AGAINST THE TIDE: A NEW TAKE ON RESPA'S SECTION 8(C)(2) SAFE HARBOR BY THE CFPB

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Consumer Financial Services Alert

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Grab a flotation device – the final decision recently issued by Director Richard Cordray of the Consumer Financial Protection Bureau ("CFPB") in the administrative enforcement proceedings against PHH Corp. ("PHH") has rocked the boat for the real estate settlement services industry as portions of the decision run directly counter to decades of legal precedent and the prior writings and Policy Statements issued by the Department of Housing and Urban Development ("HUD") – the federal agency previously tasked with interpreting the federal Real Estate Settlement Procedures Act ("RESPA") and enforcing its provisions.[1] As K&L Gates summarized in its June 22, 2015 Alert,[2] the decision addresses a number of topics, including Director Cordray's interpretation of several provisions of RESPA. And while many of the CFPB's views and interpretations attempt to expand the scope of RESPA's reach and are subject to criticism, one of the most significant developments is Director Cordray's conclusion that Section 8(c)(2) of RESPA is not the type of safe harbor that has long been widely accepted.

RESPA SECTION 8: THE PROHIBITIONS AND EXEMPTIONS

The CFPB's current view that Section 8(c)(2) merely "clarifies section 8(a), providing direction as to how that section should be interpreted, but does not provide a substantive exemption from section 8(a)"[3] is hard to square with the plain language of the statute.

Section 8(a) and (b) have long been considered the subsections of Section 8 that prohibit certain conduct. Section 8(a) reads, "[n]o 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 a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."[4]

Section 8(b) provides that "[n]o person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed."[5] It is these subsections that form the bases for causes of action in connection with enforcement proceedings or private litigation.

By contrast, Section 8(c) sets forth *permissible* conduct. Rather than describe conduct that is prohibited, it lists several types of conduct Congress identified as acceptable, so long as certain conditions are met. Importantly, the subsection begins, "Nothing in this section [i.e., sub-sections 8(a) and (b)] **shall be construed as prohibiting**…

- the "payment of a fee" to attorneys, title company agents, or lender agents "for services actually performed" (Section 8(c)(1));
- "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" (Section 8(c)(2));
- "payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers" (Section 8(c)(3)); and
- affiliated business arrangements "so long as (A) a disclosure is made of the existence of such an arrangement … [and] a written estimate of the charge or range of charges" is provided; (B) use of the affiliated entity is not required (except for "the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender"); and (C) "the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship" (Section (c)(4), (5)).[6]

Thus, when read together, the plain language of Section 8(c)(2) on its face stands for the proposition that a "bona fide" payment for "services actually performed" falls outside the sphere of conduct that is prohibited by subsections 8(a) and (b). Indeed, as explained below, this has been the position taken by the courts and even HUD prior to Director Cordray's decision.

WHEN INTERPRETING RESPA, FEDERAL APPELLATE COURTS AND HUD HAVE UNIFORMLY CONCLUDED THAT SECTION 8(C)(2) PROVIDES AN EXEMPTION TO RESPA 8(A) LIABILITY

HUD had long recognized that Section 8(c) of RESPA, including subsection 8(c)(2), provides a carve-out for conduct that would otherwise be prohibited by subsections 8(a) and (b):

- In 1997, HUD sent a letter to a lender explaining how Section 8(c)(2) applies to captive mortgage reinsurance agreements – which PHH heavily relied upon in its appeal to Director Cordray.[7] In that letter, HUD advised that "[i]f … the lender's reinsurance affiliate actually performs reinsurance services and compensation from the primary insurer is bona fide and does not exceed the value of the reinsurance, then such payments would be permissible under subsection 8(c)," but arrangements "in which reinsurance services are not actually performed or in which the payments to the reinsurer are not bona fide and exceed the value of the reinsurance would violate Section 8 …"[8]
- Later, in 1999, HUD issued Statement of Policy 1999-1 addressing the interplay of Section 8(a) and (c)(2) for payments between lenders and mortgage brokers, which recognized that if "goods or facilities were actually furnished or services were actually performed for the compensation paid" and if "the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed" then the payments did not violate Section 8(a), because they were protected by Section 8(c)(2)'s safe harbor.[9] Indeed, the 1999 Policy Statement was issued in response to a Congressional Report requesting HUD clarify Section 8, and which read, in part, that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) … of RESPA."[10]

