Are Title Company Kickbacks Harming Your Clients?

Cozy relationships between title companies and brokers create problems for consumers

Recent enforcement actions by the Minnesota Department of Commerce have underscored both the prevalence of real estate title insurance kickbacks and the inadequacy of the available enforcement mechanisms. In this article, the author explores the problem and suggests that litigation over breach of fiduciary duty could help to stem self-dealing in the industry.

By Doug Miller

The Minnesota Department of Commerce (DOC) has become the national pacesetter for Real Estate Settlement and Procedures Act (RESPA) kickback enforcement actions. And they are doing it in a regulatory arena that few consumers, let alone attorneys, understand: title insurance. The misunderstood importance of the title insurance industry to residential real estate transactions has made title company referrals very profitable for those who are willing to break the law. The DOC and the Consumer Finance Protection Bureau (CFPB) have been investigating these activities with limited enforcement penalties that provide little deterrence.

While some in the industry denounce the recent Minnesota DOC's actions as over-reaching and unfair, their complaints are unfounded. In fact, the enforcement actions are minimal in comparison to the massive amount of money involved and the violations that continue to plague unwitting consumers. RESPA is a minimum standard with a meager one-year statute of limitations. It wasn't designed to handle the far more severe conduct of self-dealing and predatory fiduciaries.

There is a massive amount of uninvestigated civil liability when it comes to how fiduciaries routinely manipulate clients into title firms that provide financial benefits to the fiduciary. And it's not just realtors, lenders, and title firms who should be worried. Attorneys who sell title insurance to their clients are juggling a time bomb that could put their careers at risk.

No one at the closing table should be related to the title company

Title insurance companies provide some of the most important services to the residential real estate transaction. They investigate and examine title and make important insurability and closing decisions. Their impartiality isn't just desirable; it's imperative to the integrity of the transaction. Unfortunately, most transactions that close in the Twin Cities metro area are confounded by conflicts of interests in both the title company selection process and the title process itself. Title companies are owned by realtors, lenders, and construction firms, and many independent title firms have cozy financial arrangements with real estate professionals who refer them business. These arrangements stifle competition, increase prices, and threaten the integrity of the transaction itself.

In 2006, I spoke before Congress about the predatory methods being employed to steer clients into over-priced title firms.[1] At the time, I was owner and president of a Minnesota title firm and had found that we weren't just competing with other title firms for business; we were competing with realtors. Realtors would exert such control over their clients' title business that instead of looking out for their clients' interests, they would conceal our offers of discounts (many times with savings in excess of $600). When we were hired for one side of the closing and contacted the other side's realtor with a discount offer, not only were our offers not communicated to their clients, we were often threatened with boycotts if we told their clients about the savings. When it came time to close their own personal transactions, we would often find these same

realtors saving money by using our title firm. Although I no longer own that firm, it was a success story and had grown to be one of the largest title firms in Minnesota through service excellence, technology, and price. But our firm paid no kickbacks.

I remember watching helplessly as a substantial amount of our business was lost to over-priced, realtor-owned title firms engaged in providing fiduciary services that measured success in how well they "captured" their clients' title business. We lost business to firms that set up alleged sham title companies with realtors, loan officers, builders, and developers[2] to funnel "profits" (which the DOC termed kickbacks) to those referral partners. We also lost business to firms blatantly paying kickbacks. Today, the methods are stealthier and leave fewer paper trails.

In 2007, the GAO published a report[3] about title insurance that stated, "Certain factors raise questions about the extent of competition and the reasonableness of prices that consumers pay for title insurance. Consumers find it difficult to comparison shop for title insurance because it is an unfamiliar and small part of a larger transaction that most consumers do not want to disrupt or delay for comparatively small potential savings. In addition, because consumers generally do not pick their title agent or insurer, title agents do not market to them but to the real estate and mortgage professionals who generally make the decision. This can create conflicts of interest if those making the referrals have a financial interest in the agent…. Furthermore, recent investigations… have identified instances of alleged illegal activities within the title industry that appeared to take advantage of consumers' vulnerability by compensating realtors, builders, and others for consumer referrals…. Given consumers' weak position in the title insurance market, regulatory efforts to ensure reasonable prices and deter illegal marketing activities are critical."

