# RESPA Dos and Don'ts

## RESPA DOs

Real estate brokers and agents must comply with the Real Estate Settlement Procedures Act, or RESPA. Violators of RESPA may receive harsh penalties, including triple damages, fines, and even imprisonment. Here are a few examples of what RESPA allows.

### RESPA...

**Allows** a title agent to provide, during an open house, a modest food tray in connection with the title company's marketing information indicating that the refreshments are sponsored by the title company.

**Allows** a home inspection company to sponsor association events when representatives from that company also attend and to post a sign identifying its services and sponsorship of the event.

**Allows** you to jointly advertise with a mortgage broker if you pay a share of the costs in proportion with your prominence in the advertisement.

**Allows** a lender to pay you fair market value to rent a desk, copy machine and phone line in your office to prequalify applicants.

**Allows** a hazard insurance company to give you marketing materials such as notepads, pens, and desk blotters, which promote the hazard insurance company's name.

**Allows** a title agent to pay for your dinner when business is discussed, provided that such dinners are not a regular occurrence.

Speak with a RESPA attorney to make sure you comply with all applicable laws. Some state and local laws prohibit activities that are permissible under RESPA.

## RESPA DON'Ts

RESPA prohibits giving or receiving anything for the referral of settlement services, subject to certain exceptions. Violators of RESPA may receive harsh penalties, including triple damages, fines, and even imprisonment. Here are a few of the examples of what RESPA prohibits.

### RESPA...

**Prohibits** a title company from regularly providing dinner and receptions for real estate agents.

**Prohibits** acceptance of discounted or free business equipment, such as a free lockbox.

**Prohibits** acceptance of reimbursement of the cost for an open house lunch from a mortgage broker who does not display any marketing materials at the event.

**Prohibits** acceptance of a dinner paid for by a home inspector who does not attend the dinner to market his/her services to you.

**Prohibits** acceptance of contributions from a title company to offset the cost of a real estate agent's promotional event except to the extent of the value of any marketing done by the title company during that event.

**Prohibits** accepting gifts from mortgage brokers, such as paying your greens fees.

**Prohibits** a mortgage broker or title company from paying for your tickets to a sporting event.

**Prohibits** participation in a tropical "getaway" weekend, the cost of which is underwritten by a title company, during which only two hours is dedicated to marketing by the title company and the remainder is recreation.

**Don't EVER** accept payment from a mortgage lender just for taking a loan application.

**Disclaimer:** The DOs and DON'Ts examples listed here are not all-inclusive and small variations in the facts can lead to different outcomes. They also do not take into consideration any additional regulations that may have been imposed in your state, which may prohibit activities that are permissible under RESPA. Speak with a RESPA attorney to make sure you comply with all applicable laws.

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NATIONAL ASSOCIATION *of* REALTORS®

# RESPA

## A Guide to Complying with the Real Estate Settlement Procedures Act

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# Introduction

In 1974, Congress enacted the Real Estate Settlement Procedures Act (RESPA) as a consumer disclosure and anti-kickback statute. As a result, RESPA serves four primary purposes:

**RESPA requires disclosures that list settlement costs to be given to homebuyers and sellers.**

**RESPA eliminates abusive practices, such as kickbacks and referral fees, which increase the costs paid by consumers.**

**RESPA reduces the amounts that homebuyers must place in escrow accounts.**

**RESPA reforms and modernizes local recordkeeping and land title information.**

This guide is designed to provide an introduction to RESPA's requirements and prohibitions affecting real estate brokers and agents. Part 1 of this guide briefly explains the scope of the Act, the general prohibition on kickbacks and referral fees under Section 8 of RESPA, exceptions to Section 8, penalties available for RESPA violations, and significant enforcement actions settled by the U.S. Department of Housing and Urban Development (HUD or Department) prior to July 21, 2011, which is the date when RESPA was transferred to a new regulator, the Consumer Financial Protection Bureau (CFPB). Part 2 contains examples of activities permitted and not permitted under Section 8 of RESPA.

Please be aware that RESPA requires certain consumer disclosures, including a HUD-1 Settlement Statement, a Good Faith Estimate, Special Information Booklets, Transfer of Servicing notices, and Escrow Account statements. Since real estate brokers and agents are not responsible for providing these disclosures, this guide does not review the disclosure requirements under RESPA.

Moreover, please be aware that many states have enacted laws with similar prohibitions and consumer protections as provided under RESPA. This guide discusses only the federal requirements of RESPA and does not take into consideration any additional regulations that may have been imposed on the state level. It is possible that state laws may prohibit activities that are permissible under RESPA, and we recommend that you consult with a RESPA attorney to ensure that you comply with applicable laws. This guide is not intended to provide you with legal advice as to the matters discussed herein.

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# Part 1

## SCOPE OF RESPA

RESPA applies to ***settlement services.**** Settlement services are provided by settlement service providers. Settlement services are things associated with the purchase of a home that occur at or before settlement. If the service occurs *after* settlement, it is generally *not* considered a settlement service. Settlement services include the following:

- Real estate broker or agent services
- Services related to the issuance of a title insurance policy
- Origination of a mortgage loan
- Services rendered by a mortgage broker
- Services related to origination, processing, or funding of a mortgage loan
- Services rendered by an attorney
- Document preparation, including notarization, delivery, and recordation
- Rendering credit reports and appraisals
- Rendering inspections
- Settlement or closing
- Services involving hazard, flood, or other casualty insurance or homeowners' warranties
- Services involving real property taxes or other assessments or charges on real property
- Any other services that a settlement service provider requires a borrower to pay for before or at closing

RESPA, therefore, governs the activities of a person or entity that provides any of the services listed above, including real estate brokers and agents.

RESPA does not apply to:

- Transactions that are primarily for business, commercial, or agricultural purposes
- Government or governmental agencies or instrumentalities
- Temporary financings
- Secondary market transactions

## ANTI-KICKBACK PROVISIONS

Section 8 of RESPA prohibits referral fees and kickbacks to settlement service providers because these fees raise the cost of services to consumers. Section 8 is divided into four parts:

- Section 8(a) prohibits referral fees
- Section 8(b) prohibits the splitting of unearned fees
- Section 8(c) lists exceptions to the prohibitions in Sections 8(a) and (b)
- Section 8(d) governs the enforcement of RESPA

## SECTION 8(a)—PROHIBITION AGAINST REFERRAL FEES

Section 8(a) prohibits a person from giving or receiving any fee, kickback, or thing of value pursuant to any written or oral agreement or understanding that business involving a real estate settlement service and a federally related mortgage loan will be referred to any person.

