid, even though Section 8(c)(2) clearly permits payments for actual services rendered.**

E.g., A mortgage lender may not pay a real estate agent for completing loan applications.

This issue arises frequently with respect to the submission of on-line applications. HUD's position is clear, however, that the performance of only minimal work will not justify compensation. The concern is that the payment is actually in return for referrals in violation of Section 8(a).

**2. World Savings Bank**

The Bank had paid up to \$100 to real estate agents for completing and submitting on-line applications for prospective borrowers. A settlement agreement was executed under which the Bank paid \$7,557.

### **3. Znet Financial and ReMax of Atlanta**

The lender had paid real estate agents \$400 per transaction as “employees” for completing loan applications. HUD determined that the lender had created the “illusion of employment” to circumvent Section 8 of RESPA and that the employment arrangement was a sham. By Settlement Agreement, the lender agreed to pay \$15,000, the real estate agents refunded \$400 to each consumer referred to Znet Financial (totaling \$9,200), and the arrangement was terminated.

#### **D. Builder Cases**

- 1. HUD is currently investigating a number of cases where a homebuilder charges a builder's fee in the amount of a percentage (i.e., usually 1% to 1.5%) of the total purchase price to the consumer at closing. In some cases, the sales contract states that the fee is intended to cover a portion of impact fees, building permit fees, and sewer and water connection fees that the builder pays. In other cases, the sales contract merely presents the fee as an add-on.**

The concern is that the fee constitutes a charge for which no services are performed, or an excessive charge, in violation of HUD's view of Section 8(b).

- 2. The homebuilders have offered several defenses.**

- a. A homebuilder's sale of properties is not a settlement service under RESPA because it is not included in the definition, which focuses more on real estate brokers/agents, lenders, and services related to the financing of the home. HUD may disagree with this argument and take the position that the sale of a home falls within at least the regulatory definition of settlement service because it is essential to the homebuying process, is in connection with the mortgage loan, and requires a consumer to pay something at settlement.

- b. RESPA is not a rate-setting statute.

[64 Fed. Reg. 10080; S. Rep. 93-866 (1974), reprinted in 1974 U.S. Code Cong. & Admin. News 6546 – 6550]

- c. The builder's fee is better for the consumer than simply raising the purchase price. A buyer saves money in connection with real estate taxes, transfer taxes, documentary stamp taxes, and title insurance premiums, all of which are based on the purchase price or mortgage amount.

- d. There is no compensation for referrals, so there can be no violation of Section 8(a).
- e. There is no splitting of fees, so there can be no violation of Section 8(b). In addition, the fee reimburses the builder for actual costs, so it complies with HUD's interpretation of Section 8(b), as well as with Section 8(c)(2). The argument for compliance, however, would not exist if the fee exceeded the actual costs incurred by the builder in a particular case.

## **E. Joint Advertising**

### **1. Analysis of Issues – Payment for Services Actually Rendered or Goods Actually Provided**

- a. Free or discounted advertising space – If one settlement service provider paid for the advertisement and permitted the other settlement service provider to list contact information, available loan products, real estate listings, etc., at no cost or at a discount, this provision of free or discounted advertising would constitute the payment of a thing of value (the free advertising) for the referral of business (directing the consumer reading the advertisement to the listed settlement service provider).
- b. Actual Goods – Joint advertising arrangement where each settlement service provider pays a portion of the advertising costs.
- c. Reasonable Payments – The settlement service providers' payments for the advertising should be reasonably related to the value of the goods received in return, i.e., the amount of advertising each settlement service provider receives in the advertisement.
  - i. Fair market value of goods provided or the internal costs of providing services are the relevant factors according to HUD.
  - ii. Each settlement service provider should pay the proportionate fair market value of the amount of space his or her advertisement utilizes on the page.
  - iii. Example – Real estate agent listings cover 75% of the page, while loan officer's advertisement covers 25% of the page, real estate agent should pay 75% of cost of advertisement, and the loan officer should pay the remaining 25% of the cost.
- d. Conclusion – To jointly advertise, each settlement service provider should pay its pro-rata share of the cost of the advertisement.