- Then in 2001, HUD issued Statement of Policy 2001-1 in response to courts that had misinterpreted the 1999 policy statement, and HUD stated that "application of both parts of the HUD test [articulated in its 1999 policy statement] is required before a determination can be made regarding the legality of a lender payment to a mortgage broker …"[11]
- On January 5, 2011, HUD intervened and filed an appellate brief in Carter v. Welles- Bowen Realty, Inc., No. 10-3922 (6th Cir.), in which HUD acknowledged that Section 8(c) sets out exceptions.[12] In its brief, HUD stated:

> Congress, however, provided a safe harbor for certain activities. The prohibition of kickbacks and unearned fees does not apply to "bona fide * * * payment[s] * * * for services actually performed." Id. § 2607(c)(2). Another exception is for "affiliated business arrangements," as defined by RESPA, provided that three additional statutory conditions are satisfied: the arrangement is disclosed to the consumer; the consumer is not required to use any particular settlement services provider; and the only thing of value received from the arrangement, other than payments for services actually performed, is a return on the ownership interest or franchise relationship. Id. § 2607(c)(4)(A), (B), (C).[13]

Similarly, courts, including federal Circuit Courts of Appeal across the country, have long held that Section 8(c)(2) creates a safe harbor to protect conduct that would otherwise be considered actionable under subsections 8(a) or (b).[14] For example, the Seventh Circuit has stated that "as long as the [defendant] performed any services … they are allowed a reasonable fee under Section 8(c)(2). To establish a violation of Section 8, the plaintiffs would need to show that the fee paid was not reasonably related to the services provided."[15] Likewise, the Eighth Circuit has stated "Section 8(c) clearly anticipates payments to individuals for goods or facilities actually furnished or for services actually performed, and specifically excludes these payments from the Section 8(a) proscription."[16] Notably, none of these decisions concludes that the amount of the payment for settlement services rendered is irrelevant to the extent an agreement exists in which one party receives business as a result of the referral.

Thus, prior to the PHH Decision, HUD as well as the federal courts of appeal appear to be unanimous in their treatment of Section 8(c)(2).[17]

THE PHH DECISION CHARTS A NEW COURSE

In the PHH Decision, the CFPB addressed Sections 8(a) and (c) in the context of mortgage insurance and reinsurance. As the PHH Decision explained, mortgage lenders obtain mortgage insurance to protect themselves in case a borrower defaults, and mortgage insurers sometimes engage mortgage reinsurers to share some of the risk, in exchange for a portion of the mortgage insurance payments.[18] In the enforcement proceeding, the CFPB alleged that PHH, a mortgage lender, referred business to certain mortgage insurers, who, in turn paid kickbacks to PHH by making payments to PHH's subsidiary mortgage reinsurer.[19]

On appeal from a decision of an administrative law judge, Director Cordray concluded that PHH (and its subsidiary mortgage reinsurer) violated Section 8(a) by referring loans to mortgage insurers in exchange for

kickbacks in the form of mortgage reinsurance payments to the subsidiary. Key to Director Cordray's decision was PHH's referral of almost all of its mortgage insurance business to mortgage insurers who had signed "captive" agreements to purchase mortgage reinsurance from PHH's mortgage reinsurance subsidiary.[20] PHH argued that its conduct fell within Section 8(c)(2)'s safe harbor, because the payments from the mortgage insurers to its subsidiary mortgage reinsurer were "bona fide … compensation … for services actually performed;" the mortgage reinsurer took on risk commensurate with the payments it received from the mortgage insurers.[21] Director Cordray, however, adopted a new and stark interpretation of Section 8(c)(2) that is at odds with the plain language of the statute, legal precedent, and even HUD's prior statements. According to the decision, Section 8(c)(2) "does not provide a substantive exemption from section 8(a)" and Section 8(a) prohibits "a payment that is tied in any way to a referral of business."[22] In other words, even if payments made for services rendered were at (or even below) market rate, Section 8(c)(2) did not insulate the parties from liability under Section 8(a) if there is a referral in the transaction, because the payments would merely be a "pretext to provide compensation for a referral."[23] This interpretation guts the import of Section 8(c)(2)'s safe harbor.