Four elements are required for a Section 8(a) violation:

1. A settlement service involving a ***federally related mortgage loan.*** RESPA defines a federally related mortgage loan as a loan secured by a first or subordinate lien on a one-to-four family residential dwelling (including manufactured homes) that meets certain other criteria. A federally related mortgage loan means *any* loan that places a lien on a one-to-four family property and includes both government-insured and conventional mortgage loans.
2. A ***referral*** of business incident to or part of a settlement service pursuant to an ***agreement*** or ***understanding.*** Please be aware that the agreement or understanding does not have to be written or verbalized, but may be established by practice, pattern, or course of conduct.
3. Payment or receipt of a fee or ***thing of value.*** RESPA regulations provide that a fee or thing of value is virtually anything one receives in consideration for referring a settlement service, including, but not limited to:
   - Money or fees
   - Discounts
   - Duplicate payments of a charge
   - Stock, dividends, distribution of profits
   - Credits representing money that may be paid at a future date
   - Opportunity to participate in a moneymaking program

- Retained or increased earnings
- Increased equity in a parent or subsidiary entity
- Special bank deposits or accounts, or special or unusual banking terms
- Services of all types at special or free rates
- Lease or rental payments based in whole or in part on the amount of business referred
- Trips and payment of another person's expenses
- Reduction in credit against an existing obligation

4. For the referral of settlement service business.

## SECTION 8(b) — PROHIBITION AGAINST SPLITTING UNEARNED FEES

In addition to the prohibition on kickbacks and referral fees, RESPA prohibits a person from *giving and receiving* any portion, split, or percentage of any fee charged or received for a real estate settlement service in connection with a federally related mortgage loan, unless the portion of the fee is for services actually performed.

Federal circuit courts have interpreted Section 8(b) differently. Some courts concluded that Section 8(b) requires an *actual split* of a fee between two or more parties when no services are performed in order for a Section 8(b) violation to occur. Other courts concluded that a single party can violate Section 8(b) by marking up a third party's fee or charging a fee and not performing services in return.

Prior to the transfer of RESPA to the CFPB, HUD issued a Policy Statement expressing its interpretation of Section 8(b). Under that Policy Statement, HUD did not require a split of a fee to find a Section 8(b) violation. HUD's Policy Statement described three scenarios where a Section 8(b) violation would occur:

- Two or more persons split a fee and one person did not perform any services to receive a share of the fee
- One person marks up the cost of a third party service and keeps the difference without providing any goods or services to justify the additional charge
- One person charges a fee for no, nominal or duplicative work, or a fee that exceeds the value of the goods or services provided

For example, HUD would have taken the position that the lender's markup of a $400 appraisal fee to $450, and retention of the $50 extra, is all that is required to constitute a violation of Section 8(b).

The U.S. Supreme Court settled the split in the federal circuit courts as it relates to Section 8(b).[1] In response to plaintiffs' allegations that a mortgage lender charged them a fee for no services when it assessed a loan discount fee and did not lower the interest rate, the U.S. Supreme Court issued a decision on May 24, 2012 and held that a person must split a charge with another person that performs no services to constitute a violation of Section 8(b). As a result of this decision, real estate brokers are able to assess flat fee charges for their own services without regard to Section 8(b).

[1] *Freeman v. Quicken Loans, Inc., 2010 U.S. App. LEXIS 23624 (5th Cir., Nov. 17, 2010); 2012 WL 1868062 (May 24, 2012).*

## SECTION 8(c) — EXCEPTIONS TO THE ANTI-KICKBACK PROHIBITIONS

Despite the prohibitions in Section 8 of RESPA, Congress understood that a number of business referrals that occur in the settlement service industry do not harm consumers. As a result, Congress permitted certain conduct to be exempt from RESPA. If a fee or thing of value is paid under one of these exceptions, the person or entity does not violate RESPA. These exceptions are listed below.

1. **Cooperative agreements between listing and selling real estate brokers**
   This exception refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity. Please be aware that this exception has no applicability to fee arrangements between real estate brokers and mortgage brokers, or between mortgage brokers.
2. **Payments to an attorney for services actually rendered**
3. **Payments by a title company to its duly appointed title agent for services performed in the issuance of a title policy**
   To qualify for this exception and receive compensation as a title agent, an entity must perform "core title services" and be liable to its insurer for any negligence in connection with the issuance of a defective title policy. Core title services include:
   - Examination and evaluation of the title evidence to determine insurability
   - Preparation and issuance of the title commitment
   - Clearance of underwriting objections
   - Preparation and issuance of the title policy
   - Handling of closing or settlement where the closing is part of an all-inclusive title insurance rate
4. **Payments by a lender to its duly appointed agent for services performed in the making of a loan**
   This exception is unclear and there is little explanation provided in the statute, regulations, or legislative history regarding the meaning of the exception.

5. **Payments by an employer to its employee**
Under this exception, an employer may pay its own employees for any referral activities. The referred party, however, may not pay the employee or reimburse the employer for the employee's referral.

Regulators have not articulated a position on who constitutes an "employee" under RESPA. Nevertheless, if a person satisfies all Internal Revenue Service requirements for employment, a reasonable basis exists to conclude that he or she will be considered an employee under RESPA. These employment requirements include, to name a few:

- Employee is subject to employer's supervision and control
- Employee maintains a physical presence at the employer's office
- Employee uses employer's office supplies and equipment
- Employee works a set number of hours for employer
- Employee receives paychecks and W-2 forms from employer

It is important to emphasize that real estate agents are typically considered independent contractors and not employees, and, therefore, are not eligible for this exception.

6. **Payments for services actually rendered or goods actually provided**
To qualify for this exception, a two-part test must be satisfied:

1. Actual, necessary, and distinct goods or services must be provided.
2. The compensation must be reasonably related to the goods and services provided.

With regard to actual goods and services:

- A title agency must perform core title services.
- A mortgage broker must take a loan application and perform at least five of the following 13 additional items:
  - Analyze the borrower's income and debt, and prequalify the borrower to determine the maximum allowable mortgage.
  - Educate the borrower in the home buying and financing process, advise him or her about different types of available loan products, and demonstrate how closing costs and monthly payments differ for different products.
  - Collect financial information (tax returns, bank statements) and other related documents.
  - Initiate and order Verifications of Employment and Deposit.
  - Initiate and order requests for mortgage and other loan verifications.
  - Initiate and order appraisals.
  - Initiate and order inspections or engineering reports.
  - Provide disclosures to the borrower.
  - Assist the borrower in understanding and clearing credit problems.
  - Maintain regular contact with the borrower, real estate agents, and lender between the time of application and closing, and gather any additional information as needed.
  - Order legal documents.
  - Determine whether the property was located in a flood zone or order such service.
  - Participate in the loan closing.

If a mortgage broker takes a loan application and performs counseling-type services, the following additional factors are considered to ensure that meaningful counseling is performed and that a broker is not compensated for steering a customer to a particular lender:

  - The entity furnishes the borrower an opportunity to consider products from at least three different lenders
  - The entity receives the same compensation regardless of which lender's products are ultimately selected
  - Any payment for the counseling services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender

- Core services for other types of settlement service providers are not defined. Nevertheless, numerous other goods, such as rental of a desk in a real estate broker's office, services performed by a real estate broker or agent for other settlement service providers, or goods provided, such as software technical support, can qualify for the exception, as long as the services are actual, necessary, and distinct from services already being provided by the real estate broker or agent.

With regard to the compensation paid, it must be reasonably related to the value of the goods or services provided.

