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Real Estate & Title Insurance

New State and Federal Closing Regulations Leave Attorneys in a Quandary

The referral of legal work in return for title insurance orders on a quid pro quo basis is called into question

By Alfred D. Santoro Jr.

New state and federal regulations affecting title insurance and mortgage lending appear to be impacting on New Jersey attorneys and leaving them searching for guidance in the future of their real estate practice.

The new, more clearly defined state prohibitions covering improper relationships between attorneys, title companies and other professionals are at odds with federal proposals encouraging rebates and packaging of services.

Illegal Inducements Can Take Many Forms

In response to growing inquiries by and against many members of the title insurance industry, the New Jersey Department of Banking and Insurance has recently distributed Bulletin No. 02-29, further defining *Inducements for the Placing of Title Insurance* and prohibited activities in connection therewith.

The bulletin seeks to re-enforce both prior bulletins and current state law. Importantly, the department stresses that penalties can be assessed on all parties to the transaction.

Neither this prohibition nor its occasional violation is news to the department or members of the industry. However, a new wrinkle has been added that has drawn the attention of the department's limited enforcement assets, that is, the referral of legal work in return for title insurance orders on a quid pro quo basis.

Such a relationship may seem like good business in a time where many of us, including attorneys, realtors, mortgage brokers and title agents, are actively seeking new ways to attract clients. In fact, however, it may be a violation of state law. The bulletin issued by the department on Dec. 9, 2002, states:

> Recently the Department has learned of certain practices that appear to be inconsistent with applicable standards. These include some title insurance producers offering real estate transaction work to attorneys, or placing their names on a "recommended attorney list" provided to purchasers of title insurance in exchange for referral of such purchasers.

Of particular concern to the industry and the department are attempts by or on behalf of title insurance producers to develop quid pro quo relationships that impair the ability and the right of a consumer to select the title insurance provider of his choice and circumvent the regulatory scheme controlling title insurance costs throughout the state.

Under an exception to Federal Anti-Trust laws, a Title Insurance Rating Bureau, comprised of title insurance underwriters, proposes rates for title insurance in New Jersey and the justification for same, to be reviewed by the department. Once these rates are reviewed and approved, they become binding on all title insurance transactions within the state by member insurers.

Deviations from these rates are not permitted unless they are filed with and approved by the department. It is the active oversight and control of the department that permits the federal exception.

N.J.S.A. 17B: 46B –1, et seq., known as the Title Insurance Producers Act, is one of the statutes that governs the conduct of the title insurance industry in New Jersey. N.J.S.A. 17:46B-34 provides:

> No title insurance company and no title insurance agent shall pay, allow or give, or offer to pay, allow or give, directly or indirectly, any commission or part of its fee or charge or any other consideration as an inducement or compensation for the placing or procuring of any order for title insurance; provided, however, that nothing herein contained shall be construed to prohibit

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> the payment of a commission or other compensation to a regular full-time employee of a title insurance company or agent of a title insurance company as part of the regular compensation of such employee or agent.

Similarly, rebate schemes or unapproved deviations from rates filed with and promulgated by the department for the issuance of title insurance are also prohibited by law under N.J.S.A. 17:46B-35.

Previous department bulletins have addressed other specific questionable practices. In Bulletin 97-14, the department stated that

> As a result of recent market conduct examinations, the Department of Banking and Insurance has found that some title insurance producers are expending funds to entertain clients and other individuals, such as realtors, mortgage lenders, lawyers and other professionals who channel business directly to the agency. This type of activity, if it is an "inducement … for the placing or processing of any order of title insurance," violates N.J.S.A. 17:46B-34 and N.J.S.A. 17:46B-35.

And in Bulletin 99-08, the department noted that the practice of title insurance producers paying a room rental fee to real estate brokers deviates from the requirements of N.J.S.A. 17:46B-34 because an inducement is being paid to the broker for the placement of the insurance.

This bulletin addressed a growing problem, particularly in areas of the state where realtors controlled the placement of title insurance and title insurance companies regularly closed transactions. In these cases, a fee was paid to the originating realtor for the use of its conference room for closing purposes. The practice was viewed not as a legitimate closing expense but as an improper rebate.

The most recent bulletin was issued in response to a variety of statewide practices by various title producers. Consider the following scenarios:

- an attorney is asked to use a particular title insurance agent exclusively in return for the referral of real estate transactions;
- an attorney is one of several placed on a list of "recommended attorneys" given to real estate purchasers or prospective borrowers by a title insurance office in return for obtaining business from those attorneys;
- a title insurance company, on an understanding that a law firms' real estate work is to be placed with that company, gives that firm litigation or transactional work; and
- a realtor receives printed promotional material from a title agent in return for referrals.

All of these scenarios are addressed in the department's bulletin:

> The Department believes that this practice is prohibited by N.J.S.A. 17:46B-34, which prohibits title insurance agents from paying or giving directly or indirectly, any consideration as an inducement or compensation for the placing or procuring of any order for title insurance by someone other than a regular or full time employee or agent of a title insurance company.