### **2. HUD has investigated a loan officer who entered into a joint advertising agreement with real estate agents to jointly advertise their services in real estate magazines.**

## F. Customer Lists

### 1. Analysis of Issues

- a. Payment of a thing of value for the referral of settlement service business. Each lead provided could result in settlement service business from the lead, and thus is a thing of value. Providing the lead would constitute the referral of settlement service business.
- b. Actual Goods Provided – HUD has informally taken the position that a sale of a customer list does not violate the provisions of Section 8. See e.g., HUD Advisory Letter from Grant E. Mitchell dated January 26, 1989 (stating that the sale of lists of names of prospective borrowers for \$15.00 to \$20.00 per name does not violate RESPA). The following conditions must be met:
  - i. The payment for a customer list may not be tied to whether the customer ultimately procures settlement services from the purchaser of the list.
  - ii. The payment may not be conditioned on any other consideration, such as an endorsement of the products being offered by the settlement service provider selling the customer list. See HUD Advisory Letter from Grant E. Mitchell dated March 24, 1994.
  - iii. The payment must be merely for the use of the customer list.

Compensation based on the commissions generated by the sale of a customer list has been viewed as a RESPA violation. See HUD Advisory Letter from Grant E. Mitchell dated May 31, 1985 (stating that a builder may not receive commissions generated by policies written to persons on a list provided by the builder to an insurer).

HUD distinguishes between payments that are “transactionally based,” which are prohibited, and payments that are not so based, which are permissible.

- iv. The purchasing settlement service provider must owe the fee regardless of the outcome.
- v. The payment for the customer list must be reasonable, which is a factual question.

## **G. Affiliated Business Arrangements**

### **1. Employee Issues that Arise in AfBAs**

#### **a. Part-Time/Shared Employees –**

- i. E.g., Title examiner works part-time for two affiliated title agencies. The examiner's time is divided evenly between the two entities, the title examiner provides all core title agent services for each entity and works in separate office space leased by each title agency. Each title agency pays 50% of the title examiner's salary and other related expenses and issues a W-2 directly to the examiner.
- ii. There is no prohibition, however, on the use of part-time employees and HUD has not articulated a position on who constitutes an "employee" under RESPA.
- iii. HUD will analyze whether the AfBA "borrows" employees from the joint venture partner.
- iii. Part-time/shared employment permissible,
  - assuming the employee is a *bona fide* W-2 employee of each AfBA, not an independent contractor, and
  - assuming all indicia of an employer-employee relationship are present (e.g., income and FICA taxes are withheld and paid as necessary, unemployment taxes are paid, annual W-2 forms are provided, the examiner devotes fixed periods of time exclusively to the business of each title agency on such agency's physical premises, and the title examiner is subject to each entity's supervision and control while working for that entity).
- iv. There is little formal guidance on the issue.

#### **c. Leased Employees –**

- i. E.g., AfBA title agency leases title agents from the title agent owner of the AfBA. Legally an employee of the owner, but effectively an employee of the AfBA.
- ii. Often arises when the reason for leasing the employee is to offer insurance benefits on par with employees of the owner and maximize efficiency of administrative services (accounting, tax, payroll)

- iii. Same concern arises – whether the AfBA is providing substantial services.
- iii. The leased employee must provide the services typically associated with the settlement service provider (i.e., “core title services” discussed below for a title agency)
- iv. HUD has indicated in informal conversations that if an entity meets all other AfBA requirements discussed in Section III.B, above, the leasing of employees for these reasons would not be a fatal flaw and generally would not result in an enforcement action.

## 2. Special Considerations for AfBA title agencies

- a. Core Title Services – AfBA title agencies must perform all core title services for which liability arises. These core title services include:
  - i. Evaluation of the title search to determine the insurability of the title
  - ii. The clearance of underwriting objections
  - iii. The actual issuance of the policy or policies on behalf the title insurance company
  - iv. Where customary, issuance of the title commitment, and
  - v. The conducting of the title search and closing.
    - HUD’s 1996 Policy Statement regarding AfBA title agencies indicates that the handling or the closing or settlement is a “core title agent service” when “it is customary for title insurance agents to provide such services and when the agent's compensation for such services is customarily part of the payment or retention from the insurer.” 61 Fed. Reg. at 49,399.