When HUD was responsible for regulating and enforcing RESPA, it did not offer meaningful guidance as to how to determine the reasonableness of a particular fee. The Department, however, did indicate that it may be appropriate to consider fees generally charged in the marketplace for the service provided or the internal cost of providing the service. Determining fair market value is a business decision that a real estate broker or agent must be able to defend should regulators or a court question its reasonableness.

Please be aware, however, that RESPA is not a rate-setting statute and does not prescribe how much a real estate broker or agent may charge. As noted above, RESPA requires that a fee be commensurate with the value of the services provided.

7. **Payments among affiliated business arrangements (AfBA)**
In 1983, RESPA was amended to permit two settlement service providers to own other settlement service providers or enter into a joint venture operation, so long as the AfBA adheres strictly to RESPA requirements and guidelines. Thus, if a real estate broker refers customers to a title insurance agency in which the real estate broker owns a 50% interest, this arrangement qualifies as an AfBA. Generally, this exception permits the AfBA owners to receive a return on their ownership interest in the AfBA, and these payments are not considered to be referral fees.

To comply with RESPA, an AfBA must meet the following requirements of a safe harbor test:

- The AfBA owner who refers business to the AfBA must provide a written disclosure on a separate sheet of paper of the existence of the arrangement along with a written estimate of the charge or range or charges imposed by the AfBA no later than the time of the referral.
- The customer being referred must not be *required to use* any particular provider of settlement services.
- No payments, other than a return on ownership interest or payments otherwise permitted under the statute, may be received under the arrangement.

In addition to meeting the three-part safe harbor test, an AfBA must be a bona fide provider of settlement services, rather than a "sham" business used to disguise referral fees. When HUD was responsible for regulating and enforcing RESPA, HUD issued a Statement of Policy that listed several factors to be used to determine if an AfBA is a bona fide provider of settlement services. Please note that an AfBA does not have to meet all factors to be lawful, and no one particular factor will determine whether an AfBA is legitimate. These factors are summarized below:

- An AfBA must have sufficient initial capital, typical in the industry, to conduct the settlement service business for which it was created.
- The AfBA must have its own employees.
- The AfBA must either manage its own affairs or, if one of its owners provides management services, pay such owner the fair market value of its services.
- The AfBA must have its own office space so that the public can clearly identify the entity with which it is doing business. If an AfBA rents space from an owner, it must pay fair market rent to the owner for the space and facilities used.
- The AfBA must provide "substantial services," or the essential functions and types of services generally performed by the type of entity at issue. For example, in the case of a joint venture title insurance agency, these substantial services are termed "core title services."
- The AfBA must perform all "substantial services" itself and may not subcontract out such functions. Non-substantial services may be subcontracted out, which include, for example, those related to management, accounting, and human resources.
- The AfBA must actively compete in the marketplace for business and attempt to market its services to others besides its joint venture partners.

An entity that meets both the safe harbor test and performs the functions of a bona fide business will satisfy the AfBA requirements. As a result, such entity may refer business to and receive dividends from an affiliated settlement service provider without risk of violating Section 8.

Please refer to ***Affiliated Business Arrangements, A Guide to Complying with the Real Estate Settlement Procedures Act*** for more information on RESPA's requirements.

## SECTION 8(d) — ENFORCEMENT OF SECTION 8

Real estate brokers and agents should be aware that RESPA authorizes harsh penalties for those in violation of Section 8. Specifically, to enforce the prohibitions against kickbacks and the splitting of fees, Section 8(d) gives the CFPB the authority to impose the following penalties:

- Civil and criminal penalties
- Imprisonment for up to one year
- A fine of up of $10,000
- Both imprisonment and a fine
- Treble damages, which means a person who violates Section 8 of RESPA must pay three times the amount of the charge for the settlement service involved in the violation

RESPA also authorizes the following entities or persons to sanction violators:

- State attorney generals and state insurance commissioners
- Consumers

If a person or entity violates the anti-kickback provisions of RESPA, a consumer has one year to bring an action in court in connection with the violation. The government, however, may bring an action within three years of the violation. Business competitors have no standing to bring a lawsuit to enforce RESPA.

Prior to the transfer of RESPA to the CFPB, HUD had increased its enforcement staff and stepped up its pursuit of RESPA violators. From these efforts, HUD often focused its enforcement efforts on real estate brokers and affiliated business arrangements. For example, in a July 28, 2003, press release, HUD announced a settlement agreement with a savings bank, which allegedly paid up to $100 to real estate agents for filling out and submitting online applications for prospective borrowers. Under the settlement, the bank agreed to discontinue the practice and paid a fine to the U.S. Treasury. The Department stated that "HUD has long considered that a real estate agent may not be compensated for merely filling out a loan application" and that such "compensation may even be considered a fee for the referral of business in violation of Section 8(a) of RESPA." A few months later, HUD announced a similar settlement for alleged payments to real estate agents for allegedly taking loan applications. This lender agreed to pay the government $15,000 as a settlement.

HUD also pursued real estate brokers and agents for accepting website "virtual tours" of broker properties paid for by various title companies. In two separate settlement agreements, real estate brokers agreed to pay $5,200 and $14,000 respectively to settle HUD's allegations and to discontinue all such practices. In addition, HUD pursued real estate brokers for accepting conference room rental fees in excess of fair market value. According to the Department, any portion of the rental fee received above fair market value constituted an alleged fee for the referral of business. Two real estate brokers agreed to pay HUD $45,000 and $15,000. HUD also entered into a settlement agreement with an Atlanta-based real estate broker for alleged payments to real estate agents. Specifically, HUD alleged that the broker provided agents with relocation services, paid commissions immediately at closing, offered incentives, such as trips and baseball tickets, and paid higher commissions in exchange for referrals to the broker's affiliated business. The real estate broker agreed to pay a $250,000 fine.

Moreover, as real estate brokers and agents often maintain ownership interests in joint ventures, HUD's enforcement efforts involving affiliated business arrangements are of particular concern. For example, on March 21, 2005, HUD announced a settlement with several entities that owned a joint venture settlement company. One such entity was comprised of real estate agents and distributed its profits from the joint venture based on the agents' volume of referrals. HUD alleged that these payments constituted referral fees, rather than returns on an ownership interest, and the parties agreed to pay $325,000 and to modify certain business practices.

Finally, in one of the last HUD settlements prior to the RESPA transfer to the CFPB, on July 11, 2011, HUD announced a settlement agreement with a national title insurance company. HUD alleged that real estate brokers entered into "Application Service Provider Agreements" to gain access to a Web-based platform that allowed the brokers to place orders for settlement services. The real estate brokers, in turn, entered into Sub-License agreements with subsidiaries of the title insurance company to enable the subsidiaries to be listed as providers in the Web-based platform. As part of the Sub-License agreement, HUD alleged that title insurance subsidiaries paid improper referral fees to the real estate brokers for each settlement service order placed through the platform. HUD, however, did not take issue with the licensing fees paid by the title insurance subsidiaries to the real estate brokers for use of the Web-based platform. The title insurance company agreed to pay $4.5 million to HUD to settle these allegations.

