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How to Set Up a Compliant Joint Venture or MSA

American Land Title Association Webinar

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Introduction

Today's Topics:

- RESPA Refresher
- Section 8(c)(2) – Payments for Goods or Services
- Tips for Compliant Marketing Services Agreements
- Section 8(c)(4) – Affiliated Business Arrangements
- Tips for Compliant Affiliated Business Arrangements

Section 8 - Kickbacks and Fee Splits

- Most important and most controversial statute affecting settlement service industry
- Statute defies BUSINESS LOGIC
- Consequences for violating RESPA
 - Criminal penalties and fines
 - Treble damages
 - Loss of license, reputation

Section 8(a) – Anti-Kickback Provisions

1. **Idea:** Eliminate abusive practices such as payment of kickback fees that drive up cost of product to consumers
2. 5 Elements of a Section 8(a) kickback

Section 8(a) says it is illegal to Give or Receive any: (i) **thing of value** pursuant to (ii) **an agreement or understanding** to (iii) **refer** (iv) **settlement services**, in connection with (v) **a federally related mortgage loan**

Section 8(a) – Anti-Kickback Provisions

- i. **Federally Related Mortgage Loan** = Any loan secured by a first or subsequent lien on a 1 – 4 family residential property
 - Includes: Refinances, Purchase money mortgages, Second liens, ARMs, Reverse mortgages, Interest only mortgages
 - Excludes: Commercial loans, Construction loans, Temporary financing, Property over 25 acres, Business purpose loans, All cash transactions

Section 8(a) – Anti-Kickback Provisions

ii. **Settlement Services** = Anything done by Title Agents; Attorneys; Real Estate Agents; Mortgage Brokers; Lenders

- Title searches
- Credit reports / appraisals
- Origination of loans
- Title insurance, etc.
- Closing services
- Flood insurance
- Surveys
- Pest inspections
- Home warranties

Section 8(a) – Anti-Kickback Provisions

- iii. **Referral** = Conduct directed to a person that affirmatively influences the selection of a settlement service provider
- iv. **Agreement or Understanding** = Need not be in writing or even articulated or verbalized – may include a practice or course of action where the receipt of a THING OF VALUE is understood
 - Wink, wink

Section 8(a) – Anti-Kickback Provisions

v. **Thing of Value** = Broadly defined to be virtually anything one receives in consideration for making a referral

- \$
- Trips
- Scanners
- Free advertising
- Commissions
- Discounts
- Computer
- Football tickets
- Property
- Low interest loans
- iPad

IMPORTANT: ALL 5 ELEMENTS MUST BE PRESENT. ANY ONE MISSING: Not a violation of RESPA

Section 8(b) – Splitting of Unearned Fees

- No person shall give . . . No person shall accept a split or percentage in connection with a real estate settlement service **other than for services rendered**
- A referral is not required to violate Section 8(b)

Section 8(c) – Exceptions

- Congress recognized certain exceptions where paying a referral fee is ok
 - To an Attorney for services actually performed
 - By a Title Company to its duly appointed Title Agent for services performed in issuance of a title policy
 - By a Lender to its duly appointed Agent
 - Cooperative Agreements between listing and selling agents

Section 8(c) – Exceptions

- Congress recognized certain exceptions where paying a referral fee is ok (cont'd)
 - Payments by Employer to Employee
 - Section 8(c)(2) payments for services rendered or goods/facilities actually provided
 - Secondary Market Transactions
 - Section 8(c)(4) Affiliated Business Arrangements

Section 8(c)(2) – PHH Decision

- “Nothing in this section [Section 8] shall be construed as prohibiting...(2) 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 USC § 2607(c)(2)
- June 2015, former CFPB Director Cordray said:
 - 8(c)(2) not an exemption at all
 - Bona fide payments do not include payments tied to the referral of business

Section 8(c)(2) – PHH Decision

- October 2016, Circuit Court 3-Judge Panel said:
 - Statutory question in this case “not a close call”
 - Nothing means nothing
 - Bona fide payments means “reasonable market value”
 - Even if parties to transaction engage in referrals
 - Adopts HUD interpretation of statute
- January 2018, En Banc Circuit Court said:
 - “The panel opinion, insofar as it is related to the interpretation of RESPA... is accordingly reinstated as the decision of the three-judge panel on those questions.”

Section 8(c)(2) – Payment for Goods/Services

- Court Endorses HUD Established 2-part Test for Section 8(c)(2) Compliance

Part 1: Goods and Services

- Actual = real
- Necessary = useful, meaningful
- Distinct = not done elsewhere in transaction

Part 2: Reasonable Market Value

- Payment commensurate with value of services and goods
- Amount in excess of FMV considered a referral in violation Section 8(a)

Marketing Services Agreements

- What are MSAs?
 - Marketing agreements between settlement services providers, where one SSP pays another to advertise it to the other's customers
 - Typically, lender or title company pays real estate broker to advertise to broker's customers

CFPB Guidance on Strategic Alliances

- October 7, 2020 – CFPB rescinds Compliance Bulletin 2015-15, *RESPA Compliance and Marketing Services Agreements*
 - Issued under Director Cordray
 - Intended to “describe the substantial risks posed by entering into marketing services agreements (MSAs)”
 - Did not offer helpful guidance; mostly viewed as CFPB’s statement of suspicion
 - Many companies ended their MSAs after bulletin was issued
- Also on October 7, 2020 – CFPB issues RESPA Section 8 Frequently Asked Questions related to MSAs and other arrangements

