The Importance Of Performing Core Title Services

*By Jean Partridge, Esq.**

Over the past several years, there has been much discussion regarding 'Core Title Services' — what are they and why do we in the title industry care? The term core title services has been used by both the Federal and the State regulators when discussing what would constitute a legitimate legal joint venture (JV) or affiliated business arrangement (AfBA). While there are several factors considered when making this determination, providing "substantial" or "core" title services appears to be a common thread among all the legislation regarding JVs and AfBAs in the title arena. The purpose of this article is to remove some ambiguity for the reader as to what constitutes core or substantial title services and the importance of such services. The Federal and State regulations will be examined, as well as, pending legislation in New York.

The purpose of the legislation, both by the Federal government and the State of New York, is an attempt to prohibit AfBAs that are really sham operations designed to circumvent the law and give kickbacks to the actual source of business. Many of the sham AfBAs are formed for the primary purpose of providing an incentive (kickback), in the form of partnership revenue, to the actual source of business. In its simplest form, the AfBA is often formed between the "client" (source of business, sometimes referred to as the originator) and a title agent or an underwriter. The "client" then receives a percentage of the partnership profits on transactions he or she refers to the title agent or underwriter. The present legislation prohibits this type of potentially collusive partnership between title insurance corporations, title agents, real estate attorneys, mortgage brokers, real estate developers and lenders.[1] The federal statute, the Real Estate Settlement Procedures Act (RESPA), which went into effect in 1975, prohibits kickbacks or any other compensation for the referral of settlement services business.[2] Similarly, New York has passed legislation which proscribes improper relationships between title insurers, agents and other participants in real estate transactions.[3] New York also has a licensing bill pending that addresses the concept of core services. The intent of all the legislation is to protect the consumer from unnecessary charges.

While RESPA focuses on fair-dealing and reducing settlement costs throughout the entirety of the real estate transaction process, the New York statute is focused particularly on title insurance practices.[4] N.Y. Ins. Law §6409 prohibits the payment of any commission or rebate to any person acting as an agent for a person

* *Jean Partridge is Chief Counsel for Benchmark Title Agency, LLC in White Plains, NY. She can be reached by e-mail at jpartridge@benchmarkta.com.*

prospectively acquiring an interest in real property for the referral of that business to a particular title insurer or its agent (hereinafter "company").[5] Federal and state legislation devised to prevent collusion in real estate transaction practices have produced mixed results. A party to a real estate transaction (*e.g.*; a mortgage broker, a developer or a real estate agent) may participate in an arrangement where it forms a mutually beneficial partnership with a title agency or an underwriter. Many of these partnerships formed create a *bona fide* provider of settlement services, which are permissible under the RESPA AfBA exemption; however, many are not and are merely creating a screen behind which circumvention of the laws may be attempted and achieved.

RESPA refers to these types of partnerships as "affiliated business arrangements" (AfBAs).[6] The New York State Insurance Department (NYSID) has adopted the term "joint venture" to refer to such arrangements.[7] The attempts made by the U.S. Department of Housing and Urban Development (HUD) to adjust its regulatory scheme to differentiate between AfBAs appropriate under RESPA and illegitimate "sham" business arrangements will be discussed in some detail below. For now, it is important to recognize that one factor considered by HUD and NYSID when evaluating these schemes is whether those compensated for their participation in a real estate settlement, as title agents, provided core or substantial services.

THE FEDERAL STATUTE

Requirements Under RESPA

When RESPA was enacted in 1975, it contained a strict prohibition against giving or receiving any fee, kickback or thing of value for the referral of settlement service business, and AfBAs were not permitted. In 1983, Congress amended RESPA to permit affiliated or controlled business arrangements provided certain conditions were met. RESPA retained its prohibition against the giving or receiving of any referral fees, which prohibition still exists today. The regulations relating to the amendments were not published until 1992. The 1992 regulations set forth a three prong test that must be satisfied in order to be RESPA compliant. These regulations provided that Section 8 of RESPA would not be violated if 1) the consumer received a written disclosure of the nature of the relationship and an estimate of the AfBA's charges; 2) the consumer was not required to use the AfBA; and 3) the only thing of value received from the arrangement, other than payment for services rendered, was a return on ownership interest.[8] This is commonly known as the Affiliated Business Rule or the AfBA exemption.