Since taking responsibility for RESPA enforcement on July 21, 2011, the CFPB has geared up its enforcement staff and has opened investigations regarding RESPA issues. The CFPB also has established an online complaint system that permits consumers to file complaints with the CFPB related to their mortgage loan. As of May 2012, however, the CFPB has yet to publicly announce any RESPA settlements or actions. That said, in addition to the statutory penalties for violations of Section 8 of RESPA (a fine of $10,000, imprisonment for up to one year, or both), the CFPB could impose a number of sanctions against those who violate RESPA, including mandated refunds, restitution, damages, disgorgement of profits, and civil money penalties, to name a few.

Based on these past HUD actions and the CFPB's enforcement powers, if you encounter an issue in your day-to-day operations that raises a question under RESPA, it is important that you seek additional resources and legal advice, if necessary. As you have read, RESPA violations can carry serious consequences, and it is imperative that you be aware of possible RESPA issues at all times.

Please contact NAR, or visit our website at **www.REALTOR.org/RESPA** for more informational materials on RESPA compliance.

# Part 2

## RESPA QUESTIONS AND ANSWERS

1. **QUESTION:** A real estate agent is sponsoring an open house for other agents. A local title agency reimburses the real estate agent for the cost of a luncheon and the title agency does not market its title services at the open house. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *Yes, this is a violation of RESPA. By reimbursing the real estate agent for the cost of the luncheon, the title agency has given the real estate agent a thing of value in consideration for the referral of business. Both the title agency and the real estate agent could be held responsible for the RESPA violation. If, however, the real estate agent attends the open house to make a presentation or to otherwise market its services, such payments may be lawful under RESPA.*

2. **QUESTION:** A real estate broker and a mortgage lender agree to jointly place a full-page advertisement in a local newspaper. Each company gets exactly one-half of the page to advertise its services. Each company pays one-half of the cost of the advertisement. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *No, this appears to comply with RESPA. As long as the advertising costs paid by each party are reasonably related to the value of the goods or services received in return (i.e., the amount of advertising), no violation exists. In the past, HUD stated that "[n]othing in RESPA prevents joint advertising[,]" but "if one party is paying less than a pro rata share for the brochure or advertisement, there could be a RESPA violation."[2] Without guidance to the contrary, we assume the CFPB would agree with HUD's statement.*

3. **QUESTION:** The owner of a title agency meets the owner of a real estate brokerage firm for dinner at a local restaurant. The purpose of the dinner is for the two individuals to discuss future marketing opportunities. After the discussion has ended, the owner of the title agency pays for the real estate broker's dinner. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *No, this appears to comply with RESPA. The owner of the title agency can pay for dinner and not violate RESPA because the purpose of the dinner was business related and was not a payment for the referral of business.*

4. **QUESTION:** A real estate broker charges a seller a $250 administrative fee and does *not* split the fee with anyone. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *No, according to the U.S. Supreme Court, this is not a violation of RESPA. In Freeman v. Quicken Loans, the Supreme Court held that a single party cannot violate Section 8(b) of RESPA with its own, unilateral charges.*

5. **QUESTION:** A mortgage lender devises a contest among local real estate agents where the real estate agent who refers the most customers to the lender will receive a vacation cruise to Alaska. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *Yes, this is a violation of RESPA. The vacation cruise is a thing of value in exchange for the referral of business and violates Section 8's anti-kickback provisions. Both the mortgage lender and the real estate agents can be held responsible for the violation under RESPA.*

6. **QUESTION:** "A" is a real estate broker who refers business to its affiliate title company "B." "A" provides its customers with an affiliated business disclosure that lists the range of charges that "B" will charge for title services, states that "A" has a financial interest in "B," and notifies the customer that he or she is not required to use "B" for title services. Does this violate Section 8 of RESPA?

   **ANSWER:** *No, this complies with RESPA. The referrer of business to an affiliated entity is required to provide a written disclosure to each consumer that identifies the affiliated relationship, provides the charges or range of charges that the joint venture generally charges, and notifies the consumer that he or she is not required to use the affiliated business.*

7. **QUESTION:** Real estate broker "A" and title insurance company "B" create an affiliated title agency "C." "C" pays annual dividends to "A" and "B" in proportion to the amount of business that each refers to "C" during the year. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *Yes, this is a violation of RESPA. An affiliated business may only pay its partners in annual dividends that are based on the amount of stock held by the partners. RESPA prohibits the payment of dividends based on the amount of business referred or expected to be referred to an affiliated business.*

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[2] *HUD Website, Frequently Asked Questions About RESPA For Industry, http://www.hud.gov/offices/hsg/sfh/res/resindus.cfm.*

8. **QUESTION:** A title company places a fax machine in the office of a real estate broker to expedite the process of placing title orders with the title company. The title company expects that the real estate broker will refer business to the title company if the broker can quickly send information to the title company. The fax machine is used only for communication between the real estate broker and the title company. The real estate broker has a separate fax machine for general business. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *No, this appears to comply with RESPA. The title company provides the fax machine in exchange for actual services from the real estate broker and the fax machine is dedicated to business conducted only with the real estate broker. If, however, the real estate broker uses the fax machine both for business with the title company and its general real estate business, this may constitute a violation of RESPA.*

9. **QUESTION:** A settlement agent conducts real estate closings in the conference room of the real estate broker with the expectation that the real estate broker will refer closing business to the settlement agent. The settlement agent pays fair market value to rent the conference room for each closing. Is this a violation of Section 8 of RESPA?

   **ANSWER:** *No, this appears to comply with RESPA. A settlement service provider may rent a conference room or other office space from another settlement service provider, as long as it pays fair market value to rent the space. Fair market value should be based on what a non-settlement service provider would pay for the same amount of space and services in the same or a comparable building.*

10. **QUESTION:** A real estate broker pays its real estate agents $20 for each referral the agents make to the real estate broker's affiliated mortgage company. Is this a violation of Section 8 of RESPA?

    **ANSWER:** *Yes, this is a violation of RESPA. Although RESPA provides an exception for payments made from an employer to its employees, payments between a real estate broker and its real estate agents do not qualify for this exception. Real estate agents are considered independent contractors, rather than employees of the real estate broker. As a result, the $20 payments described above constitute payments in return for the referral of business in violation of RESPA.*

11. **QUESTION:** A homeowner's insurance company gives a real estate broker marketing materials, such as desk calendars, pens, and notepads, all of which promote the homeowner's insurance company's name. Is this a violation of Section 8 of RESPA?

    **ANSWER:** *No, this appears to comply with RESPA. RESPA regulations provide an exception to Section 8 for normal promotional and educational activities that are not conditioned on the referral of business and that do not defray expenses that otherwise would be incurred by persons in a position to refer settlement service business.*

12. **QUESTION:** A mortgage lender occupies an office in a real estate broker's business in order to prequalify customers for mortgage financing. Occasionally, real estate agents take loan applications from their customers and receive $40 in return for each application. Is this a violation of Section 8 of RESPA?

    **ANSWER:** *Yes, this may be a violation of RESPA, according to HUD. Although the CFPB is now responsible for RESPA, HUD took the position that to be compensated as a mortgage broker, a person must take a loan application and perform at least five additional services in order to receive payment. Thus, assuming the CFPB agrees with HUD's position, if a real estate agent takes the loan application, but does not perform any other functions, he or she cannot receive payment under RESPA.*

# Glossary

## AFFILIATED BUSINESS ARRANGEMENT

An arrangement in which:

- A person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than one percent in a provider of settlement services; and
- Either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.

