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January 27, 2014

Mr. Christopher D'Angelo
Chief of Staff, Bureau of Consumer Financial Protection

Re: The Mortgage Closing Process

Dear Mr. D'Angelo,

Consumer Advocates in American Real Estate (CAARE) is the only non-profit 501(c)3 charity dedicated to consumerism in the residential brokerage industry. I am uniquely qualified to speak on this topic because I have examined this process in my roles as consumer, owner of an independent title firm, real estate broker, transactional real estate attorney, class action work, and as a consumer lawyer in my capacity as Executive Director of CAARE.

Instead of investigating the “pain points” of mortgage closing, perhaps it would be a more beneficial starting point to examine the purpose of the closing and determine if consumers receive anything remotely similar to a process that promotes safe, impartial and expert service that is free of outside financially interested influences. Why bother asking if the consumers are empowered at the closing, if they have already been steered into a compromised closing firm? Instead, ask why we have closings and what are closings supposed to accomplish and are there protections in place to accomplish those goals. What metrics best exemplify a good closing? How do we educate consumers about the importance of selecting a closing firm and how do we empower Realtors and loan officers to recommend impartial closing firms free of employment consequences? How do we insulate title/closing firms from the financial pressures of success fee referrers? Are there things we can do to ensure the impartiality of title/closing firms?

The closing should be the most important safeguard in the entire transaction. The closing is the best and last opportunity to stop consumer fraud and mortgage fraud. A good closing/title firm should be examining and exposing title and closing problems even if those decisions are undesirable to referral sources. A closing/title firm needs to be in a position to report illegal conduct by closing parties and professionals. A closing/title firm needs to be in a position to make a decision to stop a bad closing without consequences. A truly impartial title/closing firm could even participate in spotting certain types of mortgage fraud. However, so long as success-fee service providers are in control of closing/title company referrals, firms that do the right thing will be boycotted out of existence. A good closing is not necessarily a “smooth” or “quick” one.

A consumer who is truly informed and demands impartial and expert title, closing and escrow service is a much more appealing result than a snowed consumer who “feels” empowered or knowledgeable and walks away from a closing happy and satisfied. A consumer who places his trust in a fiduciary who truly walks in the consumer’s shoes and avoids self-serving advice is a much more appealing result than a consumer who trusts a compromised fiduciary laden with “disclosures.” The CFPB is competing against mammoth financial interests that have processes to keep the consumer in the dark, capture their business through deceit and raise prices through anti-competitive practices. The CFPB should examine how conflict-ridden closing services compromise the integrity of transactions and how impartial firms might enhance them.

The closing firm “selection” process of most consumers is typically accomplished by fiduciary exploitation or coercion. That is not an exaggeration. Consumers are routinely steered into over-priced in-house title/closing firms by Realtors who pledge to represent their clients’ interests above all others and to avoid conflicts of interests (definition of a fiduciary). Cost savings and safeguards at other firms are ignored or more likely concealed from clients. Realtors, loan officers, builders and others are now in the business of selling title insurance and serve to frustrate the consumers’ ability to shop and compare. The so-called Affiliated Business Arrangement disclosures exonerate fiduciaries from liability and perpetuate the problem. The typical “disclosure” built into fiduciary representation contracts provide the consumer with a choice – pick our title company or you are on your own. For a consumer who knows nothing about title companies, that is not much of a choice and there is no “disclosure” of the hazards of retaining a biased title firm. We have seen Realtors routinely refuse to convey information about savings to their clients and retaliate against title firms that convey the information directly to their clients. Fiduciary relationships have become a tool to conceal important competitive information from clients. This form of steering is far worse than fiduciaries “selling” title insurance to their clients (they should be providing advice) because it constitutes self-dealing, a betrayal of the most important fiduciary duty owed – the duty of loyalty. At the very least, the CFPB needs to examine these fiduciary relationships and determine if special rules should apply to them in regards to their role in advising their clients on matters involving AfBA’s.

How about a third choice: Realtor will provide consumer with a list of unaffiliated title firms and their pricing?

