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Hearing before the United States House Committee on Financial  
Services, Subcommittee on Housing and Community Opportunity

United States House of Representatives



“Title Insurance: Cost and Competition”

April 26, 2006

Chairman Ney, Ranking Member Waters and distinguished Members of the Subcommittee, I appreciate the opportunity to be here today to discuss the important issues related to title insurance under the Real Estate Settlement Procedures Act (RESPA), and to highlight aspects of RESPA enforcement that provide examples of improper schemes by title companies and other settlement service providers to avoid the prohibitions of RESPA. At your pleasure, I would like to submit my written testimony for the record.

Enforcement of the Real Estate Settlement Procedures Act (RESPA) is a high priority of Secretary Jackson, and Brian Montgomery, the Assistant Secretary for Housing and Federal Housing Commissioner. We view RESPA enforcement as a very important part of HUD's mission to increase homeownership and help provide affordable housing opportunities. Let me also say that while the focus of the hearing today is on title insurance, we certainly recognize that RESPA enforcement is an industry-wide issue with respect to settlement service providers, and that most providers across the industry desire a level playing field on which to compete, and take their obligations under RESPA seriously.

### **RESPA Coverage and Prohibitions**

Prior to enacting RESPA in 1974, Congress found that consumers needed more timely information on the nature and costs of the settlement process, and that abusive practices, including the payment of referral fees and kickbacks among settlement service providers, had developed in the process of buying a home. Congress also found that these payments artificially drove up the cost of settlement because consumers indirectly paid the referral fees. It sought to end these kinds of payments as one way of lowering costs to consumers when buying a home.

RESPA, therefore, was enacted to provide consumers protection during the homebuying and mortgage process by: (1) requiring that consumers receive certain information in the form of disclosures during the process; and (2) prohibiting certain practices that unnecessarily increase the costs of settlement. The statute was later amended several times, primarily to allow affiliated business arrangements and to address loan servicing and escrow account issues. More than 30 years later, it is still against the law for "any thing of value" to change hands merely for the referral of business related to a settlement service.

RESPA covers millions of transactions every year, as its coverage extends to virtually all loans secured by one-to-four family residential properties. RESPA's jurisdiction extends to all providers of settlement services required to close the loan. Among these services are the provision of title and closing services, including title examinations, and the issuance of title commitments and title insurance policies.

Disclosures required by RESPA include the Settlement Costs Booklet, the Good Faith Estimate, and the HUD-1. The Good Faith Estimate is given by the lender or mortgage broker and itemizes charges it is anticipated the borrower will have to pay to

close the transaction. This disclosure is intended, in part, to be a shopping tool to help borrowers compare costs among various settlement service providers. The HUD-1 itemizes the charges actually imposed upon both the buyer and seller in connection with the settlement. All charges by the lender and other settlement service providers must be reported on the form.

Another key purpose of RESPA is to eliminate practices such as kickbacks, referral fees, and unearned fees in the settlement process. Specifically, Section 8(a) of RESPA provides that “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.”

Section 8(b) prohibits the giving or acceptance of “any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service ...other than for services actually performed.” By regulation, HUD has established that the prohibitions include a charge for which “no or nominal services are performed.” 24 C.F.R. § 3500.14(c).

Section 8(c) of RESPA sets forth various exclusions from these prohibitions. In particular, Section 8(c) provides that nothing in Section 8 shall be construed as prohibiting: (1) the payment of a fee by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance; and (2) the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

### **Affiliated Business Arrangements, Required Use and the Provision of Settlement Services**

Affiliated business arrangements are arrangements in which a person who is in a position to refer business to a real estate settlement service provider has an ownership interest in or affiliate relationship with a provider of settlement services, and directly or indirectly refers business to that provider.

Section 8(c)(4) permits affiliated business arrangements so long as: (1) a disclosure is made of the existence of such an arrangement to the person being referred, which includes a written estimate of the charge or range of charges generally made by the provider to which the person is referred; (2) such person is not required to use any particular provider of settlement services; and (3) the only thing of value received from the arrangement, other than the payments permitted under other exemptions in Section 8(c), is a return on the ownership interest or franchise relationship.

