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Drilling down on the New York Effect

You may have heard people talk about New York a lot in the last few years, and with good reason. In response to an investigation, the New York State Department of Financial Services last year implemented a new regulation for title insurance providers that many thought were onerous and confusing. So much so that the state's land title association and some independent title agencies filed suit against the department to stop the regulation.

In addition, effective March 1, 2017, the NYSDFS came out with first in the country cybersecurity regulations and is now beginning to conduct examinations. During the National Settlement Services Summit, Christopher Gulotta, partner, Gulotta Grabiner Law Group PLLC and principal of Real Estate Data Shield, Inc. and Jean Partridge, chief counsel and managing member, Benchmark Title Agency LLC, delved into these new regulations and explained why it's important for you to understand, even if you don't live in New York.

History

Gulotta began the conversation by explaining that customarily at the New York purchase closing table, there is going to be a buyer's attorney, a seller's attorney, two Realtors and the title closer. Typically the buyer's attorney helps select the title insurance provider because the buyer typically pays for title insurance.

"The custom in New York has been that on a purchase transaction, the title closer might get a nominal fee from the title agent or title underwriter that they are working for, then the bulk of their compensation came in the form of either a gratuity," Gulotta said. "The buyer's attorney might turn to the buyer and say, 'hey, the title agent did a great job marking up the title report and making the requisite omissions to the exceptions and doing everything we needed, give them $100-$200 for their efforts.' That has pretty much been the custom forever, especially in Zone Two, which is the Greater New York City area.

"The other form of compensation that closers have received in New York is what is called a pick-up fee," he continued. "That is where if a seller's loan is being paid off, the title closer is going to undertake to get the payoff checks and funds to the payoff bank, then follow up and make sure that the payoff bank received the check and that it was in fact in the correct amount so that the title company insuring clear title has comfort in knowing that the lien was properly extinguished. That is the backdrop of how purchase transactions happen in New York."

Partridge added that in New York state, title agents weren't licensed until 2014, after 10 years of proposed licensing statutes being introduced in the legislature. "My understanding is that New York was the 47 or 48 state in the country to finally have title agent licensing," she said. "There were years and years, at least 10 years that I can recall of proposed licensing statutes that never came to fruition then finally in 2014 we were licensed. As many of us say in New York, be careful what you wish for, because with legislation and licensing comes regulation."

What's happening

DFS promulgated several sets of regulations in 2017, in particular Regulation 208. This regulation went into effect in December 2017, with one section being delayed until February 2018 due to legislative intervention.

"The main onerous provisions of this regulation is firstly that it prohibits ordinary marketing expenses," Partridge said. "In fact, it is illegal to buy a client a breakfast lunch or dinner, or even a cup of coffee.

"The other major thing it does is it expands Section 6409(d), which is the New York anti-inducement statute," she continued. "The regulation expands the statute by saying that no longer is a quid pro quo required. Anything you do will be deemed an inducement for the placement of title insurance and is therefore illegal.

"The regulation also substantially reduces ancillary fees, places caps on all nonpremium items that a title provider charges," she said. "Things like bankruptcy searches, patriot searches, municipal searches now are all subject to a cap on the fees."

Partridge then went into more detail on these and other issues the industry has with the regulation, beginning with the expansion of Section 6409(d).

"DFS decided to expand the statutory language of 6409(d)," she said. "The New York statute is very similar to RESPA in that you can't give a New York person anything of value as an inducement for the placement of title insurance. The statute ends there. The DFS added the following, "… including future title insurance business, maintaining existing title insurance business, regardless of whether it was provided as a quid pro quo for specific business."

"The argument that we have … is that the DFS exceeded their authority in doing so, that they have a right to interpret and enforce legislation, but certainly not to change legislation. We do have some good legislative support for that," Partridge said.

"Right now there are two bills pending," she added. "There is a bill in the assembly that makes it clear that a quid pro quo is required. This bill passed in the assembly and is pending senate approval. There is also a bill in the senate that states that the DFS does not have any authority to regulate ancillary charges. Again, this is pending and we are seeing where that will end."