Builders are in a class all their own and routinely coerce consumers by providing “discounts” that far exceed the costs of services and those discounts are only available if the consumers use their lender and title firm. In other words, consumers will be penalized often tens of thousands of dollars if they use an independent firm of their choice. New construction is one of the highest risk and most complex title transactions. It is irresponsible to allow consumers to be coerced into quick, smooth, rubber-stamped closing/title processes with few protections. Builders should be prohibited from having affiliations with title firms.

These manipulations, referred to as “choice” have mostly been legalized through untimely and inadequate disclosures that serve to protect the industry from class action lawsuits. At the very least, special rules addressing self-dealing should be considered for fiduciaries who are affiliated with closing firms.

Perhaps the most reckless thing we could do is to avoid studying the importance of impartiality

in the closing process and assume that a compromised closing is ok just because the consumer provides their consent. There is a lot more at stake than customer satisfaction in allowing unsecure closings to take place. And, there is so much benefit for everyone if competitive and impartial elements are re-introduced to this important safeguard service industry.

As long as affiliated title firms exist, there will be market manipulations in existence that interfere with free market forces and destroy competition and the very integrity of the real estate transaction process.

Consider the following examples:

- **The distressed builder/developer with an affiliated title firm.** Builders proclaim the benefits of speed and smoothness of their affiliated title firms. However, builders typically have the most money at stake and the most complex title issues, especially if they are in financial trouble. What safeguards exist to protect the new construction homebuyer when the house they are buying is littered with unrecorded mechanics liens and underlying blanket mortgages? A distressed home builder is in a position to direct its closing company to ignore the mechanics liens, not provide mechanics lien coverage, and not to payoff the underlying mortgages. Entire communities are at risk.
- **The broker affiliated title firm.** Real estate brokers and their agents owe fiduciary duties to their clients. Brokers hold state issued licenses that impart important supervisory responsibilities on them. Brokers also determine agent commission splits, floor time opportunities and a lot more. Brokers routinely bonus agent managers based on the agent capture rate of title business. Agents are often given higher commission splits, more floor time and better prices on rent because of their capture rate. Agents are discouraged from shopping and comparing title firms on behalf of their clients. Brokers exploit their fiduciary capacity to charge more to their trusting clients. Brokers use their state supervisory licensing privileges to pressure agents to steer clients to the affiliated title firms. What if the broker agreed to allow an illegal side deal between the seller and the buyer – the in-house title company would likely close it. All of these things are occurring, yet they are difficult to track, they have no paper trails, yet the appearance of impropriety exists and so does the presumption that these things are more likely to happen. Does it make sense to continue to allow such conflictive situations to exist?
- **Consequences to competition when major brokers affiliate with title firms.** Brokers are in a position to charge their clients without question practically anything they want – and they do. Consider the consequences to competition, pricing and financial influence on underwriters, when all the major brokers in a marketplace affiliate with title/closing firms. Because consumers in a fiduciary relationship expect their broker's advice to be uncompromised, few ever question the quality of the product or the undisclosed conflicts of interest or the price of title or closing services. In many marketplaces, brokers heavily influence the drafting of standard purchase agreement forms. We know of once instance in Minnesota in which brokers on the Forms Committee of the Minnesota Association of Realtors redrafted their “standard” purchase agreement that created a market inefficiency that caused title fees to go up. We estimate this has cost Minnesota home buyers more than \$150 million. What if the brokers (through their AfBA's) pressured title insurance underwriters to do away with reissue credits or raise premiums for all title agencies (including independents)? We believe that may be happening as well.
- **Pressures on independent title firms.** Independent title firms have always been the only

source of competition and downward pressure on pricing. Affiliated business arrangements are the exception to the anti-kickback provision of RESPA and their existence has proven to result in reverse competition (upward pricing pressures). This AfBA “exception” provides unfair competitive advantages to AfBA’s and has caused the number of independents to dwindle. By legalizing kickbacks for some and not for others, it created an unlevel playing field that has stifled competition. Either eliminate AfBA’s or legalize kickbacks for everyone. Hopefully, the choice will be an obvious one. In addition, most underwriters have succumbed to the pressures of the larger volume affiliated businesses and raised the premium prices for everyone. The consolidation of underwriters has made this even more pronounced and has created the opportunity for parent corporations to homogenize the pricing of all their underwriters and eliminate lower priced options that used to attract independents. Many underwriters did this a few years ago.