In response to numerous complaints regarding the aforesaid Affiliated Business Rule, which alleged that sham arrangements were created to sidestep the RESPA bans, HUD issued a policy statement in June of 1996 to help determine whether an arrangement is a sham or whether the AfBA was a *bona fide* provider of settlement services. Both the federal statute and HUD's 1992 regulations make the AfBA exemption available in situations where the referral of business is made to a "provider of settlement services."[9] The policy statement makes clear that one must find or create an entity which is a *bona fide* provider of settlement services before

it may be determined whether the entity has satisfied the three conditions required for the AfBA exception to apply. Therefore, it can be said that the test is really a four prong, rather than a three prong test to determine AfBA RESPA compliance.

In determining whether an entity is a *bona fide* provider of settlement services or is merely a sham arrangement used as a conduit for referral fee payments, HUD balances a number of factors through a series of ten questions to make this determination. However, HUD provided neither a maximum nor a minimum number of criteria to be met; rather HUD states it will balance the answers and then make their determination. Four of the ten questions focus on performing substantial services. As mentioned earlier, even if an entity qualifies as a *bona fide* provider of settlement services, it must still meet the three prong test of the AfBA exemption rule in order to comply with RESPA.

Further, HUD requires that any entity that receives a fee perform and provide "substantial services" for which it is receiving the fee.[10] Congress has indicated that "substantial services" in the title arena may include the following: a) a title search; b) an evaluation of the title search to determine the insurability of title;c) clearing and underwriting objections to title; d) conducting the closing; e) the actual issuance of the policy on behalf of the title company, and f) the maintenance of records relating to the policy and the policy holder. However, Congress has not definitely defined substantial services for the title agency AfBA's.[11] One point that is clear, however, is that when all of these substantial services are provided by the pre-existing entity (NOT the AfBA entity) that otherwise could have actually received referrals of business directly, that such AfBA or JV would not pass the AfBA exemption rule and would violate RESPA. This idea was promulgated in the RESPA/HUD policy statement. Thus, if a mortgage broker and an *existing* title agency or underwriter form an AfBA *new* title agency and the *existing* agency or underwriter performs all the services noted above, with the staff and in the office space of the existing agency or underwriter, this arrangement would clearly violate RESPA.

AfBAs formed to circumvent Section 8 of RESPA typically provide little or no services to their customers. In the sham type of arrangement, the AfBA entity does not perform title examinations, does not read and clear the title, nor does it typically have a staff of employees. However, the policy statement does recognize that in some instances legitimate title agencies may contract out *some* services. For example, few title agencies or underwriters have title examiners or closers on staff – these services are typically performed by independent contractors, and the reading and preparation of title reports may even be performed by a third party independent contractor on occasion. HUD has not established that ALL settlement services must be performed by the AfBA in order to comply with RESPA; rather, HUD has established a "substantial" standard. HUD has stated that "substantial" settlement services must be performed by the AfBA. HUD has looked at whether the contracting party is independent of the existing entity and whether the contractor receives payment from the new AfBA entity at less than the reasonable value of the services rendered. HUD has indicated that if the new AfBA entity is paying a

fee of only $50.00 for the examination, reading and preparation of a title report to the existing title agency, it would view the difference between the payments made to the contracting party and the value of the services rendered as a disguised referral fee, clearly in violation of RESPA.

In concluding the discussion regarding the RESPA regulations, it should be apparent that a key to the permissible AfBA under RESPA is the performance of substantial or core settlement services. The AfBA entity must be a "bona fide provider of settlement services" – not a mere shell entity. Further, all of the substantial services cannot be provided by an existing agency whose principals are also the principals in the AfBA or by the underwriter partner. Unfortunately, it may not be clear to the reader (as it is not to the writer) what services or combination thereof would meet the "substantial" services criteria and RESPA is ambiguous regarding this issue. The criteria set forth above serve only as a guide to the services RESPA regulators review to determine the AfBA title agency's RESPA compliance.

