2016 CLM Annual Conference
April 6-8, 2016
Orlando, FL

"Here Comes the CFPB – Will Professional Liability Be Changed Forever?"

1. Who/What is the Consumer Financial Protection Bureau?

The CFPB is an independent agency of the United States government responsible for consumer protection in the financial sector. In 2010, the Dodd–Frank Wall Street Reform and Consumer Protection Act created the CFPB as a response to the financial crisis of 2007–08 and the subsequent Great Recession.

The CFPB has authority to:

- Write rules, supervise companies, and enforce federal consumer financial protection laws
- Restrict unfair, deceptive, or abusive acts or practices
- Take consumer complaints
- Promote financial education
- Research consumer behavior
- Monitor financial markets for new risks to consumers
- Enforce laws that outlaw discrimination and other unfair treatment in consumer finance

Also included is regulatory authority over Regulation X – Real Estate Settlement Procedures Act (RESPA).

Of note, the CFPB is one of only two Federal agencies that has NO Congressional oversight – the other being the Central Intelligence Agency.

Also, of note, the CFPB boast a 100% success rate in its enforcement actions. This is in part because most respondents do not contest the CFPB's enforcement actions and enter into Consent Orders agreeing to the penalties sought by the CFPB.

2. How Does RESPA impact Professional Liability Defense?

Section 8 of RESPA: kickbacks, fee-splitting, unearned fees

Section 8 of RESPA prohibits anyone from giving or accepting a fee, kickback or **anything of value** in exchange for referrals of settlement service business involving a federally related

mortgage loan. Simply put, fees, or something of "value", cannot be exchanged for the referral of business. In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed

Significantly, RESPA has been in place since 1974 and, hence, RESPA violations have been actionable for over four decades. Yet, because the U.S. Department of Housing and Urban Development was charged with RESPA compliance and had limited resources, enforcement has been sparse. That will and has changed with the CFPB.

3. Which Professionals will RESPA enforcement impact?

The key inquiry here is assessing settlement services and who are **settlement service providers** under RESPA? Settlement service providers are those entities/individuals who assist in the loan settlement process and/or have "piece" of it. Specifically, **lenders, title and escrow companies, appraisers, inspectors, home warranty companies, home insurers and even attorneys.**

4. What are "kickbacks" under RESPA?

Marketing Service Agreements. Within CFPB's enforcement realm, and increasingly wrapped-up in it, are Marketing Service Agreements (MSAs) entered into and between settlement service providers. In fact, many of the recent enforcement decisions from the CFPB relate to MSAs and RESPA violations that arose out of them. In turn, a number of settlement service providers are taking the position that they cannot or will not enter into MSAs any longer.

By way of background, an MSA is an agreement where one provider seeks to advertise its services to another provider. For example, a lender may want to explore a relationship a with a real estate brokerage. They enter into a MSA wherein the lender will pay a fee directly to the brokerage for access to the brokerage's agents (attending weekly meetings, providing literature and hand-out at events, having a presence at brokerage offices, etc.) It is truly an agreement wherein one provider pays to market its services to another.

Given CFPB and RESPA's prohibition on "kickbacks", this begs the question: Are MSAs prohibited under RESPA?

Answer: No. However, to be clear, the CFPB is scrutinizing the MSAs and we are in the early stage of CFPB enforcement and regulation. But, as of today, no reported CFPB decision has outright prohibited the use of MSAs. Further, industry partners have concluded that, assuming the MSAs - and the providers contracting through the MSAs - follow certain guidelines, the MSA's should be compliant and not violate RESPA.

To be compliant, at minimum, the MSA's and the arrangement between providers need to include and honor the following:

A. The agreement between the settlement service providers should not be exclusive. The providers should have the right to work with other providers and partners and allow those providers and partners marketing access.

B. Again, MSA's contemplate one provider paying to another provider a fee for the opportunity to market its services. The fee being paid must be "fair market value" for the opportunity being presented.

C. The parties to the MSA must be able to track and show what "fair market value" is for the opportunity. Settlement service providers could achieve this in a number of ways, such as engaging a third party to analyze proposed services and provide an independent opinion as to fair market value or by using various internal and external data points and cost analysis to arrive at fair market value. If the settlement service provider opts to use a third party to provide a valuation, presumably that company will provide a report summarizing its analysis to document the settlement service provider's determination of fair market value. Similarly, if a settlement service provider opts to calculate and arrive at fair market value using its own resources, it should consider documenting how it determined that its marketing fees represent fair market value. Regardless of the method used, RESPA does not permit that analysis to be based on referrals of settlement service business or on an analysis of what competitors might be willing to pay under a services agreement.

D. The providers should monitor the performance of the parties to the MSA to ensure the services for which compensation is being paid are actually being performed. Arguably, this could be accomplished through certain periodic reporting requirements incorporated into the agreement that affirmatively obligate the service provider to document and report the services performed. In addition, the MSA could require an audit that incorporates recordkeeping and verification of the number and types of services actually performed.