Not only may it be unlawful for a title producer to offer such proposals, but it may be unlawful for them to be agreed to or accepted. N.J.S.A. 17:46B-35C provides:

> c. No applicant for insurance, nor any insured, nor any owner, lessee, mortgagee, existing or prospective, of the real property or interest therein which is the subject matter of the application for insurance, nor any person acting as agent, representative, *attorney*, broker or employee of such applicant, insured, or such owner, lessee or mortgagee, shall knowingly receive or accept, directly or indirectly, any commission, rebate, discount, abatement, credit or reduction of premium, or any special favor or advantage or valuable consideration or inducement prohibited by this act. (emphasis added.)

The department clearly warns that N.J.S.A. 17:46B-35 permits the imposition of penalties of up to five times of the amount of the payment upon any person who receives or pays an improper inducement.

Changes to RESPA Regulations

Two proposed changes to RESPA regulations have elicited over 40,000 comments from individuals and groups involved in the real estate closing process. Further, they appear to be directly opposed to our own state regulations!

The first change to §5 (c) of RESPA proposes to change the good faith estimate form by grouping charges and fees for settlement costs into categories rather than breaking out the costs.

The proposal also requires the lender to guarantee that the charges as set forth in the good faith estimate will not be exceeded by more than 10 percent. This good faith estimate would have to be provided to the borrower within three business days of the lender receiving a loan application. If at the time that the rate is locked in the rate changes, a new good faith estimate needs to be delivered, but only those items affected by the rate change may be altered.

This revision contains a second new proposal. It alternatively allows a lender to provide, at no cost, a guaranteed mortgage package agreement. This would be binding for 30 days and provide a guaranteed loan amount, rate and single price for all closing costs.

To encourage discounts in settlement services by third-party service providers, lenders and service providers offering packaged settlement costs would be exempt from the prohibitions against rebates and mark-ups contained in §8 of RESPA. This exception would also allow lenders to *require* the use of affiliated service providers.

The Mortgage Bankers Association of America strongly supports the guaranteed cost packaging proposal of the U.S. Department of Housing and Urban Development.

On Feb. 25, 2003, on behalf of the

Association to the Committee on Financial Services of the U.S. House of Representatives, John Courson, president and chief executive officer of Central Pacific Mortgage Company of California, stated in a prepared statement: "The proposed system will go a long way in clarifying difficult rules and regulations that pose unnecessary legal risks and serve to trump operational efficiencies that could streamline the mortgage process."

Importantly, the MBA of America offers several recommendations for HUD's consideration, including: "HUD should clearly announce its intent to seek pre-emption of state law that conflicts with the provisions established by any final rule. HUD should also take immediate action to facilitate this pre-emption of state law."

In her comments at this same hearing, Margot Saunders of the National Law Center, speaking on behalf of the Consumer Federation of America, Consumers Union and U.S. Public Interest Research Group, insisted that the removal of RESPA's §8 prohibition on rebates and volume-based discounts could only be justified if it clearly requires that the value of the volume based discounts be passed along to consumers.

The American Land Title Association has proposed an alternative to the guaranteed mortgage package agreement by offering two separate packages. The first would be a guaranteed mortgage package for lender related services. Second, they propose a guaranteed settlement package for all closing and title insurance related items as well as government recording charges.

However, even this proposal does not resolve the problems for New Jersey. The aforementioned existing laws prohibiting title insurers from offering inducements or rebates are at odds with the federal mandates. They may prohibit attorneys and title companies from affiliating to offer a guaranteed settlement services package. Unaffiliated parties could be forced out of the residential real estate market altogether.

The National Association of Insurance Commissioners opposes the pre-emption of state laws regarding insurance rate filings and prohibitions against kickbacks and rebates. They have recommended that "[S]ince title insurance and mortgage guaranty insurance are risk based products rather than market based services … and differ from all other services that are included in the mortgage package … that HUD exclude title insurance and mortgage guaranty insurance from the Guaranteed Mortgage Package."

There appear to be serious problems with both alternatives. Under the new good faith estimate proposal, if the estimated charges are incorrect, who bears the loss?

From the position of the title industry, there is very little ability to ensure that lenders are correctly quoting locally regulated premiums and fees.

Even worse, as stated by The American Land Title Association, these proposals "are based on the assumption that whatever services are needed by and are good enough for the lender, will also meet the needs of a buyer or seller."

The guaranteed mortgage package agreement, by allowing lenders to require the use of specified service providers, would have the effect of excluding all nonaffiliated attorneys, title insurance agents, appraisers, surveyors and other professionals from the closing transaction.

Which Way Do Attorneys Turn?

Existing state law appears to prohibit affiliations and quid pro quo service arrangements. Clearly rebates and kickbacks in connection with real estate transactions are prohibited.

Federal regulations in the offing seem to favor some type of settlement service packaging, including volume discounts for the benefit of consumers. The question remains as to whether state law will survive what appears to be a concerted effort at pre-emption by federal regulation.

New Jersey's title producers, appraisers, surveyors and mortgage lenders must be prepared to adapt their practices to whatever changes lay ahead. The challenge for New Jersey attorneys appears to be fitting their obligation to independently and zealously represent their clients into this evolving framework. ■