THE NEW YORK STATUTES

While the HUD analysis under RESPA differs from the analysis required under the laws of the State of New York, the New York Insurance Law prohibition on rebates was a direct response to the adoption of RESPA. However, New York Insurance Law §6409(d) is broader and aims at a "flat bar" on receipt of any compensation for the referral of any title insurance business. The operative statute in New York is New York Insurance Law §6409(d), which states:

> No title insurance corporation or any other person acting for or on behalf of it shall make any rebate of any portion of the fee, premium or charge made, or pay or give to any applicant for insurance, or to any person, firm or corporation acting as agent, representative, attorney, or employee of the owner, lessee, mortgagee or the prospective owner, lessee, or mortgagee of the real property or any interest therein, either directly or indirectly, any commission, any part of its fees or charges, or any other consideration or valuable thing, as an inducement for, or any compensation for, any title insurance business. Any person or entity who accepts or receives such a commission or rebate shall be subject to a penalty equal to the greater of one thousand dollars or five times the amount thereof.[12]

In order for a joint venture to operate legally under New York Insurance Law §6409(d), the joint venture must satisfy the criteria enumerated by NYSID. The Department has opined, in its opinion letters, that a joint venture does not violate §6409(d) when the joint venture has multiple sources of business and is not limited to the referrals made by a co-owner of the joint venture. In addition, a client of a co-owner must not be obligated to obtain title insurance from the joint venture, and any compensation paid to a co-owner must be based solely on such co-owner's ownership interest in the joint venture and NOT based on the volume of business they refer to the joint venture. These criteria are very similar to the policy state-

ment issued by HUD relating to RESPA, previously discussed.

As mentioned above, the RESPA analysis also requires that any entity perform and provide "substantial settlement services" for which it is receiving a fee. While §6409(d) does not contain such a requirement, presently pending before the New York legislature is a bill to amend the insurance law regarding the licensing of title agents. Under this proposed amendment, in addition to similar disclosure requirements found in RESPA, the pending bill does address "core title services." However, the reference to "core title services" as used in the proposed licensing bill of the New York State Land Title Association does not mirror the purpose of "core title services" as used in RESPA. While core title services are defined in the bill in §2151 (c) as: (1) examination of the title search to determine insurability of the title; (2) preparation and issuance of a title insurance commitment; (3) clearance of title exceptions in connection with the issuance of a title insurance policy; (4) the collection of the title insurance premium; and (5) the marking up of a title insurance commitment to bind a title insurance corporation or the preparation and issuance of a title insurance policy on behalf of a title insurance corporation — these are NOT set forth as criteria that must be met in order to be a legitimate title agent.[13] Pursuant to the proposed bill, separate criteria are set forth under §2151(n) which, if performed, designates one as a title agent and therefore, a license would be required.[14] "Core title services," as used in this bill, seems to be merely a list of functions for which an agent must not pay more than the reasonable and customary compensation to independent contractors. Proposed §2159 (e) of the bill states "a person, other than a title insurance corporation or a title insurance agent who is not an originator, who performs one or more, but less than ALL (emphasis added), of the core title services shall not be paid, by a title insurance corporation or a title insurance agent, more than the reasonable and customary compensation for the services actually rendered."[15] The purpose of this section is to prohibit the payment of fees for services rendered in connection with the issuance of a title insurance policy to no more than "the reasonable and customary compensation for the services actually rendered" and to prohibit payments that are merely disguised referral fees. Many in the title industry will agree that "core title services" may not have been the best choice of words for use in this context since the phrase does not have the same meaning or impact as "core title services," as used under RESPA. As opposed to the RESPA statute, where "core title services" are a primary focus in the statute, "core title services" in the New York bill is merely incidental to the main focus of the bill — which is to require the licensing of agents.

