CHAPTER

05 RESPA COMPLIANCE

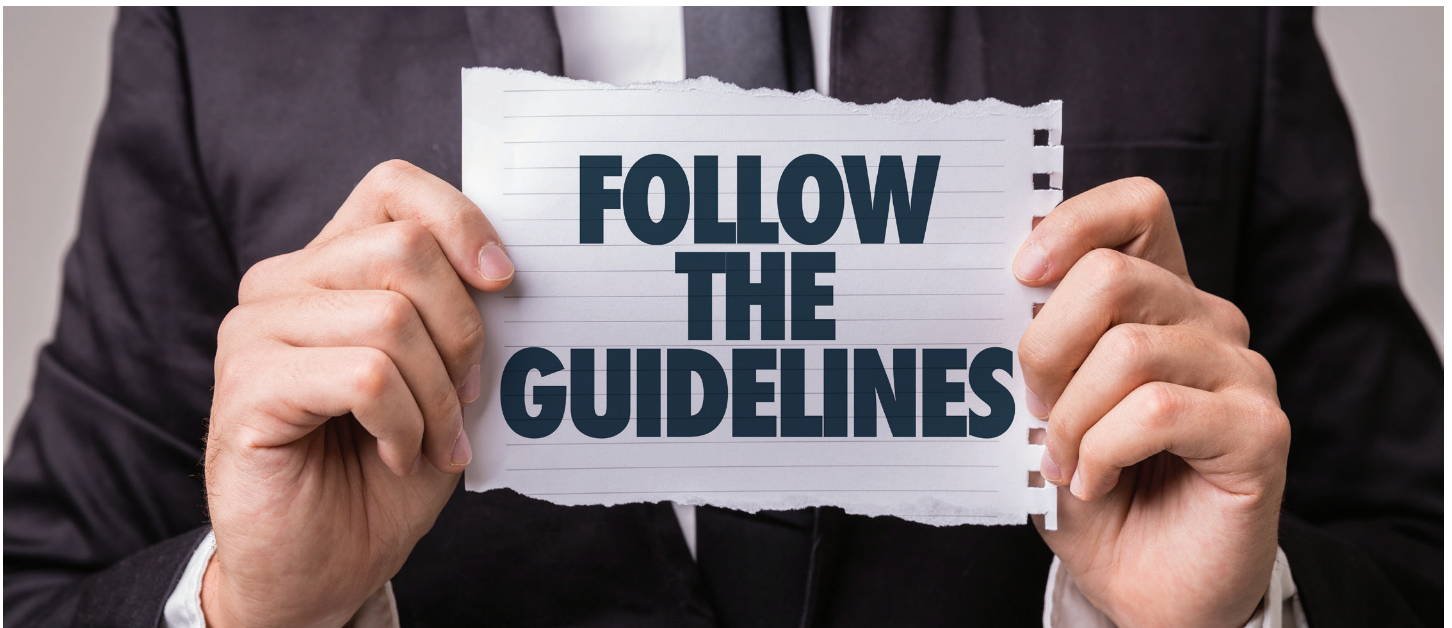
Learning Objectives

After this chapter, you will be able to

→ Identify what is allowable and not allowable to be paid by title companies for a broker or agent under the Texas Dept. of Insurance's Rule P-53.

→ Discuss the issues surrounding Marketing Service Agreements between title companies and brokers that have led to increased scrutiny from the CFPB.

→ Be familiar with TREC Rule §535.148 that addresses consumer protection issues involving settlement service providers.



RESPA – Real Estate Settlement Procedures Act . . . and related rules affecting relationships with title companies and title agents.

The Real Estate Settlement Procedures Act (12 U.S.C. 2601 et seq.) was enacted by Congress in 1974. Regulation X (12 C.F.R. Part 1024), which implements the act (the act and Regulation X collectively referred to herein as "RESPA"), states: "No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. A company may not pay another company or employees of the other company for the referral of settlement service business."

Settlement services are generally those services provided in connection with purchasing property, such as title insurance and settlement, real estate brokerage, mortgage lending, appraisals, home inspections, surveys, casualty insurance and home warranties.