*12 U.S.C. § 2602(7).*

## AFFILIATE RELATIONSHIP

The relationship among business entities where one entity has effective control over the other by virtue of a partnership or other agreement or is under common control with the other by a third entity or where an entity is a corporation related to another corporation as parent to subsidiary by an identity of stock ownership. *12 C.F.R. § 1024.15(c)(2).*

## AGREEMENT OR UNDERSTANDING

An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by practice, pattern, or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business. *12 C.F.R. § 1024.14(e).*

## ASSOCIATE

One who has one or more of the following relationships with a person in a position to refer settlement business:

- A spouse, parent, or child of such person;
- A corporation or business entity that controls, is controlled by, or is under common control with such person;
- An employer, officer, director, partner, franchisor, or franchisee of such person; or
- Anyone who has an agreement, arrangement, or understanding, with such person, the purpose or substantial effect of which is to enable the person in a position to refer settlement business to benefit financially from the referrals of such business.

*12 U.S.C. § 2602(8).*

## FEDERALLY RELATED MORTGAGE LOAN

Any loan (other than temporary financing such as a construction loan) which:

A) Is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from one to four families, including any such secured loan, the proceeds of which are used to prepay or pay off an existing loan secured by the same property; and

B) (i) Is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the federal government, or is made in whole or in part by any lender which is regulated by any agency of the federal government; or

(ii) Is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary or any other officer or agency of the federal government or under or in connection with a housing or urban development program administered by the Secretary or a housing or related program administered by any other such officer or agency; or

(iii) Is intended to be sold by the originating lender to the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or a financial institution from which it is to be purchased by the Federal Home Loan Mortgage Corporation; or

(iv) Is made in whole or in part by any "creditor," as defined in section 1602(f) of title 15 [Truth in Lending Act], who makes or invests in residential real estate loans aggregating more than $1,000,000 per year, except that for the purpose of this chapter, the term "creditor" does not include any agency or instrumentality of any State.

*12 U.S.C. § 2602(1).*

### REFERRAL

A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business. A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use a particular provider of a settlement service or business incident thereto. *12 C.F.R. § 1024.14(f).*

### REQUIRED USE

A situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service. However, the offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process. *12 C.F.R. § 1024.2(b).*

### SETTLEMENT SERVICES

Any service provided in connection with a real estate settlement including, but not limited to, the following: title searches title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement. *12 U.S.C. § 2602(3).*

### THING OF VALUE

Any payment, advance, funds, loan, service, or other consideration. *12 U.S.C. § 2602(2).*

It includes, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses, or reduction in credit against an existing obligation. *12 C.F.R. § 1024.14(d).*

## *Federal Information Resources*

For more information on the CFPB's regulation and enforcement of RESPA, please contact the CFPB at **CFPB_RESPAInquiries@cfpb.gov**.

# AfBA

## A Guide to Complying with the Real Estate Settlement Procedures Act

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NATIONAL ASSOCIATION of REALTORS®

# Introduction

In 1974, Congress enacted the Real Estate Settlement Procedures Act (RESPA) as a consumer disclosure and anti-kickback statute.

As a result, RESPA serves four primary purposes:

**RESPA requires disclosures that list settlement costs to be given to homebuyers and sellers.**

**RESPA eliminates abusive practices, such as kickbacks and referral fees, which increase the costs paid by consumers.**

**RESPA reduces the amounts that homebuyers must place in escrow accounts.**

**RESPA reforms and modernizes local recordkeeping and land title information.**

Prior to 1983, if a real estate broker or agent received dividends from an affiliated mortgage or title entity, the payment would have violated the anti-kickback provisions of RESPA as a payment for the return of business. In 1983, however, Section 8 of RESPA was amended to allow an exception for affiliated business arrangements so long as certain requirements are met. An affiliated business arrangement exists when a person in a position to refer settlement business, such as a real estate broker, or an "associate" of such person, has an affiliate relationship with, or a direct or beneficial ownership interest of more than one percent in, an entity to which business is referred, such as a joint venture title or mortgage entity.[1]

An "associate" is defined, among other things, to include a spouse, parent company, or an employee, officer, director or partner of such person.

This guide is designed to provide you with an introduction to affiliated business arrangements (AfBA) and RESPA's requirements for real estate brokers and agents who have ownership interests in AfBAs. Part 1 of this guide briefly explains the general prohibition on kickbacks and referral fees under Section 8 of RESPA, the affiliated business arrangement exception to Section 8, and the necessary factors to establish a bona fide settlement service provider as well as significant enforcement actions involving AfBAs settled by the U.S. Department of Housing and Urban Development (HUD or Department) prior to July 21, 2011, which is the date when RESPA was transferred to a new regulator, the Consumer Financial Protection Bureau (CFPB). Part 2 contains common questions about AfBAs and provides answers under RESPA to aid you in establishing and maintaining a compliant joint venture. This guide is intended to identify only those obligations of an AfBA and its owners under RESPA and does not cover RESPA's other requirements.

For an overview of all RESPA requirements for Section 8, please see NAR's ***RESPA, A Guide to Complying with the Real Estate Settlement Procedures Act.***

Please be aware that many states have enacted laws with similar prohibitions and consumer protections as provided under RESPA. This guide discusses only the federal requirements of RESPA and does not take into consideration any additional regulations that may have been imposed on the state level. It is possible that state laws may prohibit activities that are permissible under RESPA, including those applicable to AfBAs, and we recommend that you consult with a RESPA attorney to ensure that you comply with all applicable laws. This guide is not intended to provide you with legal advice as to the matters discussed herein.

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[1] *See 12 U.S.C. § 2602(7).*

# Part 1

## SECTION 8 OF RESPA — PROHIBITIONS AGAINST KICKBACKS AND REFERRAL FEES

RESPA applies to ***settlement services***. Settlement services are provided by settlement service providers. Settlement services are things associated with the purchase of a home that occur at or before settlement.[2] If the service occurs after settlement, it is generally not considered a settlement service. Services performed by real estate brokers and agents are considered settlement services under RESPA.

RESPA also applies only to ***federally related mortgage loans***, which are loans secured by a first or second lien on, among other things, a one-to-four family dwelling or condominium, or, in certain circumstances, a manufactured home. A federally related mortgage loan means any loan that places a lien on a one-to-four family property and includes both government insured and conventional mortgage loans.

In enacting RESPA, Congress expressed an intent to outlaw kickbacks and referral fees that tend to increase costs to consumers. To this end, Section 8 of RESPA prohibits payments in return for referrals of real estate settlement service business and the splitting of unearned fees for the performance of real estate settlement services. In general, therefore, four elements are required for a Section 8 violation:

- The presence of a settlement service
- The referral of business incident to or part of such settlement service pursuant to an agreement or understanding
- The payment or receipt of a fee or thing of value, or the splitting of any portion of a charge imposed by a provider of settlement services
- A payment made in consideration for such referral instead of for services actually performed or goods and facilities actually furnished

Congress, however, also recognized that certain activities that occur in the settlement service industry do not harm consumers. As a result, Congress enacted certain exceptions to the Section 8 prohibitions, including an exception for affiliated business arrangements.

