

# AfBA

Affiliated  
Business  
Arrangements

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



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# AfBA

## Affiliated Business Arrangements

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



NATIONAL ASSOCIATION  
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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.***

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.<sup>1</sup>

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

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<sup>1</sup>See 12 U.S.C. § 2602(7).

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). 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*** (item #126-110).

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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# PART 1

## **SECTION 8 OF RESPA- PROHIBITIONS AGAINST KICKBACKS AND REFERRAL FEES**

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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.<sup>2</sup> 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.

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<sup>2</sup> 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.

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***

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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, using the same terminology, as far as practical, as used in Section L of the HUD-1 Settlement Statement*
- *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 HUD's RESPA regulation contains a model disclosure form that can be adapted to provide the required disclosure. This form can be found at <http://www.hud.gov/offices/hsg/sfh/res/resappd.cfm>*

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 would consider, 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*
- *Ownership interests in the AfBA have been adjusted based on referrals*

In addition to meeting the three-part safe harbor test above, the AfBA must satisfy certain criteria established by HUD. The Department has 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 is 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 declares 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 will consider several factors in determining whether an AfBA is a "sham" and whether a Section 8 violation exists. In order to satisfy HUD's 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 HUD 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 non-affiliate 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 HUD defines 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 has 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 pre-qualify the prospective borrower to determine the maximum mortgage that he or she can afford<sup>3</sup>*
- *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*

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<sup>3</sup> The services marked by an asterisk above are those that HUD considers to be counseling-type services.

- *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 has indicated that it will be satisfied 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*
- *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 non-essential 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 HUD’s criteria, the Department will consider the above factors together and weigh them in light of the facts and circumstances of a specific situation. 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 HUD criteria set forth above.

# **HUD ENFORCEMENT OF AfBAs**

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Over the past couple of years, HUD has increased its enforcement staff and stepped up its pursuit of RESPA violators. From these efforts, the Department often has 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.

Finally, one of HUD’s recent settlements 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.

The Department also has targeted real estate brokers who share ownership interests in AfBAs. For example, on September 1, 2005, HUD announced 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.

Based on these actions, 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](http://www.REALTOR.org/RESPA)** for more informational materials on RESPA compliance.



# PART 2

## **AFBA QUESTIONS AND ANSWERS**

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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, HUD's 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 is 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 HUD has 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. HUD's Statement of Policy 1996-2 permits an AfBA's non-essential functions to 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), which 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 takes 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. 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 RESPA and HUD's regulation of real estate brokers and agents, please visit:

**[http://www.hud.gov/offices/hsg/sfh/res/respa\\_hm.cfm](http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm)**

or contact HUD's RESPA Enforcement Office at:

U.S. Department of  
Housing and Urban Development  
Office of Consumer and Regulatory Affairs  
Interstate Land Sales/RESPA Division  
Room 9146  
451 Seventh Street, SW  
Washington, DC 20410

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