No free lunch under RESPA

There are many other serious conflicts that make title company relationships with realtors and other service providers inappropriate. Real estate brokers often have extremely large commissions riding on the deal closing, and it is not hard to imagine how that might influence the title exam and closing decision process at an in-house title firm. Is a realtor-owned firm more likely to facilitate illegal side agreements between buyers and sellers that might constitute mortgage fraud? Consider the builder-owned title company closing on a transaction with mechanic's liens, tax liens, and underlying blanket mortgages that would terminate the closing at any other firm, but could also represent the builder's last hope of obtaining much-needed cash. There are endless situations that create the appearance of impropriety or the financial motivation to commit mortgage fraud through control of the title company.

It is this type of logic that provided the basis for a zero-tolerance policy toward any form of quid pro quo for referrals. The doctrine is strict when it comes to section 8(a) of RESPA: "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 a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." There is no "de minimis" amount and there is no mythical exemption for gifts under $25. Put simply, there is no free lunch under RESPA. But offering free lunches and a lot more is a big problem in Minnesota. Offering kickbacks intended to influence fiduciaries' advice (the very definition of commercial bribery[4]) is rampant in Minnesota.

> Kickbacks harm consumers by hampering fair market competition and by unnecessarily increasing the costs of getting a mortgage.

Those who pay kickbacks can reap huge financial rewards. On April 30, the Star Tribune ran a story about kickback enforcement actions against Liberty Title and other firms.[5] The Star Tribune reported that between 2013 and 2015, Liberty Title "spent more than $170,000 to wine and dine local real estate agents and other players in the industry, according to records Liberty Title provided to the Commerce Department. The company hosted more than 100 events per year, ranging from intimate lunches to parties that drew hundreds of real estate professionals."

The story continued, "Jeff Zweifel, vice president and co-owner of Liberty Title, said the company's spending was critical in turning it into one of the Twin Cities' top title firms. Since 2011, closing volume has tripled, with revenue reaching $8.5 million last year." The DOC fined them only $45,000 for paying kickbacks. In seeming defiance of their recent enforcement action, the Star Tribune reported that Liberty Title will cut their marketing budget—noting, however, that "Free lunches will be greatly reduced but not eliminated."

TitleSmart is another local firm fined $45,000 that was alleged to have benefitted from paying kickbacks. In a Star Tribune article,[6] Cindy Koebele, the president and owner of TitleSmart, exemplified the industry's attitude about kickbacks by characterizing her dinner cruises as "routine networking opportunities" and noting that many businesses in real estate host similar events: "Whether it be a boat ride on the river or Lake Minnetonka, golf outing, baseball game… there are an endless number of networking events where the venue and food are paid for by a hosting company."

Kickback arrangements are often extremely complex and difficult to track. Consider the loan officer who offices in a realty firm's office and as a quid pro quo for mortgage leads sends his refinance customers to the realtor's title firm. Often the realty firm's title company goes by an unrelated name and the consumer is oblivious that they were referred to an over-priced title firm as a means to keep mortgage referrals flowing to the loan officer. The examples of problems in Minnesota are too numerous to detail in this article, but it is likely that your clients and possibly even you have been a victim of some iteration of this conduct and that you will likely never know the full extent of the damage.

Kickbacks do a lot of damage to both the marketplace and consumers. They create a "pay to play" environment with one of the most important safeguard services in the entire real estate transaction. When it comes to kickbacks, CFPB Director Richard Cordray has said, "Kickbacks harm consumers by hampering fair market competition and by unnecessarily increasing the costs of getting a mortgage…. The CFPB will continue to take action against schemes designed to let service providers profit through unscrupulous and illegal business practices." Unfortunately, the DOC fines are hardly a deterrent and barely constitute a cost of doing business.

Why kickbacks?