## EXCEPTION TO SECTION 8 — AFFILIATED BUSINESS ARRANGEMENTS

Section 8(c)(4) of RESPA provides that an AfBA is not a violation of Section 8 so long as three requirements are met. As described below, this three-part ***safe harbor test*** involves disclosures to consumers, required use, and returns on ownership interest. So long as an AfBA satisfies all three requirements, it will satisfy the Section 8(c)(4) safe harbor test.

1. The AfBA owner referring business to the AfBA must provide a written disclosure on a separate sheet of paper to each consumer who is referred to the AfBA no later than the time of the referral. The disclosure must include the following information:
   - A statement of the existence of the AfBA relationship
   - An explanation of the nature of the AfBA relationship among the parties, including an explanation of the ownership and financial interests in the joint venture
   - An estimate of the charge or range of charges generally imposed by the AfBA
   - A statement that the consumer is not required to use the AfBA and may elect to use any provider of his or her choice
   - The disclosure should be signed and dated by the consumer receiving it. Appendix D of the RESPA regulation contains a model disclosure form that can be adapted to provide the required disclosure. This form can be found at: **http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=7fa74a3dff938c4920e7c83904e69a5a&rgn=div9&view=text&node=12:8.0.2.14.17.0.1.24.42&idno=12**

[2] *Settlement services include, but are not limited to, the following: (1) real estate broker or agent services; (2) services related to the issuance of a title insurance policy; (3) origination of a mortgage loan; (4) services rendered by a mortgage broker; (5) services related to origination, processing, or funding of a mortgage loan; (6) services rendered by an attorney; (7) document preparation, including notarization, delivery, and recordation; (8) rendering credit reports and appraisals; (9) rendering inspections; (10) settlement or closing; (11) services involving hazard, flood, or other casualty insurance or homeowner's warranties; (12) services involving real property taxes or other assessments or charges on real property; (13) any other services that a settlement service provider requires a borrower to pay for before or at closing.*

2. The customer being referred to an AfBA must not be required to use the AfBA. In other words, the consumer's use of an AfBA may not be required as a condition to the availability of any other settlement service for which the consumer will pay.

   Offering a package of services to a consumer at a discount, or offering another consumer incentive, would not constitute required use and would be acceptable under RESPA. Any such discount or incentive must be a true discount and not result in higher prices elsewhere in the settlement process. For example, while a builder may not require a consumer to use a joint venture title agency for title insurance as a condition to the purchase of a home, the builder may offer discounted pricing to a consumer who elects to obtain title insurance from the joint venture. Likewise, the joint venture title agency itself could offer consumers a discount to encourage the use of the joint venture.

3. No payments, other than a return on ownership interest or payments otherwise permitted under the statute, may be received under the AfBA. Thus, even if the two requirements above are fulfilled, any payments between or among the AfBA and its partners must be for services rendered or must constitute a return on ownership interest.

**Permissible compensation would include:**

- Bona fide dividends, and capital or equity distributions, related to ownership interest
- Bona fide business loans, advances, and capital or equity contributions, so long as they are for ordinary business purposes and are not fees for the referral of settlement service business or unearned fees

**Impermissible compensation would include:**

- Any payment without an apparent business motive other than to tie the amount of a payment to the number of actual, estimated, or anticipated referrals
- Any payment that varies according to the volume of referrals
- A payment based on the volume of previous referrals

In other words, apart from permissible payments for goods or facilities provided or services performed, AfBA partners may only receive returns on their ownership interests from the AfBA. In determining whether payments meet this standard, HUD considered, among other things, whether:

- The AfBA partners invested their own capital in the AfBA or borrowed their capital contributions from one another or the AfBA;
- The AfBA partners received interests in the AfBA based on their capital contributions;
- Returns are tied in any way to referrals; or ownership interests in the AfBA have been adjusted based on referrals.

In addition to meeting the three-part safe harbor test, the AfBA must satisfy certain criteria. When HUD was responsible for regulating and enforcing RESPA, the Department expressed concern with AfBAs that meet the safe harbor test, but that, in HUD's view, may have been designed to circumvent RESPA's prohibitions against referrals fees. HUD's concern was that an affiliated entity, such as a real estate broker, could refer business to another affiliated entity, such as a joint venture mortgage lender, and accept referral fees masked as returns on its ownership interest. The Department, therefore, issued Statement of Policy 1996-2, which declared HUD's intent to determine whether entities are bona fide providers of settlement services or merely "sham" business arrangements that do not qualify for the AfBA exception to Section 8 of RESPA. HUD considered several factors in determining whether an AfBA is a "sham" and whether a Section 8 violation exists. Although the CFPB is now responsible for RESPA, real estate brokers should continue to follow HUD's AfBA Policy Statement until the CFPB provides its own guidance on AfBAs. In order to satisfy these criteria, the AfBA must consider the following:

**Capitalization**—The AfBA must have sufficient capital, typical in the industry, to conduct the settlement service business for which it was created. Although the Policy Statement does not require any specific amount, it would be prudent for the initial capitalization to cover all start-up costs and operate the business for 90 to 120 days without any income.

**Employees**—The AfBA must have its own employees. It should have at least one paid employee who works exclusively for the AfBA.

**Management**—The AfBA must either manage its own affairs or, if an AfBA partner provides management and administrative services, pay the partner fair market value compensation in return for such management services.

**Location**—The AfBA must have its own office space separate and apart from its AfBA partners so that the public can clearly identify the entity with which it is doing business. The office space should be identified with separate signage, listings in telephone directories, account materials, and other indicators of the business. If an AfBA rents office space from an AfBA partner, it must pay fair market rent to the partner for the space and facilities used. The value of any referrals may not be considered in the rental payments, and the rent would have to be based on what a nonaffiliate would pay for similar space and facilities in a similar building. In other words, the rent may be based on such factors as square footage and location, or it may be embedded in an executive lease that provides not only for space, but for various services such as the use of telephones, kitchen facilities, common areas, furniture, or other amenities. Rental payments could be viewed as disguised referral fees if they are not reasonably related to the market value of the space and facilities provided.

**Substantial Services**—The AfBA must provide "substantial services," which are defined as the essential functions and types of services generally performed by the type of entity at issue.