Marketing Services Agreements

- CFPB effectively affirms that MSAs are permissible under RESPA as long as the agreements are carefully structured to meet the requirements of Section 8(c)(2)
 - CFPB warns that whether a particular MSA violates Section 8 will depend on specific facts and circumstances
- FAQ reinforces Section 8(c)(2) requirements:
 - A lawful MSA involves marketing services that are “actual, necessary, and distinct” (and not nominal) from the primary services performed by the person
 - Payments under the MSA must be reasonably related to the value of the services actually performed and not be a duplicative charge or a fee for referrals

Marketing Services Agreements (cont'd)

- FAQs note distinctions between referrals and marketing services for purposes of RESPA
 - Example of a referral includes “directly handing clients the contact information of another settlement service provider that happens to result in the client using that other settlement service provider”
 - Example of marketing service includes placing advertisements for a settlement service provider in “widely circulated media (e.g., newspaper, a trade publication, or a website)”
 - Marketing services are not directed to a person and are generally targeted at a wide audience

Marketing Services Agreements (cont'd)

- FAQs highlight those MSAs that would be *prohibited*:
 - MSAs that provide for payments based on the number of referrals received
 - MSAs that include above-market-rate payments for marketing services
 - MSAs that involve payment for nominal services or services not actually rendered
 - MSAs that are designed or implemented in a way to disguise the payment for kickbacks or split charges are prohibited

Marketing Services Agreements (cont'd)

- General considerations when structuring MSAs:
 - Comply with the Section 8(c)(2) 2-part test
 - Consider whether a business purpose exists for the agreement
 - Cushion between amount paid and fair market value
 - Anything in excess of fair market value is considered a referral fee
 - Consider whether the agreement is similar to conduct that is the subject of CFPB enforcement actions

Marketing Services Agreements (cont'd)

- Some Do's and Don'ts
 1. No exclusive arrangements
 2. No endorsements
 - No referral to "preferred" providers
 3. No pressure on agents to steer business
 4. No quid pro quo arrangements
 5. Don't use capture rates and ROI to value marketing effectiveness in discussions between the parties

Marketing Services Agreements (cont'd)

- Some Do's and Don'ts (cont'd)
 6. Independent third party valuation a must
 7. Trust but verify
 8. All advertisements directed to general public, not individual consumers or agents
 - banner ads
 - brochures
 - signage
 - rider signs
 9. Justify reasons for adjusting monthly fees
 10. Disclosure to consumer encouraged

Co-Advertising

- What is Co-Advertising and Does it Differ from MSAs?
 1. Joint advertising of two settlement service providers
 - Title agent and real estate broker co-market
 - Newspaper, television, radio, Internet ads, joint mailers, etc.
 2. HUD guidance (FAQ #18)
 - Payment based upon prominence
 - No endorsement of title agent by real estate broker/agent
 3. Include co-advertising in MSAs?

Section 8(c)(4) – Affiliated Business Arrangements

- AfBAs
 - Prior to 1983 affiliations unlawful
 - Example: ABC Title Agency
 - Real estate broker A and B, and Title agent C form ABC Title Agency
 - 1983 RESPA amendments
 - 3-part Safe Harbor Test

Section 8(c)(4) – Affiliated Business Arrangements (cont'd)

- Settlement Service Providers Abuse Arrangements
 - Little or no capital
 - Contract out work
 - Split Dividends

Section 8(c)(4) – Affiliated Business Arrangements (cont'd)

- 1996 HUD Policy Statement
 - HUD addresses abuses
 - 10 factors considered to determine bona fide AfBAs
 - Need not meet all 10 factors
 - Weigh factors to determine if AfBA is bona fide
- CFPB has not formally adopted Policy Statement
 - Informal adoption through enforcement
- *Carter v. Welles-Bowen Realty* (Nov. 2013)
 - 6th Circuit states include Kentucky, Michigan, Ohio, Tennessee
 - Policy Statement not entitled to deference

Section 8(c)(4) - Affiliated Business Arrangements (cont'd)

- 3-part Statutory Safe Harbor Test
 - Disclosure to consumer on separate sheet of paper identifying affiliate relationship, no required use, and estimate of AfBA's charges
 - No required use
 - Returns based strictly on ownership interest
 - No payments based on volume of business
 - Can pay for services performed

Section 8(c)(4) - Affiliated Business Arrangements (cont'd)

- HUD 10-point test
 - 10-point test includes factors regulators weigh to evaluate whether AfBA is a bona fide entity
 - Capitalization
 - Dedicated employees
 - Separate office space
 - Core services
 - Management
 - Contracting out services
 - Marketing
 - Exclusivity with owners

Section 8(c)(4) - Affiliated Business Arrangements (cont'd)

Both HUD and CFPB settlement agreements or consent orders have targeted “sham” AfBAs

- Owners received distributions based on referrals
- Affiliated entity was not sufficiently capitalized
- Affiliated entity had no employees or leased employees from the AfBA owner
- Affiliated entity did not have separate office space
- Affiliated entity did not perform substantive work
- Owner failed to provide AfBA disclosure statements or used non-compliant forms
- Owner required the use of the affiliate by including checkboxes in pre-printed forms

Section 8(c)(4) - Affiliated Business Arrangements (cont'd)

- Considerations for compliant AfBAs
 - Disclosure in all cases of a referral
 - Closing cost incentives ok (Don't forget to consider state law implications)
 - Distributions strictly according to ownership interest
 - Invest initial capital sufficient to operate business
 - Dedicated employees working from AfBA's office space
 - Employees perform core services
 - Adding/removing members
 - Cannot be based on referrals
 - How to handle owners with low referral volume

State Law Considerations

- RESPA is not your only consideration. Even if an arrangement complies with RESPA, it must also comply with state law.
- State title insurance anti-inducement laws run the gamut from permissive to restrictive on marketing-related activities.
- Controlled business restrictions exist related to affiliated business arrangements

Questions?



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