Yet, Director Cordray was dismissive of PHH's contention that his interpretation of Section 8(c)(2) would "undo years worth of official interpretations and policy statements issued by HUD" – concluding that PHH's own interpretations of these agency statements are "not particularly germane."[24] He then attempted to distinguish HUD's 1997 letter regarding Section 8(c)(2) – while ignoring the 1999 and 2001 Statements of Policy. Director Cordray stated that the 1997 letter was nonbinding, and regardless, "to the extent that the letter is inconsistent with my textual and structural interpretation of section 8(c)(2), I reject it."[25]

Additionally, Director Cordray relied solely on two inapposite legal decisions – while largely ignoring the numerous cases holding that Section 8(c)(2) protects bona fide payments for goods, services, and facilities rendered. First, Director Cordray looked to Culpepper v. Irwin Mortg. Corp., 253 F.3d 1324 (11th Cir. 2001), but in the 2001-1 Statement of Policy, HUD expressly rejected Culpepper's holding of "focusing exclusively on the presumed intent of the lender in making the payments" rather than looking at whether the payments were reasonably related to the service performed.[26] After the 2001 Policy Statement was issued, the Eleventh Circuit adopted HUD's analysis concluding that "the 2001 [Statement of Policy] had made clear that 'it [was] necessary to determine whether compensable services were provided by the broker and whether the total amount of broker compensation was reasonable in the light of the circumstances of each loan.'"[27] And Director Cordray's reliance on Arthur v. Ticor Title Ins. Co. of Florida, 569 F.3d 154, 158 (4th Cir. 2009), appears misplaced as the court there recognized that the examples listed in Section 8(c) create safe harbors to liability under Section 8.[28]

Although the PHH Decision is only Director Cordray's interpretation in an administrative enforcement proceeding, and not a policy statement or binding rule subject to notice and comment, the position taken by the CFPB in the PHH enforcement action reflects a willingness by the CFPB to regulate and influence conduct through enforcement without regard to case law and prior agency decisions, leaving the settlement services industry to square a novel interpretation of RESPA without reliance on their prior guides.[29]

THE ROAD AHEAD

The road certainly does not end with the PHH Decision. Indeed, PHH filed a petition for review of the Director's decision with the D.C. Circuit Court of Appeals.[30] The request for judicial review asks the D.C. Circuit to address

several issues decided by the Director, including his interpretation of Section 8(c)(2).[31] Among the issues identified by PHH for which it seeks judicial review is whether the decision "violate[s] due process by retroactively applying new interpretations of RESPA to prohibit conduct that was at the time of the conduct, expressly permitted by agency regulations and guidance."[32] We will continue to monitor the PHH litigation and report back on future RESPA developments.

Notes:

[1] In re PHH Corp., No. 2014-CFPB-0002 (June 4, 2015) ("PHH Decision") available at www.consumerfinance.gov/f/201506_cfpb_decision-by-director-cordray-redacted-226.pdf.

[2] http://www.klgates.com/resources/xpqPublicationDetailKNLG.aspx?xpST=PubDetail&pub=12911 (the "K&L Alert").

[3] PHH Decision at 15-17.

[4] 12 U.S.C. § 2607(a).

[5] 12 U.S.C. § 2607(b).

[6] 12 U.S.C. § 2607(c)(1)-(5) (emphasis added).

[7] Letter from Letter from N. Retsinas, Ass't Sec'y for Hous.–Fed. Hous. Comm'r, HUD, to S. Samuels, Countrywide Funding Corp. (Aug. 6. 1997).

[8] Id. at 3 (emphasis added).

[9] 64 Fed. Reg. 10,080, 10,084 (Mar. 1, 1999).

[10] Id. (quoting Conference Report on the Departments of Veteran Affairs and Housing and Urban Development (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998) at 260).

[11] 66 Fed. Reg. 53,052, 53,055 (Oct. 18, 2001).

[12] Carter v. Welles- Bowen Realty, Inc., No. 10-3922, Doc. No. 006110833806 (6th Cir. Jan. 5, 2011)

[13] Id. at 4.

[14] See, e.g., Galiano v. Fid. Nat. Title Ins. Co., 684 F.3d 309, 314 (2d Cir. 2012) ("RESPA's 'safe harbor provision'…, § 8(c), provides that § 8(a) shall not be construed as prohibiting payments by a title company for goods, facilities actually furnished, or services actually performed."); O'Sullivan v. Countrywide Home Loans, Inc., 319 F.3d 732, 740-41 (5th Cir. 2003) (holding that "RESPA's stated goal of eliminating 'kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services,' is furthered by the reasonable relationship test" under Section 8(c)(2)); Mims v. Stewart Title Guar. Co., 590 F.3d 298, 304 (5th Cir. 2009) ("Section 8(c) of RESPA contains several exceptions to the general rule…"); Carter v. Welles-Bowen Realty, Inc., 736 F.3d 722, 728 (6th Cir. 2013) (holding Section 8(c)(2) is one of the safe harbors under RESPA and "protects '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'"); Egerer v. Woodland Realty, Inc., 556 F.3d 415, 420-21 (6th Cir. 2009) ("Under RESPA, the referral of settlement service business is not compensable, except as provided by 12 U.S.C. § 2607(c), which contains a list of fees, salaries, compensation and payments that are not prohibited by § 2607(a)."); Howland v. First Am Title Ins. Co., 672 F.3d 525, 531-33 (7th Cir. 2012); Glover v. Standard Fed. Bank, 283 F.3d 953, 965 (8th Cir. 2002); Bjustrom v. Trust One Mortg. Corp., 322 F.3d 1201, 1208 (9th Cir. 2003)

