

CFPB Suffers Setback Enforcing RESPA's Anti-Kickback Provisions

The Consumer Financial Protection Bureau (“CFPB”) recently suffered a setback in its attempt to enforce the anti-kickback provisions of the Real Estate Settlement Procedures Act (“RESPA”) against Borders & Borders, PLC, a Kentucky law firm that provides residential real estate closing services. Despite the CFPB’s setback, those who refer residential settlement services between affiliates should remain cautious and avoid reading too much into the CFPB’s loss.

Section 8(a) of RESPA prohibits giving or accepting any “fee, kickback, or thing of value” in exchange for the referral of real estate settlement services such as title searches, surveys, appraisals, etc. An exemption exists under section 8(c)(4) for affiliated business arrangements (“AfBAs”) where a person referring a settlement service “has either an affiliate relationship with or a direct or beneficial ownership interest of more than one percent in” the business receiving the referral. To qualify for this exemption, an AfBA must meet the following conditions: (1) the person making the referral must disclose the arrangement to the client; (2) the client must remain free to reject the referral; and (3) the person making the referral cannot receive any thing of value from the arrangement other than a return on the ownership interest or affiliate relationship.

The Borders & Borders case began in 2011 with an investigation into the law firm’s potential violations of RESPA section 8(a)’s anti-kickback provision due to its affiliation with nine title insurance agencies. The investigation revealed that the law firm partners had 50% ownership interests in each title insurance agency, that the law firm provided written disclosure of its relationships to the title agencies at closing, and that all nine title insurance agencies were staffed by a single agent working as an independent contractor from a home office.

After Borders & Borders refused to settle, the CFPB filed a lawsuit in the United States District Court for the Western District of Kentucky alleging that the law firm partners’ receipt of income distributions from the title insurance agencies constituted a fee, kickback, or thing of value in violation of RESPA Section 8(a). The CFPB further alleged that the income distributions were not subject to Section 8(c)’s AfBA exemption because the title insurance agencies were not *bona fide* providers of settlement services. In other words, the CFPB viewed the title insurance agencies as sham entities set up to disguise referral fees through income distributions.

The federal district court disagreed, relying on the Sixth Circuit Court of Appeal’s decision in Carter v. Welles-Bowen Realty, Inc. In Carter, the Sixth Circuit identified the above-described three conditions for the AfBA exemption based on a plain reading of RESPA section 8(c)(4). The Sixth Circuit declined to adopt a fourth condition, based on a 1996 HUD policy statement, that the affiliate receiving the referral must be a *bona fide* provider of settlement services. HUD’s 1996 policy statement stemmed from its recognition that the AfBA exemption could be used to disguise referral fees through the creation of sham entities. In its statement, HUD listed ten factors that help distinguish a *bona fide* provider of settlement services from a sham entity created to disguise referral fees.

Several HUD factors could have impacted the Borders & Borders case if they had been applied, including: (1) whether the affiliate has its own employees or office space; (2) whether the affiliate performs services itself or relies on independent contractors; and (3) whether the affiliate competes for business from settlement service providers other than the provider that created the affiliate.

It would be unwise for settlement service providers to disregard the HUD factors (available at <https://www.gpo.gov/fdsys/pkg/FR-1996-06-07/pdf/96-14331.pdf>) based on the Sixth Circuit's decision in Carter and the Borders & Borders case. First, no other United States Court of Appeals has endorsed or followed the Sixth Circuit's refusal to consider the HUD factors. Second, neither the Supreme Court of Virginia, nor any federal district court sitting in Virginia, nor the Fourth Circuit Court of Appeals has addressed the issue of eligibility for the AfBA exemption under RESPA section 8(c). Settlement service providers that refer business between affiliates cannot predict how these courts might approach the issue.

Finally, it is worth pointing out an unsettling contrast between the Borders & Borders case and the highly publicized PHH case in which the DC Court of Appeals recently held a rehearing *en banc* (before the entire DC Court of Appeals). In the PHH case, PHH, along with various mortgage industry representatives (through amicus briefing), have argued persuasively that the CFPB unlawfully ignored prior HUD guidance regarding the legality of captive reinsurance arrangements under RESPA section 8(c). In the Borders & Borders case, however, prior HUD guidance received no consideration owing to the Sixth Circuit's decision in Carter. It goes without saying that prior HUD guidance cannot matter only when it is convenient.

For now, settlement service providers should avoid relying too much on the Borders & Borders decision to disregard the HUD *bona fide* entity guidance. Unfortunately, in the near-term, this case may create an un-level playing field by emboldening some settlement industry participants to unfairly compete using sham entities to pay for referrals, while other participants (such as banks that are subject to strict regulatory examinations) take a more cautious approach and continue to abide by the HUD guidance. Stay tuned. Undoubtedly, there will be more regulatory and judicial proceedings and interpretations to resolve the uncertainties created by this case.

For more information about the RESPA section 8 and the Borders & Borders case, contact Mel Tull, VBA General Counsel, at mtull@vabankers.org or (804) 819-4710.

This article has been prepared for informational purposes only and is not legal advice.