She then explained that the lists of prohibited and permitted marketing activities is quite confusing.

"The DFS came up with a list of permitted activities," Partridge said. "Advertising in publications or media at market rates is permitted, fair enough. Promotional items of a de minimus value which includes a permanently affixed logo is also permissible. So I can give you a mug with my company name on it, but I can't fill it with coffee under the DFS regulations."

Another part of the regulation the industry objected to was the essentially mandatory five percent rate reduction. The regulation gave underwriters three options: to affirm to the DFS that there have been no prohibited expenses in the data call in the last six years, which Partridge said would be hard to do because what is prohibited now was not at the time. They could submit new rate filings removing six years of now prohibited expenses.

"We have the same problem as the prior choice in that all the underwriters say that that is impossible," she said. "They don't have records dating back that far and what was permitted in the past may now be prohibited in the future. All underwriters who don't choose either option one or option two must file a blanket rate reduction by June 18, 2018."

There was also the issue of how to pay title closers. The regulation prohibited the payment of gratuities from the buyer and limited when pick up fees could be charged and by whom. Partridge noted that title closers who were used to receiving approximately $500 per closing between the standard closing fee, gratuities and pick up fees, had their lives dramatically changed.

"On top of that, the DFS decided that staff closers get a salary, but independent closers do not," she said, therefore the DFS permitted independent closers to charge for pick up fees, but prohibited staff closers from charging for the same service. "The independent title closers were very vocal and reached out to the legislators and DFS. DFS said they had more than 2,000 letters from independent closers. DFS decided that independent closers can be paid for pickup fees, but staff closers cannot. So staff closers and independent closers who are doing precisely the same thing, they are paying off the seller's mortgage, yet in some instances the seller will have to pay a fee and in others the seller will not."

She said this is especially contradictory because the regulation states in many places that like charges will be paid by like sellers and like insureds.

Partridge noted that the New York State Land Title Association and two independent agents filed suit against the department, choosing four areas to litigate and that a hearing was to be held the week after the conference, on June 14.

An update

Since the conference, a lot has happened in the litigation. A hearing was held on June 14, and almost immediately, the judge granted a stay of the five percent rate reduction until after a ruling was handed down in the case.

The judge granted the industry a major victory on July 5 by declaring Regulation 208 null and void in its entirety, having some very harsh words for the DFS.

"It is common sense that marketing is an inducement for business," Judge **Eileen Rakower** wrote in her 15-page decision. "Therefore, if marketing is within the ambit of 'other consideration or valuable thing,' and the statute prohibits any inducement for title insurance business, the statute prohibits title insurance corporations from marketing for title insurance business."

In a statement after the motion, **Maria Vullo**, superintendent of the department, said the department plans to appeal the decision. A notice of appeal is pending, but the appeal has yet to be filed.

"DFS remains steadfast in our belief that Regulation 208 is a necessary supervisory tool to ensure appropriate market conduct and to protect New York consumers. We remain certain of our legal opinion and are confident we will prevail on appeal," she stated.

Cyber regulation implementation

Gulotta then talked about DFS Regulation 500 regarding cybersecurity and data security, which was touted as the first of its kind when it went effective in March of last year. He noted that once the regulation went into effect, the DFS gave regulated entities six months to have cyber policies and procedures in place, ensuring things like limitations on access privileges in their digital and physical environments. He noted that DFS is about to do their on-site cyber agency examinations under the new rule.

"This includes a whole cyber component," Gulotta said. "Unlike the regular audit that agents in our industry are accustomed to, this is a unique phenomenon. Unlike an underwriter audit, where they are likely to to come in and tell you, 'hey, you need to record more quickly, document this better, remit more quickly, now you are going to have a regulator that has incredible authority when they are onsite during investigations. They can have any filing cabinet or vault opened; they can call in any of your staff and take live testimony. As part of the cyber compliance process, when an owner or manager has signed off on cyber certification and they have put their license at risk because if the regulator finds out that they haven't lived up to their certification, (due Feb. 15 of every year), they can be fined or suspended or their license can be revoked."