Perhaps the driving force behind the willingness of some to violate the prohibition against kickbacks is the inherent marketplace unfairness that was created after the real estate industry successfully lobbied for a giant exemption from the kickback law. That exemption carved out preferential treatment for in-house firms originally called "controlled business arrangements."[7] This exception made kickbacks legal for some, but not others.

At many in-house firms, there are huge incentives for the brokers and their office managers to capture as much of their clients' ancillary business as possible. There are also many illegal and almost untraceable inducements at these firms. Many agents who refer title business are known to get paid faster and receive other benefits such as better commission splits, more floor time, and referrals. Worse, brokers charged with statutory supervisory duties routinely use their authority to discourage agents from engaging in due-diligence title company comparisons—and to encourage agents to use their fiduciary capacity to "advise" clients to use the in-house firm through hard-sell strategies and scripted conversations to address objections. In a fiduciary relationship, this is called self-dealing.

The RESPA exemption created a huge advantage for brokers with in-house firms to control their clients' title company selection process and capture their clients' title business. Many firms instituted processes to automatically place clients' title business with their in-house firms on almost every transaction. This instantly created an imbalanced marketplace that allowed in-house title firms to charge almost any amount they wanted and still be guaranteed question-free referrals. For independent title firms that refused to even buy a realtor or loan officer a cup of coffee for fear of violating RESPA, it created an impossible situation. Independent firms that competed on service, price, and product and didn't pay kickbacks lost much of their business or went out of business. Marketing materials were automatically thrown out by the front desk of in-house brokerage firms and only in-house title firms were allowed free access to market to the agents. Independents were forced to choose between paying illegal kickbacks or losing market share. While many firms lost market share, others got rich paying kickbacks.

Fallout

Client trust has become a currency that has resulted in many problems for consumers, not the least of which is pricing. And not just at the title company level. Underwriters who set their premiums high see title agents flock to them. It is as if the title agents (who often receive 75 percent or more in commission on premiums) are setting the premium pricing, not the underwriters. It wasn't long before most underwriters had homogenized their pricing, and reissue[8] discounts were deleted from their rate filings and replaced with so-called discount rate filings that cost more. Instead of relying upon actuarial tables to determine premiums, underwriters succumbed to demand from their title agents to raise their prices so that their title agents could be paid more. These anticompetitive practices harmed title firms that price-shopped underwriters and drastically limited their pool of underwriter choices. Today I am aware of only one underwriter that still competes on price and pays out large reissue discounts to consumers (Westcor Land Title Insurance).

My organization, CAARE, has documented other pricing problems as well. In 2010, the Minnesota Association of Realtors forms committee met with representatives from a large in-house title firm and then agreed to change their purchase agreement form in a way that we believe caused buyers' closing costs to increase by approximately $500 each[9] and cumulatively may have cost Minnesota consumers more than $100 million.

> Low-cost providers may not be such a bad thing in a marketplace that lacks competition. Kickbacks cost money and firms that don't pay them may be able to charge less.

The real estate industry promotes these conflictive relationships with marketing spin designed to disarm their clients, such as proclaiming the arrangement "One Stop Shopping" and touting its questionable advantages. Clients are exposed to unnecessary conflicts of interest, worsened service, higher prices, and other economic consequences that often arise in markets where firms don't have to compete for business. The real advantages are to the brokers—who can capture their clients' ancillary business, ensure the transaction closes to protect their commissions, and charge higher fees for this "service." Builders have spoken to Congress about how these relationships allow them to do speedier closings, which really translates into less diligence and riskier transactions. The money at stake is enormous and the violations are rampant. No enforcement actions shy of license forfeitures will solve the problem.

This industry is ripe for litigation, and these recent enforcement actions only provide a small peek into the level of corruption and exploitation of fiduciary relationships.

Causes for action

So far, the DOC has only used a handful of the tools available to it to stop the predatory title company referral practices that plague the Minnesota marketplace. While licensing law does not provide a private cause of action, these laws do set a standard of conduct, and enforcement actions yield a wealth of often-actionable evidence available to anyone who files a Data Practices Request with the Minnesota DOC.

