Marketing-Services Pacts Are Given a Cold Shoulder

Regulators are rewriting the rules for some business relationships on the fly

By Stanley M. Gordon

The real estate-service industry has witnessed a unilateral policy change by the Consumer Financial Protection Bureau (CFPB) on the legality of marketing-services agreements under the Real Estate Settlement Procedures Act (RESPA).

The CFPB has replaced the Department of Housing and Urban Development (HUD) as the agency charged with interpreting and enforcing RESPA. Its approach in that role has caused the industry to question the RESPA risks of marketing-services agreements (MSAs) between mortgage originators and third-party service providers. Of equal concern is the likely spawning of even more regulatory sanctions and class-action lawsuits against real estate-service providers and the negative financial effect that will result from those actions.

Overall, the CFPB's effort to redefine this area of RESPA has resulted in a chilling effect on all MSAs. RESPA, in general, prohibits real estate settlement-service providers, such as title companies, from providing something of value to a third party, such as a mortgage broker or lender, in exchange for customer referrals.

The CFPB, to date, has chosen to change policy with respect to MSAs and RESPA primarily through findings that are part of enforcement actions — called consent orders. This occurs without public debate and absent the normal regulatory-review process. Complicating the situation is the fact that the CFPB's rationales and explanations as expressed in its consent orders contradict earlier RESPA interpretations from HUD — as well as the longstanding understanding of the mortgage industry and the legal counsel who have been instrumental in developing RESPA.

Lighthouse Title case

In fairness to the CFPB, MSAs have long been viewed skeptically by regulators with respect to their purpose and viability. Historically, MSAs were tolerated under HUD's watch so long as they met basic "services-rendered" guidelines.

MSAs were deemed within the boundaries of RESPA if they involved delivering valid services, such as promotional assistance, for reasonable compensation — even if the MSA was intertwined with a larger customer-referral arrangement. So long as payment under the MSA was not conditioned on business referrals, the pact could likely pass the RESPA test.

The CFPB, however, has used cases of clear RESPA violations to issue consent orders that assert broader theories of liability. For example, in the 2014 Lighthouse Title consent order, the alleged failure of the parties to properly value the MSA services to be performed by real estate brokers for the title company, as well as the fact that payment was made for services not actually performed, represented RESPA violations in and of themselves.

Yet the CFPB went on to assert in the Lighthouse case that the MSA itself was a thing of value. Consequently, the MSA's mere existence could be viewed as a form of payment to the brokers in exchange for the referral of business to the title company — making it a possible RESPA violation.

PHH Corp. case

This past June, as part of its findings in the case of mortgage lender PHH Corp., the CFPB asserted an even broader challenge to services-rendered relationships, such as MSAs. In the PHH case, mortgage insurers to which PHH referred customers agreed to choose a PHH affiliate for reinsurance of those loans. HUD had previously found that this mortgage-insurer and reinsurer relationship, on its own, was a valid services-rendered relationship because it involved providing legitimate services for reasonable compensation, independent of the referral arrangements.

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In its decision in the PHH case, however, the CFPB kicked the HUD interpretation to the curb and determined that the mortgage-insurer and reinsurer relationship was not valid simply because it was part of a larger referral arrangement. The CFPB director personally signed a decision that concluded that the RESPA exception for valid services rendered at a fair rate is not a complete exemption from the referral-fee prohibitions under the act.

That exemption fails to apply, he asserted, if the compensation for those services is deemed not to be "bona fide." As applied to real estate services generally, the CFPB's focus on bona fide compensation allows the agency to look beyond the merits of the specific compensation and services provided under pacts such as MSAs and to claim that the marketing relationship is little more than a clever means to pay for referrals.

The problem is that settlement-service business, such as loan or title insurance, is almost always being referred between mortgage-industry participants that also have in place separate services-rendered relationships, such as MSAs. Under the CFPB's broad interpretation, the perceived underlying motives of parties to such an MSA, or other services-rendered agreement, can always be questioned and deemed a subterfuge designed to support a referral arrangement.

The uncertainty and risk being created by the CFPB's application of RESPA in this area is not necessary. If the CFPB has different views from those that HUD and the real estate industry have operated under for years, then the CFPB should propose revised regulations that can be reviewed through a public-comment process.

Absent such a transparent approach by the CFPB, the real estate-service industry may need to seek clarifications on RESPA from Congress. Until the uncertainty is resolved, however, many mortgage-industry enterprises will continue to be reluctant to enter into service-rendered pacts, such as MSAs, while an incentive will exist for regulators and class-action litigators to challenge such pacts. ■

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