E. The compensation in the MSA cannot be based on the volume of business, but rather on the value of the services provided by the real estate professional.

Joint Ventures. With MSA's coming under increasing scrutiny, some settlement service providers are entering into Joint Ventures to continue the business relationship. The assertion is that they are co-owners of a business that provides settlement services and, thus, they can share in the revenue. For instance, a common Joint Venture is between an escrow company and a real estate brokerage. Meaning, these entities will come together and form an LLC or the like in which the brokerage will then refer its clients (buyers and sellers of real estate) to the LLC for it to provide escrow related services. The brokerage and escrow company will then share in the LLC revenues as joint owners.

If these relationships are legal and in RESPA compliance, they will only be so if the LLC is a legitimate and independent business. In other words, the LLC must be an actual escrow business – with its own office, own employees, own bank accounts, etc. It cannot simply be an arm or shell for the escrow company that is the part owner. In other words, referrals to the LLC cannot be passed through to the original escrow company to provide those services.

Co-Marketing amongst settlement service providers (in general). Settlement service providers co-market. They always have. For example, lenders routinely offered to assist title companies, real estate agents, inspectors, warranty companies in marketing their services to the

public. In doing so, they would historically pay for the cost of the marketing materials. That is a RESPA violation. If the joint marketing includes information (logos for instance) of both providers and the providers pay their Pro-rata share for the piece (e.g. if 75% of the piece markets title and 25% the lender), then it will be RESPA compliant.

Event Tickets, Meals and Entertainment. Marketing 101, get to know your referral partners. An effective means of marketing has always been taking a potential referral source to lunch, to a game or event. Happens all the time and across industries. Can those tickets be considered something of value to trigger a RESPA violation? Well, it is almost certainly a RESPA violation if a one provider accepts tickets or the like from another provider - and that provider does not join the licensee at the event. If they go together, then it could be argued that there is value being exchanged – e.g. an opportunity to market and grow the relationship.

3. What are the penalties for a violation The CFPB, through an administrative enforcement action, can levy fines of **$5,000** to **$1,000,000** per violation.

4. Examples of Enforcement Actions.

Lighthouse Title. The CFPB fined Lighthouse Tile $200,000, alleging that the title insurance agency offered kickbacks to real estate agents and brokers in exchange for client referrals.

According to the CFPB, Lighthouse Title, a Michigan-based title insurance agency, would enter into marketing services agreements with various companies, including real estate brokers, with the understanding that the companies would then funnel mortgage closings and title insurance business to Lighthouse.

“The agreements made it appear as if the payments would be based on marketing services the companies were supposed to provide to Lighthouse,” the CFPB said in a release.

“However, Lighthouse actually set the fees it would pay under the marketing services agreements, in part, by considering the number of referrals it received or expected to receive from each company. The CFPB’s investigation found that the companies on average referred significantly more business to Lighthouse when they had marketing services agreements than when they did not.”

Wells Fargo, JPMorgan Chase and Genuine Title. The CFPB went after each of these entities in one effort. In its press release, the CFPB noted the following:

“Today we took action against two of the nation’s largest banks, Wells Fargo and JPMorgan Chase, for illegal mortgage kickbacks,” said CFPB Director Richard Cordray. “These banks allowed their loan officers to focus on their own illegal financial gain rather than on treating consumers fairly. Our action today to address these practices should serve as a warning for all those in the mortgage market.”

“Homeowners were steered toward this title company, not because they were the best or most affordable, but because they were providing kickbacks to loan officers who referred consumers

to them," said Maryland Attorney General Brian Frosh. "This type of quid pro quo arrangement is illegal, and it's unfair to other businesses that play by the rules."

Genuine Title was a Maryland-based title company that offered real-estate-closing services from 2005 until it went out of business in April 2014. As part of the marketing-services-kickback scheme, Genuine Title offered loan officers valuable services to increase the amount of loan business generated. Genuine Title conducted this scheme at several financial institutions. The services the company offered included purchasing, analyzing, and providing data on consumers and creating letters with the banks' logos that the company had printed, folded, stuffed into envelopes, and mailed. In return, the banks' loan officers would increase Genuine Title's profits by referring homebuyers to the company for closing services. This scheme was especially profitable for the loan officers, who generally are paid by commission.

The marketing-services-kickback scheme violated RESPA.

Wells Fargo

The CFPB's investigation identified more than 100 Wells Fargo loan officers in at least 18 branches, largely in Maryland and Virginia, who participated in this scheme. The Bureau alleged that these loan officers referred thousands of loans to Genuine Title over the course of the scheme. The Bureau also alleged that, despite the fact that Wells Fargo had multiple warnings of the illegal arrangements between its loan officers and Genuine Title – including a federal lawsuit explicitly alleging the existence of such agreements – the bank failed to take action to stop the practices and did not have an adequate system in place to identify these violations.