Conclusion

The requirement that a compensated title agent actually perform "substantial" or "core" services, in both the Federal and New York proposed bill, is designed to eliminate the possibility of "sham" business arrangements creating shell title agents. Further, the intent is to prohibit referral fees for the placement of title insurance business. The ultimate goal is to protect the consumer from excessive charges in real estate transactions. HUD's existing regulations provide that where an AfBA

provides no substantive services for its portion of the premium, the AfBA violates Sections 8(a) and 8(b) of RESPA. According to HUD, the reason for the violation is that the AfBA is merely passing unearned fees back to its owner for referring business. Such a scheme is clearly something Congress did not intend when it amended RESPA to allow certain AfBAs. The intent of Congress was "not to change the current law which prohibits the payment of unearned fees, kickbacks, or other things of value in return for referrals of settlement service business."[16] Likewise, the intent of the provisions of the proposed licensing bill discussed above, even if incidental to the main purpose of the statute, which simply stated, is to prohibit referral fees.

As recently as November of 2007, HUD took the opportunity to espouse its position regarding "core services" when it entered into a settlement agreement with an underwriter in another State. In the Settlement Agreement, the underwriter did not acknowledge any wrongdoing, though they agreed that any agency in the State in which it maintains an ownership interest along with any other person in a position to refer business to such agency will be operated under certain terms, to wit: the agency will have operating capital net worth comparable to independent title agencies in the market area and sufficient capital to conduct ALL (emphasis added) the work and provide ALL the services typically provided by a title insurance agency in the market area. Further, the terms of the Agreement also state that the agency must provide "core title services." Similar to previous writings, HUD states that "core title services" are defined as 1) evaluation of the title search to determine insurability; 2) clearance of the underwriting objections; 3) issuance of the title commitment; 4) issuance of the title policy, and 5) where customary in the local marketplace, performance of the closing. The agreement also states other conditions, which are not the focus of this article, that are required for RESPA compliance. HUD's enforcement position seen in its regulations as well as most recently in this settlement agreement, seems to be that it is difficult to justify the payment or retention of a significant portion of the title insurance premium to a title insurance company or agent who fails to perform and assume responsibility for the core services provided to customers — the examination of title, the preparation of a title report and policy, the clearance of title objections, and the closing of title. Let the title industry be guided accordingly.

In conclusion, with the licensing bill pending and in light of the fact that New York Insurance Law §6409(d) was enacted in direct response to the adoption of RESPA, coupled with the aforementioned trend of HUD to focus on "core title services" when determining the legitimacy of a title agency, now may be the perfect time to codify the requirements in New York. The pending licensing bill seems to be the ideal vehicle to accomplish such a task. Although the overall intent of the proposed licensing bill appears to require the performance of "core title services", perhaps this aspect of the bill could be enhanced by a modification which would more clearly set forth said requirement.

ENDNOTES

[1] *See* N.Y. Ins. Law §6409(d), *and* Real Estate Settlement Procedures, 12 U.S.C.A. §2601.

[2] 12 U.S.C.A. §2607(a).

[3] N.Y. Ins. Law §6409.

[4] *Supra* note 1.

[5] *Id.*

[6] 24 C.F.R. §3500.15(b).

[7] *See* State of New York Insurance Dept. decision, RE: Permissibility of Proposed Business Arrangement/Joint Venture/Title Agent, *available at* http://ins.state.ny.us/ogco2005/rg050506.htm.

[8] 12 U.S.C.A. §2606.

[9] *Id.*

[10] *Id.*

[11] *See* H.R. Rep. No. 1177, 93rd Cong., 2nd Sess.1974.

[12] *Supra* note 3.

[13] Sen. Bill No. S877A, Assembly Bill No. A1743A (NY 2007).

[14] *Id.*

[15] *Id.*

[16] H.R. Rep. No. 123, 98 Cong., 1st Sess. At 76 (1983).