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NEWS

What Do You Mean I Can't Close My Client's Real Estate Transaction?

By GEORGE T. HOLLER

What's new in the world of real estate closings? The better question is what hasn't changed in the last few years? Most real estate practitioners have heard of the American Land Title Association's (ALTA) best practices, and the acronyms are enough to drive you crazy, from CFPB to TRID to KBYO. It's a real alphabet soup. However, one of the most hotly debated topics is whether a borrower can still choose her own closing attorney, or to put it another way, can a lender say "no, that attorney cannot close our loan"?

To get some answers, I met with nationally renowned Real Estate Settlement Procedures Act (RESPA) compliance attorney Marx Sterbcow and former Consumer Financial Protection Bureau (CFPB) attorney Richard Horn, who led the drafting of the TRID rule while a senior counsel and special adviser at the CFPB and is now in private practice at Richard Horn Legal.

It all boils down to resolving the tension between federal law and Connecticut law.

On the federal side, there are the new Truth in Lending/Real Estate Settlement Procedures Act Integrated Disclosure (TRID) rules that recently took effect, but equally important is CFPB bulletin 2012-3 requiring lenders to supervise their service providers. On the state side is Connecticut's anti-coercion statute, C.G.S. §38a-816(11)(a)(i), which arguably allows a consumer to select any title insurance agent she chooses without restriction. Since federal law seems to allow, and maybe even requires, lenders to restrict who can act as their title agent, the question is how can these laws be reconciled?

The Connecticut anti-coercion statute states, "No person may require, as a condition precedent to the lending of money … that the [borrower] … acquire … any policy … of insurance through a particular insurer or group of insurers or producer or group of producers." Title insurance is covered under C.G.S. §38a-417, and §38a-402(1)(C) makes clear that attorney title agents are "producers." Read most broadly, these statutes seem to say a lender can never say no to a title agent because if the lender creates a "do-not-use" list, then every title agent who is not on that list is


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part of a "group of producers." While not an "approved" list, they certainly make up the "nondisapproved" list. Moreover, whether the statute prohibits blacklisting a title agent, without doubt, it prohibits making a list of approved providers.

In the face of this, CFPB bulletin 2012-3 requires lenders to supervise their "service providers." Attorney title agents are regulated service providers pursuant to 12 U.S.C. §5481(26). To use a folksy example, imagine I tell you to supervise John: "Have John get this job done, I'll be back in an hour." I return an hour later and the job isn't done. If you tell me John wouldn't listen to you, I would likely not be very happy with your performance as a supervisor. Now imagine you are a lender and there is a state law which makes it so that even if a Connecticut attorney title agent will not do what you ask, you cannot fire the attorney.

This is a clear case of conflict preemption. If it is impossible to comply with both federal law and state law, or if complying with state law interferes with federal objectives or is an obstacle to the accomplishment of the federal purpose, the state law must give way.

Horn said, "When we [the CFPB] were drafting the TRID rule, we considered the fact that many state laws and closing customs would be affected." This is reflected in the final TRID rule as published in the Federal Register (78 F.R. 79730). In discussing alternatives regarding who would prepare the closing disclosure, the publication notes: "Commenters identified several provisions of state laws that they stated give consumers an absolute right to choose their closing attorneys in residential real estate transactions" (id. at p. 79866). "We were very concerned with consumer choice, and technically the rule does not limit choice. But at the end of the day, the Dodd-Frank Act expanded TILA's coverage to require lenders to disclose title charges. The lender's expanded liability under TILA means they might have to take more control of the process," said Horn. This is confirmed in the official interpretation to 12 C.F.R. §1026.19(e)(1)(vi)(A), where the bureau indicates that the rule "permits creditors to impose reasonable requirements regarding the qualifications of the provider."

The CFPB 2012 bulletin details the bureau's expectations with respect to lender supervision and requires that lenders conduct thorough due diligence to verify the service provider complies with federal consumer financial law; request and review the company's policies and procedures for ensuring compliance; contract with service providers and provide clear expectations in those contracts; and conduct ongoing monitoring of the providers, and take prompt action to address problems, including terminating the relationship where appropriate. In order to comply with the bulletin, the lender must have the authority to fire the attorney title agent. Without question, federal law allows a lender to say no to a title agent and, in fact, requires lenders to do so if the title agent cannot be adequately supervised. Connecticut's statute must give way.

It also appears the statute is preempted to the extent it prohibits approved lists. Given the expectations set by the bureau, which require investigation of the agent and ongoing monitoring, a lender must do more than create a blacklist, but instead must create a white list of vetted suppliers.

Sterbcow said: "If a lender accepts title insurance from an attorney it hasn't vetted, that lender will be liable for failing to supervise its service providers. If there is a data breach with the borrower's Social Security number, or if the attorney violates some consumer protection law, the lender will be liable." Sterbcow sees a further risk for the lender regarding loan buybacks: "If there is an underlying violation, secondary market investors could force a buyback of that loan."

While borrowers are certainly free to select any attorney agent for their owner's title insurance, the lender must require that its policy come from a vetted agent to be sure it will be covered by the closing protection letter (CPL). See *Capital Mortgage Associates v. Hulton*, 2009 Conn. Super. LEXIS 380, WL 567057. This coverage is imperative for lenders. Not only does the secondary market require it, but CPL coverage puts the deep pockets of large title insurers behind the attorney agents in cases of fraud. See *Aurora Loan Services v. Hirsch*, 2014 Conn. Super. LEXIS 3250. The TRID rule makes lenders liable for fraud committed by their service providers, and only CPL coverage protects against that liability.

While many real estate practitioners may not like it, the closing environment has changed. To issue lender's title insurance, attorneys must, at a minimum, fully implement ALTA's best practices, consider third-party certification and be fully versed in federal consumer financial laws.

For lenders, the days of merely reviewing "policies and procedures" packages from attorney agents are quickly coming to an end. The CFPB requires lenders to undertake ongoing oversight and take appropriate action where needed. Keeping a review package on file does not satisfy this requirement. Sterbcow recommends lenders require that their agents have a third-party attestation or certificate from a reputable CPA firm. "That is quickly becoming the minimum standard for lender oversight," he said. ■

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