Another provision of RESPA that relates to title insurance is Section 9, which provides that “no seller of property that will be purchased with the assistance of a federally related mortgage loan shall require directly or indirectly, as a condition to

selling the property, that title insurance covering the property be purchased by the buyer from any particular title company.”

A study of the title industry conducted for HUD by Peat, Marwick and Mitchell in 1980 examined title insurance and settlement practices and pricing in eight metropolitan areas. The study was designed to determine if consumers were served well in the provision of title insurance and other settlement services. It concluded that such services and products were not provided to consumers “at a price which approximates the cost of efficiently providing those services.”<sup>1</sup> The study also found that the title insurance industry followed a pattern of reverse competition, in that there is competition for “referral by providers rather than competition for customers themselves.”<sup>2</sup> Later studies substantiated the Peat, Marwick findings.<sup>3</sup> Current anecdotal evidence and case investigations discussed below indicate that these practices still exist in the title insurance market environment.

HUD has sought to clarify certain provisions of RESPA and address specific abuses in the marketplace through its regulations and policy statements. In its regulations, HUD sets forth some criteria that address whether payment is made for a “bona fide” settlement service. One provision states that “[w]hen a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are **actual, necessary and distinct from the primary services provided by such person.**” 24 C.F.R. § 3500.14(g) (3) (emphasis added). Other provisions make it clear that a charge “for which no or nominal services are performed or for which duplicative fees are charged” violates Section 8 and HUD’s regulations. 24 C.F.R. § 3500.14(a) and (c).

HUD addressed the statutory exemption for payments from a title insurance company to its duly appointed agents in its Statement of Policy 1996-4, Title Insurance Practices in Florida (61 Fed.Reg. 49398, Sept. 19, 1996). This policy statement sets forth the work a title agent must perform to share in the title insurance premium. HUD addressed abuses in affiliated business arrangements through Statement of Policy 1996-2, Sham Controlled Business Arrangements (61 Fed.Reg. 29258, June 7, 1996). This policy statement set forth factors that HUD uses to determine whether the payments made by a settlement service provider to its affiliated entities are for *bona fide* settlement services.

As provided by RESPA, HUD takes enforcement actions against those who accept kickbacks or other things of value, as well as those who give them. Other service providers are often in a position to refer settlement service business to specific providers,

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<sup>1</sup> Chapter XII: “The Title Assurance and Conveyance Industries” of *Real Estate Closing Costs, RESPA, Section 14a, Vol. II Settlement Performance Evaluation* prepared by Peat, Marwick, Mitchell and Co. for U.S. Department of Housing and Urban Development, Oct. 1980, as quoted and discussed in “An Analysis of Competition in the California Title Insurance and Escrow Industry,” Birnbaum, B., Dec. 2005, at p.32.

<sup>2</sup> *Birnbaum Study* at p. 32.

<sup>3</sup> See *Birnbaum Study* at sec. 5.1 for a discussion of economic studies conducted between 1980-2005 regarding competition in title insurance markets.

and they may demand things of value in return for referring that business. The things of value (such as money, payment of advertising costs, or provision of gift certificates and prizes) may be paid directly. In some cases, the parties may enter into elaborate affiliated business arrangements, such as joint venture companies, that have no business purpose other than to act as a conduit for distributing referral fee payments.

### **Captive Title Reinsurance Investigations**

One affiliated business practice HUD has been investigating in cooperation with several states and the National Association of Insurance Commissioners (NAIC), is captive title reinsurance. Briefly, in the cases we have looked at, the practice of captive title reinsurance operates as follows. A settlement service provider, frequently a lender, builder, or real estate broker refers business to the primary title insurer. The title insurer in turn reinsures a portion of the risk of the title insurance policy with the lender, builder, or real estate broker-affiliated reinsurance company for a significant portion of the premium. Typically, the affiliated reinsurance companies do not operate as independent business entities offering reinsurance in the market place.

It is HUD's position that it is a violation of Section 8(a) of RESPA to accept a thing of value in the form of participation in money-making captive title reinsurance arrangements in return for the referral of settlement service business without valuable services being performed. It is further HUD's position that any captive title reinsurance arrangement in which payments to the reinsurer are not *bona fide* compensation and exceed the value of the reinsurance, violate Section 8 of RESPA.