Rule P-53

Because RESPA's prohibition on providing a "thing of value" in exchange for referral of business is somewhat vague, the Texas Department of Insurance promulgated Procedural Rule P-53 ("P-53") to help define "thing of value" for the Texas title industry. Under that rule, title companies are prohibited from paying, contributing or sharing in the cost of any part of the business expenses of a real estate broker or agent. The rule defines "business expenses" to mean any cost to operate or promote

the business of the broker or agent, and specifically prohibits a title company from contributing or paying any part of the costs of: open houses held by brokers or agents; providing prizes, food, beverages, gifts, decorations, entertainment or professional services given at open houses; and parties or receptions which promote an agent or broker, amongst other examples of real estate broker and agent "business expenses."

P-53 does, however, specifically allow a title company to pay for advertising and promotional opportunities, as long as the payment is at market rates for the advertising and not conditioned on the referral of business. That means a title company can pay to advertise or promote itself at an event of an agent or broker, as long as the payment is at market rate and the title company does in fact promote itself at the event. If the payment is above market rate or the title company does not show up to promote itself, it is more likely that the payment would be viewed as pretense for providing "thing of value" exchange for referral of business.

However, the specific prohibition against paying or contributing anything towards an open house or other event just promoting the properties and activities of the real estate broker or agent controls, irrespective of the advertising opportunity. P-53 requires that a title company or title agent keep auditable records supporting compliance with the rule. Failing to comply with the rule can subject the violators to steep civil penalties, in addition to the civil and criminal penalties that may be imposed by RESPA.

RESPA itself also emphasizes the need for payments for a "thing of value" to reflect market value, stating, "If 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. These facts may be used as evidence of a violation of [RESPA]." (12 C.F.R. §1024.14(g)(2)).

Marketing Service Agreements

Marketing service agreements ("MSAs") between real estate brokers and title companies have commonly been used to establish and define the terms under which the title company may promote and advertise itself through the broker. However, in recent years, MSAs have come under increasing scrutiny from the Consumer Financial Protection Bureau ("CFPB"), the federal agency responsible for enforcing RESPA. The reasons are numerous, including but not limited to:

1) the fee amounts vary widely and are not usually directly related to the amount of advertising or promotional benefit to be received by the title company, making it hard to prove market value;
2) fees paid are above and beyond what would reasonably be required for a title company to participate in a particular event to promote itself; and
3) unless the title company or title agent can provide evidence that its marketing materials are continuously displayed, and that it promotes itself at each event, it is not in compliance with the rule.

Under CFPB Consent Order 2014-CFPB-0015, Lighthouse Title Inc. was ordered to pay a $200,000.00 civil penalty for violation of RESPA's anti-kickback provisions. CFPB found that, among other things, Lighthouse did not determine a fair market value for the services it allegedly received under numerous MSAs; it did not diligently monitor its brokers to ensure that it received the services for which it contracted; it believed that if it did not enter the MSAs that the brokers would refer their business to other companies; and the brokers referred significantly more transactions to Lighthouse when they had an MSA as compared to when they didn't. The latter is what was intended, since the purpose of "advertising" and "marketing" a business is to get more business, and yet the CFPB cited this as evidence of a violation!

MSAs may cause additional issues when the service provider, e.g. an inspector, is "ranked" on a real estate broker's website or other advertising materials based on amount paid for the advertising. That ranking may mislead the public into believing the ranking is based on quality of service provided by the service provider. For example, if a broker's website ranks service providers as platinum, gold or silver simply based on the amount paid for the MSA, such may imply that the ranking is based on quality or relative value to the consumer. The Texas Real Estate Act prohibits misleading or deceiving advertisements (Texas Occupations Code §1101.652(b)), and under Texas Real Estate Commission ("TREC") Rule §535.155(d)(19), an advertisement may be misleading if it contains a claim to a special or relative quality standard unless it includes a disclosure of the objective criteria upon which the claim is based. Ranking solely based on amount of payment may be misleading advertising.

RESPA does allow the splitting of charges made or received for rendering a settlement service involving a federally related mortgage provided it is for services actually rendered, and the fee is paid whether the transaction is completed or not. The services rendered must be actual, necessary and distinct from services already provided. If the payment to the real estate agent or broker exceeds market value for such services, the excess is considered a kickback violating RESPA. Nominal services or services which must be duplicated by the service provider are not actual, necessary or distinct.