We have heard proponents of AfBA’s state that they have referral sources other than their AfBA partners and therefore they “compete.” In fact, it is proof only that their coercion extends farther than their AfBA partners. Consider the loan officer who pays for office space inside a Realtor’s office who has been “requested” by the broker/owner to refer his refinance business to the Realtor’s title company. Consider the loan officer who has marketing agreements with Realtors who receives a similar request. AfBA’s rarely compete in an open and competitive fashion but instead are manifestations of deceit and exploitation of the consumer’s lack of knowledge (an asset for AfBA’s that has even been documented in AfBA’s prospectuses).

The closing/title insurance marketplace is in a shambles. Competitive forces are gone and reverse competition has consumed the industry. Consumers now have fewer choices than ever and are given inaccurate and self-serving advice when it comes to those choices. What good is it if consumers understand or do not understand their closing if they do not have a meaningful choice to begin with?

At the Closing

In many marketplaces, the only advisor who attends closing is the Realtor. In many states, the licensing standards are so minimal that it is possible that the “advisor” will only have 30 hours of education and lack a high school diploma. Yet these service providers are often too embarrassed to admit they lack the knowledge or experience and they will provide bad legal advice on topics that they do not understand. Who is going to advise the client that there is a significant exception to title coverage? Who is going to advise the client that signing an incorrect loan application or doing a side deal with the seller constitutes mortgage fraud? Who is going to advise the client to mark-up the title commitment, question the broker’s admin fee or commission, ask for a reissue credit on title insurance, or make necessary adjustments to the title company’s compliance agreement? Who is going to advise the client or review the builder’s sworn construction statement and signed lien waivers? Most issues that affect consumers and lenders will go unrecognized if there is not a competent advisor at closing to call attention to these problems. A closing perceived as quick and smooth often is really a closing with latent defects that will likely remain undiscovered for many months or years after closing.

While the most obvious solution to uncovering these problems and ensuring that consumers receive competent advice is to enlist the help of an attorney, consider the attorney’s conflicts. We

have interviewed many real estate attorneys who refuse to zealously represent their clients for fear of losing their referral source, Realtors. Asked if an attorney would call attention to Realtor malfeasance, the most common answer we received was no. The rationalization was, would you rather have an attorney there for part of the transaction or not at all. In many parts of the country, residential real estate attorneys have been construed as deal killers (those deal killers could have stopped a lot of bad loans a few years ago) and have been almost completely eliminated from the transaction process. Like loan officers that write bad loans, some Realtors recommend only attorneys who “get the job done” (those who do not kill deals).

Solutions

If we are going to continue to allow the integrity of the closing process to be burdened by service providers that exist to promote “smooth,” “efficient” and meaningless closings that ensure that Realtors and builders get paid, then maybe we would all be better off with handshake deals and save some money. The risk is about the same.

The alternative is to call out the problems and provide reasonable solutions. One stop shopping might be a great idea at Target, but it does not work in closing. Just like you would not want referees to be affiliated with a particular football team or judges to be affiliated with defendants or plaintiffs, title company affiliations destroy the impartial fact finding and decision making purposes of the closing.

If informed consumers and informed consumer decisions at closing is the goal, then break up the anti-competitive cartel that has invaded America called Affiliated Business Arrangements. Prohibit fiduciaries from providing self-serving advice, require that title companies be independent and separate from all referral sources and provide consumers with an unbiased method to make an informed choice about selecting a title company. Bring back competition to this important industry. In the alternative, set up a third party vendor manager that does this for the consumer. Most importantly, find a way to ensure that closing companies can make important decisions about the closing without fear of reprisal from success fee service providers like Realtors, loan officers, and builders.

Once you have solved the problem of compromised closing and title services you will find that the risk of foreclosures go down, closing costs will go down and consumers will benefit from better service and information that can only come from competition.

Sincerely,

Douglas R. Miller

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