Are you in Violation of RESPA and don’t know it?
By Henry Knebel- Member of the CRES Risk Management Legal Forum

RESPA prohibits kickbacks for the referral of settlement service business, even arrangements which on their face appear to be legitimate may violate RESPA.

Consider some recent headlines:

**HUD Sues California Hazard Reporting Company and Four California Real Estate Brokerages in Kickback Scheme – Alleges RESPA Violations; Class Actions Also Filed.**

The Department of Housing and Urban Development (HUD) sued Property I.D. and four prominent real estate brokerages in Federal Court for creating sham companies designed to generate illegal kickbacks in violation of RESPA. These brokerages were later added to an existing class action, with the plaintiffs contending that the companies were “shells” or “shams” that existed only to “disguise the funneling of illegal kickbacks or fee splits.” The Federal judge ruled that the class action claims should not be dismissed. The defendants have denied the allegations.

**Captive Reinsurance Arrangements Terminated – HUD Alleges RESPA Kickback Violations – Collects $$Millions.** HUD extracted millions from several large title insurance companies and prominent home builders who had entered into captive reinsurance arrangements. HUD argued that the arrangements violated RESPA, even though they were created to comply with state laws regulating reinsurance. Although both the title companies and the home builders denied any legal violation, they decided to pay millions to settle the disputes and stop the practice.

**RESPA**

Real estate and mortgage brokers and agents are subject to both Federal and state regulation that prohibit kickbacks. Recognizing a need, Congress passed RESPA in 1974 to assure that consumers received disclosure and protection from unnecessarily high settlement services fees. RESPA protected against unnecessarily high fees by prohibiting kick-backs for the referral of business and the payment of unearned fees.

RESPA’s Section 8(a) prohibits anyone from paying or receiving any kickback in connection with a federally related loan. It says:

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person. [RESPA § 8(a)]
Elements of Prohibition:

Ignoring the federally related loan portion (most residential transactions will involve federally related loans), the elements of the prohibition are:

1. No person can give or receive any thing of value.
2. Pursuant to an agreement/understanding.
3. For the referral of real estate settlement service business.

Read literally, this would shut down even many common practices, such as paying commissions to sales agents. However, there are a series of exceptions.

The three important elements: (i) thing of value; (ii) agreement or understanding; and (iii) a referral.

The term "thing of value" is broadly defined to include any payment, discount, loan, commission, credit, and so forth. Paying for the business expenses of someone in a position to refer title or escrow business is a thing of value.

A prohibited "agreement or understanding" need not be written or verbalized. It may be inferred from circumstances in which a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred.

The term "referral" includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service when the person will pay for the settlement service incident thereto or pay a charge attributable in whole or in part to such settlement service.

Some Major (but not all) Exemptions from Anti-Kickback Rule

There are four major exemptions from RESPA’s Section 8(a) restrictions on paying referral fees: (i) fair value for services; (ii) employer to employee; (iii) cooperative brokerage arrangements between real estate brokers and agents; and (iv) AfBAs.

Fair Value for Services. This is one of the most important exemptions. Payments made to a person who refers business are permissible if the payments are for the fair value of goods or services actually received. The services or goods must be necessary and no weight can be given to the value of the referral.

Employer to Employee. Employer to employee payments for referral of settlement services, such as commissions to sales people, are exempt. This exemption has elaborate rules.
Cooperative Brokerage Arrangements. Payments pursuant to a cooperative brokerage arrangement between real estate agents and brokers are exempt. This exemption does not protect payments to others who refer listings.

Qualified Affiliated Business Arrangements - AfBAs. An affiliated business arrangement is exempt.

AfBAs are safe harbors that permit a real estate agent or broker to receive compensation for generating settlement service business for other providers if all technical conditions are satisfied. There is no inquiry whether: (i) payments are made for necessary services and (ii) the payments are fair value without giving weight to the referral.

An AfBA is a settlement service provider owned in whole or part by a person in a position to refer the settlement service. Beware of "sham" AfBAs. HUD has very stringent and detailed rules that define legitimate AfBAs and distinguish "sham" or phony AfBAs. HUD believes that a sham AfBA can arise when two settlement providers form a third entity, one of which is the provider of services, the other refers consumers to the AfBA. Among other tests applied by HUD, if the provider supplies most of the capital and work force, and takes all the risk, HUD has taken the position that the AfBA is a sham to allow the referrer to be paid for the referral even if all the AfBA technical conditions are satisfied. HUD has issued guidelines to help address this. In a later article we will discuss AfBAs.

Basic conditions to qualify (if not a sham): (i) disclosure to consumer; (ii) no required use; and (iii) only return on ownership interest.

Returning to the headlines, in both instances it appears that HUD determined that facially legitimate business arrangements actually violated RESPA. Because HUD and state regulators have taken more aggressive action against business practices in the industry, it may be time for brokers and agents to review their practices with a view to changing those that have drifted too close to the danger zone.
Henry Knebel- member of CRES’ Risk Management Legal Forum
Henry is a practicing California lawyer, representing real estate businesses, brokers, agents, developers, title companies, lenders, other settlement service businesses, and owners. He has testified as an expert witness for the California Department of Insurance. He is the former general counsel of a national title insurance organization that did business in all states and he has represented clients in complex transactions involving RESPA and state regulation.

Henry can be reached at:

The Law Offices of Henry Knebel
23822 Valencia Blvd., Suite 304
Valencia, California 91355
661-799-3600