In HUD's view, there is almost never any *bona fide* business purpose for title reinsurance on a single-family residence, and such an arrangement between an entity or an affiliate of an entity that is in a position to refer business to the primary title insurer and the primary insurer are deserving of close scrutiny. Further, when there is a history of little or no claims being paid, or the premium payments to the captive reinsurer far exceed the risk borne by the reinsurer, there is strong evidence that there is an arrangement constructed for the purpose of payment of referral fees or other things of value in violation of Section 8 of RESPA.

### **Recent Case Examples**

**Captive Title Reinsurance Arrangement:** HUD investigated a reinsurance arrangement between a primary title insurance underwriter and a homebuilder. The homebuilder created an affiliated title reinsurance company and referred title insurance business to the primary title insurer, who in turn reinsured a portion of the risk with the builder's affiliated title reinsurance company. The homebuilder agreed to make a payment to the U.S. Treasury in the amount of \$675,000, and to refrain from entering into any such captive title reinsurance arrangements in the future.

**In Memphis, Tennessee,** a title company established eight affiliated title companies with various builders, real estate agents and mortgage brokers. HUD found

that the newly formed affiliated companies were paid for certain title and settlement work they did not perform, and that the affiliated companies were businesses created to make referral payments to the builders, real estate agents and mortgage brokers who owned the affiliated companies with the title company, in violation of RESPA. The title insurance company agreed to make a \$680,000 payment to the U.S. Treasury and cease any further business operations involving the affiliated companies. HUD later reached a settlement for \$226,000 with nine builders who were partners in the affiliated companies who received the unearned premiums. The settlements also provided that each title insurance entity will compete in the marketplace for title insurance business by actively seeking business from parties other than those that created the entity.

**In Tulsa, Oklahoma,** HUD determined that several area homebuilders, real estate companies and title companies violated Section 8 of RESPA by establishing middleman companies that distributed a portion of the profits earned by the title company that performed the core title services, to the members of the affiliated businesses in exchange for referring customers to the title company. HUD also alleged that one of the title companies violated RESPA by marking up charges for abstract services and recording fees. Together, the companies agreed to pay \$450,000 and cease the business practices that triggered HUD's investigation. The real estate broker involved agreed that all of its agents would attend at least three hours of qualified training on the requirements of RESPA within six months of the settlement.

**In Detroit, Michigan,** a title company paid real estate brokers for the use of conference rooms at rates that were substantially higher than the fair market rent in violation of RESPA and HUD's Statement of Policy on the issue. The title company agreed to make a \$150,000 payment to the U.S. Treasury, and that all future office lease agreements would conform to standard commercial lease terms. HUD later reached agreements with certain real estate brokers involved who received the above-market rent payments, and collectively paid \$80,000 to the Treasury to settle the matter.

**In Boston, Massachusetts,** HUD and the Federal Deposit Insurance Corporation (FDIC) found that a mortgage company solicited and received sporting event tickets, restaurant gift certificates, and other things of value from attorneys, appraisers, title companies and others in exchange for the referral of business. The mortgage company agreed to stop accepting kickbacks from settlement service providers, to cooperate with the agencies' ongoing investigation of the settlement service providers who provided the tickets and other things of value to the mortgage company, and pay \$150,000.

**In Atlanta, Georgia,** HUD found that a real estate broker offered its sales agents incentives including trips, Atlanta Braves baseball tickets, higher commission splits, and agent-of-the-month ads in local newspapers based on the number and volume of referrals to the broker's affiliated title company. The real estate broker agreed to make a \$250,000 payment to the U.S. Treasury, to cease the business practices that triggered HUD's concern, and to notify all of its real estate agents that any compensation to them based on referring business to affiliated partners is a violation of RESPA.

**In Houston, Texas,** HUD, the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) conducted a joint investigation that uncovered suspected acts of residential mortgage fraud that involved bank officers and a title company. The agencies claimed the title company engaged in a pattern of violating Section 4 of RESPA by providing inaccurate HUD-1 Settlement Statements to lenders and their borrowers. HUD further alleged that the title company's conduct was part of an agreement for the referral of business in violation of Section 8 of RESPA. The title company agreed to pay a \$5 million civil penalty to the U.S. Treasury and to reform its settlement service practices nationwide. In a separate but related action, the Texas Insurance Commission also fined the title company.