He said there are limited exemptions for companies that meet certain criteria, such as your number of employees, your annual revenue and your total assets, but that companies that apply for that exemption better have all the information validating their status as a limited exempt Covered Entity when the department comes to do the examination.

"The main thing is the risk assessment," Gulotta said, noting this is also a requirement under the National Association of Insurance Commissioners' model law and recently adopted South Carolina statute. "The risk assessment is something that I recommend be done independently. The risk assessment is the true north, the compass if you will for a company. Your cyber policies and procedures and your cyber program, systems and controls all have to be revised and updated in light of the findings of the risk assessment. If any remediation gaps were identified and remediation controls need to be put in place, you have to show after your risk assessment that you identified those by way of critical, medium and low importance and that you actually took steps to remediate."

He said the cybersecurity program cannot simply be that you have a shred bin and use email encryption.

"You have to actually articulate in writing your comprehensive program for digital security, physical security and administrative security. You have to have your program and policies in place and show that they reflect the findings of your risk assessment and necessary remediation steps that arise out of the risk assessment."

New York appeals title ruling, hearing expected

The New York State Attorney General's office has filed an appeal on behalf of the Department of Financial Services (DFS) in its case with the New York State Land Title Association (NSYLTA).

The appeal was filed Aug. 6 in the Supreme Court of the State of New York Appellate Division – First Department and is expected to be heard in the fall, potentially in October, according to a NYSLTA blog posting.

The case involves the DFS' promulgation of Insurance Regulation 208, which banned inducements that included marketing from the title insurance industry. New York State Supreme Court Judge **Eileen Rakower** issued a scathing opinion in July, in which she said the regulation made the existing statute absurd, and cited DFS' arguments as "unreasonable and irrational."

In its appellate brief, the state said Rakower's decision rested on "multiple errors of law."

"The court misread the plain text of the relevant statutory prohibition on inducements, Insurance Law § 6409(d), as barring title insurers and agents only from offering monetary incentives such as rebates and commissions to real estate professionals — even though the statute unambiguously prohibits giving anything of value as an inducement," the brief stated. "Supreme Court's disregard of the statute's plain text led it to the absurd conclusion that DFS has no authority to prevent title insurers and agents from giving real estate professionals plainly valuable benefits such as lavish gifts, meals, and entertainment — despite DFS' uncontested finding that such benefits had the purpose and effect of inducing recipients to place business with the title insurer or agent that provided these benefits."

The state said Rakower wrongly annulled the regulation's prohibition on closers collecting pick-up fees. "In doing so, the court ignored the detailed administrative record that DFS had developed to support those restrictions, and further disregarded DFS' unambiguous statutory authority to set the premium rates that buyers can be required to pay," the brief stated.

Finally, the state argued DFS should have been granted deference in its interpretation of statutory language.

"Finally, the court erred by giving no deference whatsoever to DFS despite DFS' expertise in this complex field, its delegated authority to supervise the title insurance industry and protect consumers, and its authority to interpret its authorizing statutes — including not only Insurance Law § 6409(d), but also articles 23 and 24 of the Insurance Law, which authorize DFS to approve and reject title insurance rates and to police deceptive trade practices," the brief stated. "Because the regulation falls comfortably within DFS' statutory authority and is otherwise reasonable, this court should reinstate it and reverse Supreme Court's decision below."

According to the NYSLTA's blog – written by Benchmark Title Agency LLC Chief Counsel and Managing Member **Jean Partridge**, a recent speaker at the National Settlement Services Summit – the attorney general's office notified NYSLTA in July after it filed a notice of appeal that it would seek an emergency stay of Rakower's decision. However, it later informed NYSLTA counsel that it declined to seek an emergency stay, leaving the regulation annulled pending appeal.