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To JV or Not to JV: That is the Question

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AGENDA

- The Problem to be Addressed: Sham JVs
- Unintended Consequences: RESPA-Compliant JVs
- Laws to Consider
  - RESPA
  - State Laws
  - The CFPA
- Questions

The Problem: Sham JV Title Companies

- A title company recruits real-estate agents to “invest” in a new JV title company.
- Agents contribute nominal amounts in exchange for promises of profit distributions that are unrealistically high given the agents’ investments.
- Agents refer their customers to the JV for title services. But the JV is a sham; it doesn’t have its own employees; it doesn’t market for business; it exists entirely to receive business referrals and to distribute profits to its parent title company and agent-investors.
- Consumers don’t shop and therefore pay more for title services.

RESPA

- RESPA prohibits giving or accepting things of value for business referrals.
- BUT! There is an exception for "**affiliated business arrangements**."
  - The arrangement must be disclosed to the consumer before the referral.
  - Consumers must not be required to use any particular provider.
  - The only "thing of value" the referring party may receive is a return on their investment that is commensurate with their ownership share.
- So if the agent discloses the arrangement, doesn't require use of the JV, and receives compensation only in the form of the JV's profit distributions, **isn't the arrangement legal**?

RESPA VIOLATION

- The arrangement violates the third requirement for affiliated-business arrangements: that the referring party receive only its profits distributions.
  - Regulation X defines "thing of value" to include "discounts," "the opportunity to participate in a money-making program," and "increased equity in a parent or subsidiary entity." 12 C.F.R. § 1024.14(d).
  - So when agents get to invest in a JV by contributing little capital in exchange for a significant return, they are receiving a "thing of value" that is different from what is permitted under the exception for affiliated-business arrangements: "a return on the ownership interest."
  - Stripped of the exception, the arrangement now violates RESPA's general prohibition on kickbacks.

STATE LAWS

- RESPA is a federal law, so why are we looking at state laws?

RESPA "does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Bureau is authorized to determine whether such inconsistencies exist. The Bureau may not determine that any State law is inconsistent with any provision of this chapter if the Bureau determines that such law gives greater protection to the consumer.

12 U.S.C. § 2616.

STATE LAWS

- **D.C. Code** § 31-5031.15.

"A title insurer or other person shall not give or receive, directly or indirectly, any consideration for the referral of title insurance business or escrow or other service provided by a title insurer."

STATE LAWS

- **Ariz. Rev. Stat.** § 20-1585.

"no title insurance agent shall pay or give to any . . . agent . . . of the prospective owner . . . of the real property[,] either directly or indirectly, any commission or any part of its fees or charges including, but not limited to, fees for escrow services performed by a title insurer or title insurance agent, or any other consideration or valuable thing, as an inducement for, or as compensation for, any title insurance business."

STATE LAWS

What about RESPA-compliant JVs?

- They seem to get caught in the crossfire of these state laws.
- States could exercise their discretion in how they enforce their more restrictive state laws.

The Consumer Financial Protection Act (CFPA)

Normally, the CFPA wouldn’t apply to real-estate agents.

- They are not “covered persons.”
  - They do not offer consumer-financial products or services.
- There is an exemption for real-estate agents.
  - § 1027(b) of the CFPA prohibits the Bureau from exercising “any rulemaking, supervisory, enforcement, or other authority . . . with respect to a . . . real estate agent,” unless the agent is “engaged in an activity of offering or providing any consumer financial product or service.”

The Consumer Financial Protection Act (CFPA)

But when they participate in JVs, the CFPA applies.

- The agents become “related persons” and are thus deemed to be “covered persons.” 12 U.S.C. § 5481(25)(B)&(C)
- As “covered persons,” the agents are then subject to the CFPA’s prohibition on “abusive” conduct.

The Consumer Financial Protection Act (CFPA)

What is abusive conduct?

- The CFPA defines abusiveness to include taking unreasonable advantage of "the reasonable reliance by the consumer on a covered person to act in the interests of the consumer." 12 U.S.C. § 5531(d)(2)(C).
- In this context, it's a breach of trust.

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Possible violations by agents:

- biased steering.
- the closing agent lacks neutrality.
  - What about the disclosure?
  - How can it be illegal under the CFPA when it is legal under RESPA?

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Why should a title company care that an agent might be violating the CFPA?

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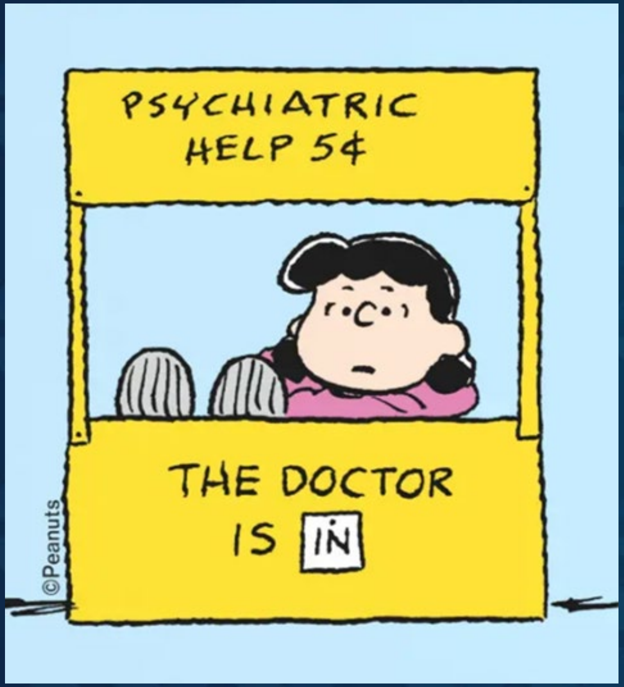
Why should a title company care that an agent might be violating the CFPA?

Substantial Assistance:

"It shall be unlawful for . . . any person to knowingly or recklessly provide substantial assistance to a covered person . . . in violation of the provisions of section 5531 . . . . [T]he provider of such substantial assistance shall be deemed to be in violation of that section to the same extent as the person to whom such assistance is provided."

12 U.S.C. 5536(a)(3).



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