**In Lebanon, Pennsylvania,** HUD's investigation of a title company revealed that it set up an affiliated title agency with real estate agents who referred business to the company, and made payments to the affiliated agency that had no employees, no office space, minimal capitalization, and performed no core title services. The title company agreed that it would receive at least 40% of its future business from real estate brokers or agents and mortgage brokers who were not affiliates, paid \$15,000 to the U.S. Treasury, and agreed to abide by RESPA in the future.

### **Other Practices that Violate RESPA**

Among its current cases, HUD is investigating other alleged practices that if true, would violate RESPA:

- A builder established affiliated mortgage and title companies. The builder requires the use of a large title insurer for closing and title insurance, however, the insurer splits the title insurance premium with the builder's affiliated title insurance company ostensibly for title services performed by the builder. In addition to the required use issue, the question is whether bona fide title services are being performed by the builder.
- To get title insurance referrals in a particular part of the country, title companies have established in-house marketing departments that employ full-time graphic artists and business development teams. The marketing department provides its services to real estate agents and builders, including producing open house flyers, "just listed" and "just sold" post cards and other advertising materials at no or below market costs.
- HUD has received complaints that allege builders are requiring buyers to purchase title insurance from the builders' affiliated title companies. In some instances, the builder may pay substantial closing costs or impact fees only if the affiliated company is used. In these examples, HUD questions whether a true discount is being offered or whether the discount is made up through the cost of the home. In a few instances, the buyer may be charged an extra fee if the affiliated title insurance company is not used.

- A title agent, who is an attorney, solicits business from a lender and is told that he must give the lender \$50,000 to be a partner in its co-branded marketing in order to receive business.
- Real estate brokers writing in contracts that their affiliated title companies must be used for closing and title services.

## **Overview of HUD's RESPA Enforcement Efforts**

HUD has recognized the need to devote more resources to RESPA enforcement. In the last several years, the Department created the Office of Regulatory Affairs and Manufactured Housing that directs the RESPA, Interstate Land Sales and manufactured housing programs. The Office of RESPA has substantially increased its staff and contracted with a private firm that includes former federal agents to provide nationwide investigative services. The Office coordinates with HUD's Office of General Counsel on policy issues and enforcement actions. This Office also has increased its staff. Additionally, HUD's Office of Inspector General (OIG) has assisted with some investigations. Last summer, the Department conducted training sessions for approximately 125 OIG agents.

## **Coordination with Federal and State Agencies**

The Department has coordinated investigations with other federal agencies including the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Federal Trade Commission and the Department of Justice. We are currently working jointly on several investigations and anticipate others this year.

The Department has also worked closely with state regulators regarding RESPA. Over the last two years it has met with the National Association of Insurance Commissioners' Title Working Group, the Association of Real Estate License Law Officials, the primary association of state regulators of real estate brokers, and the American Association of Residential Mortgage Regulators. We will continue to foster relationships with state attorneys general and insurance commissioners, as well as with these important state regulatory associations, and will continue to share information with specific state regulators.

The Department is aggressively pursuing kickback schemes and affiliated business arrangements that do not comply with RESPA. Such schemes and arrangements unnecessarily increase the costs of settlement services by enabling the payment of fees and things of value without the performance of *bona fide* services. Of course settlement costs are of paramount importance to the homeowner, and it is in the interest of fairness to maintain a level playing field among settlement service providers.

## **Legislation to Enhance Enforcement**

The success of HUD's regulatory efforts to implement RESPA for the benefit of both industry and consumers depends greatly on effective enforcement. Certain statutory amendments may advance the goals of RESPA. For example, RESPA does not currently include authority for regulators to enforce important sections of the statute: there are no remedies for violations of the requirements relating to the Good Faith Estimate, settlement costs booklet, or HUD-1 settlement statement. The effectiveness of RESPA could be enhanced by assuring that creative business structures do not defeat the purposes of Sections 8 and 9 of RESPA, and by providing the Secretary and State regulators with the necessary tools to enforce the statute.

Thank you for this opportunity to discuss these important issues regarding title insurance and the settlement services industry as they relate to RESPA.