There are other bodies of law, instances of actionable conduct, and penalties to be considered. And the industry has actively ignored these other areas of liability, making them a prime target for litigation. In Minnesota, there have been at least three attempts to bring class actions against firms for breaches of fiduciary duty for allegedly illegally steering clients for kickbacks. All three cases[10] failed to obtain class certification, and as a result no decisions were made on the merits. There likely exists a treasure trove of data for the attorneys who are successful in unsealing those matters.

The RESPA anti-kickback provision is a minimum standard. More restrictive state laws trump RESPA.[11] A perfect example is fiduciary law. Real estate brokers and salespersons are statutory and common law fiduciaries and are held to much higher standards when it comes to due diligence and self-dealing (often construed to be theft by swindle in a fiduciary setting). Brokers who abuse their statutory supervisory privileges to encourage licensees to actively steer clients to in-house services are likely violating the most serious of all the fiduciary duties—the duty of loyalty. Apply the plethora of estate, corporate, and non-profit common law regarding self-dealing to the described conduct, and you will see the liability exposure.

Realtors owe their clients a lot of the same duties attorneys owe their clients. Consumers have every right to rely upon their agents' advice as being conflict-free and the result of due diligence. However, consumers rarely get the benefit of either when it comes to title companies. Instead, consumers are not just vulnerable to being steered by fiduciaries into in-house title firms and firms that pay kickbacks; they are often ambushed. The licensing statute and realtor fee agreements provide consumers with two choices: Let the broker pick the title company or go find your own. Few consumers are savvy enough to find their own title company and don't understand that there used to be a third choice that is rarely disclosed: The realtor will recommend three title companies with which he or she has no financial ties.

Ironically, that was considered the best practice for realtors 20 years ago.

Most brokerage firms only attempt to comply with RESPA when referring clients to in-house or inducement-paying title firms while failing to look at the much broader and more serious implications of fiduciary law. Even though a broker may have clients sign a RESPA-compliant Affiliated Business Arrangement disclosure form, that form does not come close to complying with fiduciary law.

A few basic principles immediately come to mind: the duty of loyalty to avoid conflicts of interest and the strict prohibition on self-dealing. The duty of due diligence and full disclosure of all material facts and ramifications of the conflicts that could affect the client as well as the necessity of obtaining the clients' informed consent. This could be a heyday for consumer lawyers: Serious fiduciary breaches can sometimes shift the burden of proof, provide for the payment of attorney's fees, and make the award of damages automatic. Disgorgement of fees earned is a common remedy for breaches to the duty of loyalty. While a long shot, punitive damages and even rescission could be deemed appropriate given the seriousness of the predatory fiduciary practices.

And it's not just realtor-owned and kickback-paying title firms that are at risk. There are attorneys issuing title insurance to their own clients, and that's a hazard complete with all kinds of additional conflicts that are rarely disclosed and almost certainly not consented to in a meaningful way. How are attorneys' decision-making processes compromised when they have a substantial title insurance commission contingent upon the client's transaction closing? Are they going to negotiate with themselves to obtain their client better coverage and possibly expose themselves to additional liability? At what point do attorneys stop representing the client and start representing their underwriter's interests? There is a very good chance these attorneys could be in violation of the Rules of Professional Conduct,[12] yet this is big business in Minnesota and other states. Some of those same attorneys obtain their client referrals from realtors and rarely call attention to the realtor malfeasance that exists in so many transactions. If you thought predatory lending was bad, wait until consumer lawyers crack the predatory fiduciary practices that occur in residential real estate.

Solutions

While a regulatory solution to stop kickbacks is desirable, the reality is that the DOC doesn't have the resources to investigate every title firm and realtor involved in complex kickback arrangements. And unlike other state regulatory departments, the DOC is unwilling to send out bulletins to guide the industries it regulates. If the DOC were to get serious about stopping kickbacks they would go after the source of the problem, realtors who demand kickbacks and their brokers who know or should know that their agents are receiving them. In both the Liberty Title and TitleSmart actions, the DOC was aware of potentially over a thousand individual instances of kickbacks but chose to fine only one realtor and both title firms nominal amounts. While the Minnesota DOC may be leading the way in state enforcement actions, Minnesota may also be leading the nation in kickback activity.