For example, for a joint venture title agency, these substantial services are termed "core title services" and include:

- Examination and evaluation of title evidence to determine insurability
- Preparation and issuance of the title commitment
- Clearance of underwriting objections
- Preparation and issuance of the title policy
- Handling of closing or settlement where the closing is part of an all-inclusive rate

Additionally, for a joint venture mortgage broker, HUD determined that "substantial services" require the AfBA employees to take the loan application and perform at least five of the following 13 services:

- Analyze the prospective borrower's income and debts, and prequalify the prospective borrower to determine the maximum mortgage that he or she can afford[3]
- Educate the prospective borrower in the homebuying and financing process, advise the prospective borrower about the different types of loan products available, and demonstrate how closing costs and monthly payments could vary under each product*
- Collect financial information (e.g., tax returns, bank statements, etc.) and other related documents that are part of the application process*
- Initiate/order Verifications of Employment and Verifications of Deposit
- Initiate/order requests for mortgage and other loan verifications
- Initiate/order appraisals
- Initiate/order inspections or engineering reports
- Provide disclosures to the prospective borrower
- Assist the prospective borrower in understanding and clearing credit problems*
- Maintain regular contact with the prospective borrower, real estate agents, and lender between the time of loan application and closing to apprise them of the status of the application and gather any additional information as needed*
- Order legal documents
- Determine whether the property was located in a flood zone or order such service
- Participate in the loan closing

Please note, however, that if the AfBA mortgage broker takes the loan application and performs only counseling-type services, it must ensure that it provides meaningful counseling services and does not just steer customers to a particular lender. HUD indicated that the AfBA is not steering if a AfBA mortgage broker:

- Gives the borrower an opportunity to consider products from at least three different lenders;
- Receives the same compensation regardless of which lender's products ultimately are selected; and
- Receives only payments that are reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

**Subcontracting**—The AfBA must perform all "substantial services" itself and may not subcontract out such services to any third party, including its AfBA partners. The AfBA, however, could subcontract out nonessential functions, such as those related to management, accounting, human resources, and other administrative or ministerial functions. An AfBA partner could perform such administrative or ministerial functions for the AfBA so long as the AfBA pays the partner fair market value compensation in return.

**Marketing**—The AfBA must actively compete in the marketplace for business and attempt to market its services to others besides its AfBA partners. For example, it should publish advertisements and flyers and solicit business from numerous lenders, builders, real estate brokers and agents, and other settlement service providers.

**Referrals**—The AfBA should not send business exclusively to its AfBA partners, but should attempt to send business to a number of entities, which may include its AfBA partners. For example, if the AfBA is a mortgage banker, it should sell a percentage of its loans, preferably at least 10% to 15%, to others besides a mortgage lender partner. If the AfBA is a mortgage broker, it should broker a percentage of its loans, preferably at least 10% to 15%, to others besides its mortgage lender partner.

In determining whether an AfBA satisfies these criteria, the above factors are considered together and weighed in light of the facts and circumstances of a specific situation. According to HUD, a response to any one of the above considerations by itself would not be determinative of a "sham" AfBA. The AfBA, however, does ensure its legitimacy if it satisfies all of the criteria set forth above.

[3] *The services marked by an asterisk above are those that HUD considered to be counseling-type services.*

## ENFORCEMENT OF AfBAs

Prior to the transfer of RESPA to the CFPB, HUD had increased its enforcement staff and stepped up its pursuit of RESPA violators. From these efforts, the Department often targeted alleged "sham" AfBAs.

For example, on July 1, 2003, the Department entered into a settlement with a title agency, where it alleged that the title agency established several sham affiliated title insurance companies in order to pay kickbacks to real estate brokers and mortgage brokers for the referral of business. According to HUD, the sham companies had few or no employees, had no office space, and performed little or no work, but collected 80% of the title insurance premiums paid by borrowers. Under the settlement, the title agency agreed to pay the Department $7,500.

In early 2005, HUD targeted certain AfBAs for the distribution of profits made to its owners. On March 21, 2005, the Department announced a settlement with a title and settlement joint venture owned by several entities, including a real estate company operated by a group of real estate agents. In this case, the real estate company encouraged its agents to refer business to the AfBA and, in return, redistributed the profits received from the AfBA based on the sales prices of the transactions referred to the AfBA. HUD alleged that such payments did not constitute a return on the agents' ownership in the AfBA, but rather compensated the agents for the referral of business. The agents and other AfBA partners agreed to pay HUD $325,000 and to modify certain of its business practices.

Moreover, one HUD settlement involved alleged sham affiliated title agencies operating in Memphis, Tennessee. On July 13, 2005, the Department announced a settlement with a large title insurance company for permitting its affiliated title agencies to lease at least two employees from the title insurance company and for allowing the affiliated entities to rent space and use computer services at the title insurance company's office. Under these circumstances, HUD alleged that little title work was actually performed by the AfBAs. In return, the title insurance company agreed to pay HUD $680,000, withdraw from the AfBAs as a joint venture partner, and to conform all future AfBAs in accordance with certain terms.

Finally, in one of the last HUD settlements prior to the RESPA transfer to the CFPB, on July 13, 2011, HUD announced a settlement agreement with a large mortgage lender in connection with the alleged operation of AfBAs through a series limited liability company that did not comply with RESPA requirements. Specifically, HUD alleged that each series/AfBA did not maintain its own employees, did not have sufficient capital, and did not perform core mortgage origination services. In addition, HUD alleged that the AfBAs originated FHA-insured loans from unregistered branch locations and identified the series limited liability company as a "business structure unauthorized by FHA." Under the agreement, the mortgage lender agreed to pay $3.1 million to resolve the allegations and dissolve the joint ventures.

Since taking responsibility for RESPA enforcement on July 21, 2011, the CFPB has geared up its enforcement staff and has opened investigations regarding RESPA issues, including investigations involving affiliated business arrangements with real estate brokers. The CFPB also has established an online complaint system that permits consumers to file complaints with the CFPB related to their mortgage loan. As of May 2012, however, the CFPB has yet to publicly announce any RESPA settlements or actions. That said, in addition to the statutory penalties for violations of Section 8 of RESPA (a fine of $10,000, imprisonment for up to one year, or both), the CFPB could impose a number of sanctions against those who violate RESPA, including mandated refunds, restitution, damages, disgorgement of profits, and civil money penalties, to name a few.

Based on these past HUD actions and the CFPB's enforcement powers, if you encounter an issue in your day-to-day operations that raises a question about the legitimacy of an AfBA or if you are interested in creating an AfBA, it is important that you seek additional RESPA resources and legal advice, if necessary. RESPA violations can carry serious consequences, and it is imperative that you be aware of possible RESPA issues at all times. Please contact NAR, or visit our website at **www.REALTOR.org/RESPA** for more informational materials on RESPA compliance.

# Part 2

## AfBA QUESTIONS AND ANSWERS

1. **QUESTION:** I am a real estate broker who owns a 49% interest in an affiliated title insurance agency. Because my real estate agents refer business to the joint venture, but have no ownership interest in the affiliated title agency, I do not require them to provide an affiliated business disclosure to their customers at the time of referral. In addition, because I am the owner and manager of the brokerage firm, I do not act as an agent and do not directly refer business to the affiliated title agency. Thus, I also do not provide affiliated business disclosures to customers. Is this a problem under RESPA?

   **ANSWER:** *Yes, if the referrer of business to an affiliated business does not provide an affiliated business disclosure to consumers being referred, the affiliated business does not meet the statutory safe harbor test and would not qualify for the RESPA exception. Because the real estate agents actually refer their customers to the affiliated title agency, the real estate broker must require its agents to provide a disclosure at the time the customers are referred. Typically, this can be accomplished by obligating real estate agents, under an agency agreement with the broker, to provide the disclosure with every referral.*

2. **QUESTION:** A real estate agent owns an interest in an affiliated mortgage lender. To encourage its customers to use the mortgage lender, the agent offers to provide a free appraisal if the customer ultimately chooses to obtain financing from the affiliated lender. Does the agent violate RESPA by offering a free appraisal?