TREC recently revised Rule §535.148 to provide clarity about consumer protection issues when paying or receiving funds to/from other settlement service providers, to detail who is considered a settlement service provider that mostly parallels the definition in RESPA, and what activity is not prohibited.

See Appendix A for TREC Rule §535.148 (d)(e) and (h)

In addition to RESPA compliance issues, it is important to remember that if a real estate broker or agent receives a payment from a service provider for actual, necessary and distinct services rendered, the broker or agent must disclose to and obtain the consent of the party to whom the service is rendered (see TREC Rule §535.148(b)). Additionally, the client of the broker or agent receiving the compensation must consent to the payment, whether or not the client is the recipient of the service (see TREC Rule §535.148(a)).

See Appendix B for the article "RESPA Do's and Don'ts for Co-Marketing, Social Media, & Other Web-Based Marketing Tools" from the National Association of Realtors.

Case Summary

Investor Class Action Lawsuit Against Zillow Gains Traction in Amended Complaint

Investors claim that Zillow's "co-marketing program" was designed to allow participating real estate agents to refer mortgage business to participating lenders in violation of RESPA.

The lawsuit, which had previously been dismissed for lack of specificity, gained legs, when a judge declared that the amended complaint contains enough particularized facts to support a claim that Zillow maintained an arrangement, in which lenders paid for a portion of agents' advertising costs in return for mortgage referrals that violated RESPA. The case is still in the early stages—this ruling simply means that the case will likely be heard on its merits after Zillow's motion to dismiss was denied.

Based on facts alleged in the suit, "the Court can draw a reasonable inference that Zillow designed the co-marketing program to allow agents to provide referrals to lenders in violation of RESPA, and that such referrals were occurring." The allegations claim that there was "an understanding between Zillow and the co-marketing participants, that in exchange for lenders paying a portion of agents' advertising costs, lenders would receive mortgage referrals from their partnering agents." That arrangement was not documented, but "evidenced by participating agents allegedly providing, and Zillow allegedly tracking, referrals to participating lenders."

In Zillow's co-marketing scheme, vendors pay a portion of a real estate agent's advertising costs on Zillow in exchange for appearing on an agent's online listings. These lenders appear on the agent's listings as "preferred lenders," and are sent the lead when Zillow users provide an agent with their contact information. While the judge originally declared these costs to be protected under RESPA's safe harbor provision, the additional information provided in the amended complaint made a difference. These preferred lenders were paying, according to the complaint, "more than fair market value for the advertising they received and therefore fell outside RESPA's safe harbor provision."

Discussion Scenarios

Break into three groups with each group assigned a different scenario. Each group will answer the discussion questions below and report back to the class.

Scenario A

A brokerage has established a tiered Vendor Sponsorship program. The more a vendor pays for sponsorship, the more face-to-face access time will be given to the sales agents for that office. Sponsorship would be limited to only three of each type of vendors (this includes home inspectors, title companies and lenders). Sponsorship benefits are advertised by the brokerage as a limited number of your vendor type to compete against for agent referrals. Sponsoring vendors would appear on the brokerage's preferred vendor list and promoted throughout the office; only sponsoring vendors may leave marketing materials for distribution to agents; permitted to sponsor a team meeting by providing breakfast or lunch; almost exclusive interaction with agents at that office. Sponsorship fees can range from $1100.00 - $2500.00 per month. The more you pay, the higher your tier and the more personal access time you will be given to the brokerage agents.

Scenario B

A brokerage has a program where three home inspectors pay a monthly fee to contribute to the cost of marketing software purchased by the broker for the benefit of the broker and sponsored agents. Only three inspectors will be used to help cover the cost and will appear on a preferred inspectors list that will be provided to all agents at that office. The preferred inspectors would also appear on the marketing software portal. The only qualifications for selecting which home inspectors would participate is based upon which ones are willing to put up the funds.

Scenario C

A brokerage rents office space within the real estate office to a mortgage broker.

DISCUSSION

1. Does this program violate RESPA? What about TREC Rule §535.148 or TREC Advertising Rule §535.155?
2. What factors may be important in determining whether it violates RESPA or TREC Rules?
3. Is this program in the best interest of the broker's client (read fiduciary duty here)?