(holding payments did not violate Section 8 where "total compensation received … was reasonably related to the services it provided"); Geraci v. Homestreet Bank, 347 F.3d 749, 751 (9th Cir. 2003) ("Section 8(c) provides a safe harbor…"); Schuetz v. Banc One Mortg. Corp., 292 F.3d 1004, 1011 (9th Cir. 2002) (holding that under 8(c)(2) the "pivotal question is whether … total compensation is reasonable"); Smith v. Argent Mortgage Co., 331 Fed. Appx. 549, 555 (10th Cir. 2009); Culpepper v. Irwin Mortg. Corp., 491 F.3d 1260, 1276 (11th Cir. 2007) (holding Section 8(c)(2) required analysis of whether fees charged were reasonable for the services rendered); Hirsch v. BankAmerica Corp., 328 F.3d 1306, 1308-09 (11th Cir. 2003). Despite the abundance of Circuit Court decisions, some federal district courts have found that Section 8(c) is not necessarily an exception to Section 8(a).

[15] Howland, 672 F.3d at 533.

[16] Glover, 283 F.3d at 965.

[17] Indeed, in a recent Consent Order with another entity, the CFPB referred to Section 8(c)(2) as an "exemption" – although it ultimately concluded that the payments at issue still violated Section 8(a), because "[e]ntering a contract with the agreement or understanding that in exchange the counterparty will refer settlement services … violated Section 8(a)." See Consent Order, In re Lighthouse Title, Inc., No. 2014-CFPB-0015, Doc. 1 ¶ 9 (Sept. 30, 2014) available at http://files.consumerfinance.gov/f/201409_cfpb_consent-order_lighthouse-title.pdf ("RESPA Section 8(c)(2) provides an exemption for 'payment[s] to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.'" (quoting 12 U.S.C. § 2607(c)(2)).

[18] PHH Decision at 3-4.

[19] Id. at 3-4.

[20] Id. at 12-14.

[21] Id. at 12, 20-21.

[22] Id. at 16-17.

[23] Id. at 17 ("even a reasonable payment may not be 'bona fide' if it is not made solely for the services but also for a referral" and accordingly would violate Section 8); see also id. at 16 ("Regardless of whether the price that the mortgage insurers paid was inflated or was set at the fair market value of the reinsurance they received, PHH still benefited from the arrangement because [its mortgage reinsurer] received (profitable) business from the mortgage insurers that it would not otherwise have received."); id. at 17 ("Then the distinct meaning of "bona fide" in section 8(c)(2) is that the payment must be solely for the service actually being provided on its own merits, but can not be a payment that is tied in any way to a referral of business.").

[24] Id. at 19.

[25] Id. at 17-18.

[26] 66 Fed. Reg. at 53,054; Schuetz, 292 F.3d at 1011 ("The 2001 Statement explicitly rejects Culpepper's interpretation, and reiterates the position taken in the 1999 Statement…"); Culpepper v. Irwin Mortg. Corp., 491 F.3d 1260, 1276 (11th Cir. 2007) (acknowledging that its prior Culpepper decision cited by Director Cordray was rejected by HUD).

[27] Culpepper, 491 F.3d at 1269 (quoting Heimmermann v. First Union Mortgage Corp., 305 F.3d 1257, 1264 (11th Cir. 2002).

[28] Arthur, 569 F.3d at 159 ("Section 8(c)[(1)] makes clear that Ticor did not violate Section 8 of RESPA by paying its agents for their services.").

[29] For a summary of all of the issues addressed in the PHH Decision, refer to the K&L Alert referenced in note 2.

[30] PHH Corp. v. CFPB, No. 15-1177 (D.D.C.).

[31] Id., Doc. No. 1564427 (July 24, 2015).

[32] Id. at 3.