JPMorgan Chase

The CFPB also found that loan officers at JPMorgan Chase participated in the marketing-services-kickback scheme with Genuine Title. The Bureau alleged that at least six Chase loan officers in three different branches in Maryland, Virginia, and New York were involved. These officers referred settlement business to Genuine Title on almost 200 loans. The Bureau also alleged that Chase did not have an adequate system in place to ensure that its loan officers were following the law.

CFPB vs. Borders & Borders. In 2013, the CFPB filed a civil federal lawsuit against the Louisville, Kentucky law firm Borders & Borders, PLC, and its principals, Harry Borders, John Borders, Jr., and J. David Borders. The CFPB alleged that they violated RESPA by operating a network of affiliated companies to pay kickbacks for referrals of mortgage settlement business.

According to the CFPB's complaint, Borders & Borders operated nine joint ventures with the owners and managers of local real estate and mortgage broker companies, and allegedly used the joint ownership to disguise illegal kickbacks as legitimate profit sharing.

The complaint alleges that when a local real estate or mortgage broker company with a preexisting arrangement referred a homebuyer to Borders & Borders for closing or other settlement services, the law firm would arrange for the title insurance to be issued by the corresponding joint venture. The profits from the joint venture would then be split between the joint venture's owners: the Borders principals and the referring real estate or mortgage broker.

According to the complaint, the nine joint ventures were not bona fide entities and did not have their own office space, email addresses, or phone numbers, and all nine companies shared a single independent contractor who was also an employee of Borders & Borders. Each company only issued title insurance policies for homebuyers that had been referred to and by Borders & Borders, and did no advertising to attract other business. The companies allegedly performed no substantive title work, all of which was instead performed by the staff at Borders & Borders. The CFPB believes the entire arrangement served no significant business purpose beyond acting as a conduit for kickbacks in exchange for referrals.

Borders & Borders PLC received substantial fees for closing services it provided to consumers referred by the brokerages involved in the illegal referral network. Harry Borders, John Borders, Jr., and J. David Borders received substantial distributions from the nine companies during that period. The CFPB's lawsuit seeks disgorgement of all ill-gotten proceeds from the referral arrangement, and an injunction to stop the defendants from further violating RESPA. The litigation is ongoing after two-plus years.

5. What are the insurance implications for CFPB actions?

Will standard Errors & Omissions Policies provide coverage for enforcement actions? Most policies provide coverage to professionals for allegations and wrongful acts that arise out of "professional services." Yet, standard E&O policies also exclude coverage for illegal acts. And, a violation of federal law is arguably an illegal act even if the conduct at issue can be construed as part of providing a "professional service."

Still, it gets even more complicated because there may be limited coverage ("illegal act" or not) if the policy provides coverage for the following:

> *Proceedings before any state licensing board OR other governmental body regulating professional conduct, alleging misconduct in providing [real estate… appraisal… legal… etc.] professional services.*

This coverage is usually under the "Disciplinary Proceedings" section of the policy. However, there a three important limitations to the coverage:

(i) The coverage sometimes is limited to proceeding before the regulatory board that governs the professional. In other words, for real estate professionals the coverage may extend only to proceedings "before a real estate licensing board." Or, for attorneys, it may only apply in matters before a "state bar or attorney licensing board." In sum, the language may be restrictive and not extend to actions before the CFPB.

(ii) The coverage will almost always fall under a sub-limit provision that provides limited coverage (e.g. $15,000) to retain counsel to defend the proceeding. It will NEVER include coverage for the actual "fine" or "penalty" issued by the CFPB.

(iii) Even if the action taken by the CFPB is in the form of a civil lawsuit (e.g. Border & Borders), as opposed to an administrative proceeding (which is the typical route for the

CFPB), this provision will likely not provide additional coverage and "disgorgements" of fees and the like are usually excluded under standard policies.

6. Can the Professional obtain additional insurance to protect themselves in the event of a CFPB enforcement action?

Currently, there are no policies that will cover "fines" and "penalties" that arise from any regulatory action against a professional. Professionals can obtain additional coverage to defend enforcement actions (such as the sub-limit coverage noted above). They can do so potentially through their Errors & Omissions policies and through certain Directors & Officers policies.

7. How should carriers and defense counsel approach the defense of these matters?

Because coverage will often be limited and only include a fixed sum for defense costs, carriers and defense counsel must be judicious with how these claims are handled. The insured must be advised of the possibility that (1) the sub-limit defense costs may not fully cover the entirety of the defense and (2) that any fine or penalty will not be covered. In addition, normal reporting guidelines (including full assessment reports, budgets and the like) should be curtailed or streamlined in order to preserve as much of the defense funds as possible.