[24 C.F.R. § 3500.14(g)(3). See also See 61 Fed. Reg. 49,398 to 49,400]

- b. Liability – In considering liability, HUD will examine the following considerations: the AfBA title agency’s contract; whether the AfBA title agency has errors and omissions insurance or malpractice insurance; whether a contract provision regarding an agent's liability for a loss is ever

enforced; and whether an agent is financially viable to pay claims.

### 3. **Special Considerations for AfBA Mortgage Brokers**

Payments to mortgage brokers have been the subject of litigation in hundreds of cases nationwide. To clarify its position on payments to mortgage brokers, HUD issued Statement of Policy 99-1, 64 Fed. Reg. 10080 (March 1, 1999). This Policy Statement includes a two-part test for determining whether lender payments to mortgage brokers violate RESPA.

a. First, the broker must furnish actual goods (not including the loan itself) or facilities or perform actual services in return for the compensation. In order for a mortgage broker to perform compensable services, a mortgage broker must take the loan application and perform at least five of the following 13 additional items:

- (1) Analyzing the borrower's income and debt, and pre-qualifying the borrower to determine the maximum allowable mortgage.
- (2) Educating the borrower in the home buying and financing process, advising him or her about different types of available loan products, and demonstrating how closing costs and monthly payments differ for different products.
- (3) Collecting financial information (tax returns, bank statements) and other related documents.
- (4) Initiating and ordering Verifications of Employment and Deposit.
- (5) Initiating and ordering requests for mortgage and other loan verifications.
- (6) Initiating and ordering appraisals.
- (7) Initiating and ordering inspections or engineering reports.
- (8) Providing disclosures to the borrower.
- (9) Assisting the borrower in understanding and clearing credit problems.
- (10) Maintaining regular contact with the borrower, realtors, and lender between the time of application

and closing and gathering any additional information as needed.

- (11) Ordering legal documents.
  - (12) Determining whether the property was located in a flood zone or ordering such service.
  - (13) Participating in the loan closing.
- b. HUD will further analyze the payment if a mortgage broker merely takes the loan application and performs only counseling type-services, which would include:
- (1) Analyzing the borrower's income and debt, and pre-qualifying the borrower to determine the maximum allowable mortgage.
  - (2) Educating the borrower in the home buying and financing process, advising him or her about different types of available loan products, and demonstrating how closing costs and monthly payments differ for different products.
  - (3) Collecting financial information (tax returns, bank statements) and other related documents.
  - (4) Assisting the borrower in understanding and clearing credit problems.
  - (5) Maintaining regular contact with the borrower, realtors, and lender between the time of application and closing and gathering any additional information as needed.

If only these services are provided, HUD will analyze whether it is providing meaningful counseling, and not just steering. Meaningful counseling would exist if:

- (1) The entity furnishes the borrower an opportunity to consider products from at least three different lenders;
- (2) The entity receives the same compensation regardless of which lender's products are ultimately selected; and
- (3) Any payment for the counseling services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

- c. Second, the payments must be reasonably related to the value of the goods or facilities furnished or services performed.
  - (1) In applying this part of the test, HUD scrutinizes total compensation to the broker, including direct origination and other fees paid by the borrower as well as payments by the lender.
  - (2) The total compensation must be commensurate with that amount normally charged for similar services, goods, or facilities in similar transactions in similar markets.
- d. Payment should be disclosed on the HUD-1 Settlement Statement. See 12 U.S.C. § 2603(a); 24 C.F.R. Part 3500, Appendix A.

#### **4. Strategic Alliances for AfBAs Between Settlement Service Providers**

- a. Banks
  - i. Companies in position to refer settlement service business (i.e., lenders, builders, realtors) looking for alternative sources of income
  - ii. These companies want to take advantage of their unique position as the point of sale for title services
- b. Title Companies and Title Agencies

Realize that unless they partner with the companies that refer title business, they may be left behind

  - i. These companies will open up their own wholly owned subsidiaries
  - ii. Or partner with someone else