Consumer litigation may be the best solution. Considering the severity of the fiduciary breaches taking place, this is an area that should interest consumer and malpractice lawyers. If precedents are set awarding attorney's fees in these matters, the floodgates could be opened nationwide as even single cases could then become financially feasible.

In the meantime, counsel your clients about this important matter. Perhaps the best way to solve this problem is to have attorneys more involved in the title company selection process and challenge fiduciaries who abuse their clients' trust for profit. Advise your clients to shop and compare title firms (google "compare Minnesota title fees") or use a title fee comparison tool by a local title firm.[13] Tell your clients to leave the title company selection section blank on their realtor fee agreements and ask their realtors to help them make informed and unconflicted choices that do not involve using the in-house firm. Do this with refinance transactions as well. Research title companies for DOC enforcement actions, check rating and review sites (like BBB and Yelp), and verify that they are licensed. Avoid firms that pay kickbacks, are involved in Marketing Service Agreements[14] with other settlement service providers, are affiliated with any service provider, or are in the same office space as the broker, lender, or builder. Refer your clients to real estate attorneys, but only if they are truly unconflicted and don't also represent brokers or get most of their referrals from them. Compare prices, policy coverage, and ask for reissue credits (find a Westcor agent). Low-cost providers may not be such a bad thing in a marketplace that lacks competition. Kickbacks cost money and firms that don't pay them may be able to charge less. Safe title practices can help save Minnesota consumers millions of dollars and help institute much-needed change. ▲

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Notes

[1] Congressional Testimony of Douglas R. Miller: *http://archives.financialservices.house.gov/media/pdf/042606dm.pdf* and video here: *https://www.c-span.org/video/?c4515209/testimony-douglas-r-miller*

[2] Minnesota Commissioner of Commerce and U.S. Dept. of HUD In the Matter of First American Title Insurance Company. 2007

[3] GAO Report, "Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers"

[4] MINN. STAT. 609.86

[5] *http://www.startribune.com/state-crackdown-on-gifts-is-unsettling-title-industry/420820833/*

[6] Star Tribune article on CAARE's website: *http://www.caare.org/documents/FirstAmericanFined.pdf*

[7] The real estate industry lobbied to have the term, "controlled business arrangements" changed to "affiliated business arrangements" to avoid the "negative connotations" of the prior term.

[8] Reissue credits provide a discount up to 60% on the title insurance premiums. All that is needed to qualify for this discount is the home seller's prior owner's title insurance policy.

9 *http://www.caare.org/115MillionPriceFixingDetail*

[10] Grady v. Burnet Realty Inc., Larpenteur v. Burnet Realty, Inc., and Burnet Title, Inc. Gardner v. First American Title, Universal Title, Universal Partnerships. Washington Post story: *http://www.washingtonpost.com/wp-dyn/content/article/2007/03/02/AR2007030200581.html*

[11] 12 C.F.R. §1024.5(c)(1) …State laws that give greater protection to consumers are not inconsistent with and are not preempted by RESPA or Regulation X….

[12] "Avoiding conflicts in the sale of title insurance to clients" - Patrick R. Burns, Minnesota Office of Lawyers Professional Responsibility 2008: *http://lprb.mncourts.gov/articles/Articles/Avoiding%20Conflicts%20in%20the%20Sale%20of%20Title%20Insurance%20to%20Clients.pdf*

[13] *www.CalcuRater.com* compares 20 metro area title companies. Disclosure: I used to own this firm.

[14] Marketing Service Agreements are shared advertising programs between realtors, title and mortgage firms, and often disguise profitable referral arrangements. CFPB warning: *https://www.consumerfinance.gov/about-us/newsroom/cfpb-provides-guidance-about-marketing-services-agreements/*