   **ANSWER:** *No, this would be acceptable under RESPA. Although the affiliated business arrangement provisions of RESPA prohibit the required use of an affiliate entity, the definition of required use excludes customer discounts or incentives. Thus, a real estate agent could offer a free appraisal as a customer incentive, as long as the real estate agent does not raise the cost of its other services to cover the cost of the appraisal.*

3. **QUESTION:** A title insurance agency owns 80% and four individual real estate agents each own 5% of an affiliated title insurance agency. The profits of the affiliate entity are distributed as follows: (1) 80% is given to the title agency partner; and (2) the remaining 20% is divided among the four real estate agents based on the number of referrals made to the affiliate title agency. Does such a distribution comply with RESPA?

   **ANSWER:** *No, such a distribution violates RESPA. AfBA partners may only receive payments from an AfBA as a return on their individual ownership interest. In this example, the title agency partner receives a proper 80% return on its ownership interest in the affiliated entity. The real estate agent partners, however, receive impermissible payments based on their referral of business. To comply with RESPA, these individual real estate agents should each receive 5% of the affiliated title agency's profits, as each agent owns 5% of the affiliated business.*

4. **QUESTION:** A home builder and a real estate agent intend to create an affiliated mortgage lender to service each provider's customers. The builder is prepared to contribute 100% of the capital used to start up the business, which represents 60% of the builder's own cash contribution and a 40% contribution that the builder is loaning to the real estate agent. The affiliated lender will pay out 60% of its profits to the builder and 40% of its profits to the real estate agent after the loan if repaid. Is this a violation of RESPA?

   **ANSWER:** *Yes, this arrangement is improper. RESPA's affiliated business provisions prohibit an AfBA partner from borrowing its initial capital contribution from another AfBA partner. In this case, the real estate agent borrowed its initial contribution from the builder and contributed 0% of its own funds. As a result, the real estate agent had no financial risk in the affiliated business and the builder had 100% of the risk. Any profit distributions that would be made to the real estate agent are not a return on its ownership interest, but constitute payments in return for the referral of business.*

5. **QUESTION:** A title insurance agency and a real estate broker own 51% and 49%, respectively, in two different affiliated title agencies. Rather than employ a full-time employee at each joint venture, the partners hire one employee to work part-time for both joint ventures. This employee's time is divided evenly between the two entities, the employee performs all core title agent services for each entity, and works in separate office space leased by each affiliated title agency. Each joint venture pays 50% of the employee's salary and other expenses and issues a W-2 form directly to the employee. Does this employment arrangement violate RESPA?

   **ANSWER:** *No, this arrangement does not specifically violate RESPA. No prohibition exists on the use of part-time employees in an AfBA, and regulators have not articulated a position on who constitutes an "employee" under RESPA. Thus, while the issue is not free from doubt, a joint venture title agency may employ persons on a part-time basis to perform the requisite core title services, as long as all indicia of an employer-employee relationship are present. For example, and not by way of limitation, income and FICA taxes should be withheld and paid as necessary, unemployment taxes should be paid, and annual W-2 forms should be provided. Moreover, the employee should devote fixed periods of time exclusively to each joint venture, be physically located in*

*the office of each joint venture while working for that joint venture, and be paid a salary, rather than receiving compensation on a per-hour or per-transaction basis.*

6. **QUESTION:** A mortgage lender and several real estate agents have an ownership interest in a joint venture mortgage company. While the employees of the affiliate perform all core mortgage banking services, the mortgage lender partner performs all management and administrative services for the joint venture. In return, the joint venture pays the mortgage lender partner fair market value for the management services. Is this a violation of RESPA?

   **ANSWER:** *No, this arrangement would be acceptable under RESPA. It is not unusual for the joint venture partner with the expertise in the business conducted by the joint venture to also provide management services. Based on HUD's Statement of Policy 1996-2, an AfBA's non-essential functions may be subcontracted out, as long as the joint venture pays fair market value for the services. In this case, the mortgage lender partner receives fair market value compensation for the administrative services it performs. These entities must be able to demonstrate and defend how it arrived at fair market value, if called upon to do so by a government agency or a court of law.*

7. **QUESTION:** A joint venture title agency is owned by a title insurance agency and a real estate broker. Although the joint venture is staffed with its own employees, employees from the title agency partner issue all title commitments on behalf of the joint venture. Is this a violation of RESPA?

   **ANSWER:** *Yes, this is a violation of RESPA. The employees of a joint venture should perform all of the entity's core services. With regard to an affiliated title agency, core title services include determining insurability (i.e., the preparation and issuance of the title commitment), should be performed by the joint venture's employees. A joint venture partner should never perform core services on behalf of its affiliate.*

8. **QUESTION:** A mortgage lender has offered to pay a real estate agent $100 for each loan application the real estate agent takes from his or her customers. Does such a payment violate RESPA?

   **ANSWER:** *Yes, this may be a violation of RESPA. RESPA provides an exception to Section 8's prohibitions for payments made in return for actual services provided, but HUD took the position that the mere completion of a loan application is not a compensable service. Instead, if a party wishes to be paid for taking a loan application, in HUD's view, the party also must perform five additional services to be compensated as a mortgage broker. Until further guidance is issued by the CFPB, arguably HUD's position is still applicable. Thus, in this case, receiving $100 for taking a loan application, without performing any other services, would be considered a payment in return for the referral of business in violation of RESPA.*

9. **QUESTION:** A builder and a real estate agent each own an interest in an affiliated mortgage lender. Although the affiliated entity has placed an ad in the Yellow Pages and has placed joint advertisements with its builder partner in local newspapers, the mortgage lender receives the majority of its customers from the builder and the real estate agent. Is this a violation of RESPA?

   **ANSWER:** *No, this appears to be acceptable under RESPA. The affiliated business arrangement provisions do not require an affiliated entity to receive a certain percentage of its business from providers other than its joint venture partners. Rather, the affiliated entity must attempt to market its services to others besides its AfBA partners. Note, however, that some states do require affiliated businesses to receive a percentage of its business from sources other than its owners. Check to see if your state imposes such restrictions.*

10. **QUESTION:** A real estate broker owns an interest in a joint venture title agency. Although the broker's agents are obligated to provide an affiliated business disclosure to every customer it refers to the joint venture title agency, to further encourage its agents to consistently provide the disclosure, the real estate broker also offers its agents $50 for each customer he or she refers to the affiliated entity. Does the $50 payment violate RESPA?

    **ANSWER:** *Yes, such a payment violates RESPA. Real estate agents are not considered employees of the real estate broker and cannot be paid for the referral of business. Thus, each $50 payment to a real estate agent in this case would constitute a thing of value in exchange for the referral of business in violation of Section 8.*

# *Federal Information Resources*

For more information on the CFPB's regulation and enforcement of RESPA, please contact the CFPB at **CFPB_RESPAInquiries@cfpb.gov.**