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AFFILIATED BUSINESS ARRANGEMENT DISCLOSURES

This article presents an overview of so-called "Affiliated Business Arrangement ("AfBA") Disclosure Statements" and the requirements of 12 C.F.R. 1024.15(b) and Appendix D to Part 1024.

I. RESPA and Affiliated Business Arrangements

The Real Estate Settlement Procedures Act, "RESPA," prohibits referral fees and kickbacks relating to real estate settlement services involving federally related mortgage loans. 12 U.S.C. § 2607(a). As stated, "(a) Business referrals: No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." Id.

This prohibition does not apply, however, to an "affiliated business arrangement," subject to various requirements discussed below. An affiliated business arrangement is defined in RESPA, 12 U.S.C. § 2602(7) as follows:

> the term ''affiliated business arrangement'' means an arrangement in which (A) 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[1] of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider[.]

[1] An "associate" means "one who has one or more of the following relationships with a person in a position to refer settlement business: (A) a spouse, parent, or child of such person; (B) a corporation or business entity that controls, is controlled by, or is under common control with such person; (C) an employer, officer, director, partner, franchisor, or franchisee of such person; or (D) 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).

12 U.S.C. § 2602(7).

An affiliated business arrangement itself is not a violation of RESPA's kickback / referral fee prohibitions if (and only if) the conditions set forth in 12 C.F.R. § 1024.15(b) are satisfied. The conditions are as follows:

(1) The person making each referral has provided to each person whose business is referred a written disclosure, in the format of the AfBA Disclosure Statement set forth in Appendix D, with the disclosures required therein.

(2) The disclosure must be provided on a separate piece of paper no later than the time of each referral.

(3) The person making the referral has not required any person to use any particular provider of settlement services or business incident thereto.

(4) The only thing of value that is received from the arrangement is a return on an ownership interest or franchise relationship. Bona fide dividends, and capital or equity distributions, related to ownership interest or franchise relationship, between entities in an affiliate relationship, are permissible.

12 C.F.R. 1024.15(b).

The fourth condition above is often misunderstood in my experience, and is very, very important. To repeat, the only thing of value that can be received is a return on an ownership interest or franchise relationship. An affiliated business arrangement, even with proper disclosure, *does not permit disguised referral fees*, or any agreement or arrangement (whether in writing, oral, or "wink-wink") by which payment or other compensation is given to a referring party based upon a referral or referrals. Any benefit received must be based simply upon the referring party's ownership interest, just like any other owner or stockholder.

Examples of items that are not permissible (and that do not qualify as a permissible return on an ownership interest) include:

i. Any payment which has as a basis of calculation no apparent business motive other than distinguishing among recipients of payments on the basis of the amount of their actual, estimated or anticipated referrals;

ii. Any payment which varies according to the relative amount of referrals by the different recipients of similar payments; or

iii. A payment based on an ownership, partnership or joint venture share which has been adjusted on the basis of previous relative referrals by recipients of similar payments.

12 C.F.R. 1024.15(b)(1)-(3). The use of the term "arrangement" is probably a misnomer and would be best replaced with the term, "relationship." Section 1024.15 permits a person to have an ownership interest in a settlement provider, and such person can refer clients or customers to such settlement provider so long as the required Disclosure Statement is given, disclosing the interest. BUT – this does <u>not</u> mean that the person and the settlement provider can have an "arrangement" to provide such referrals, or get any compensation based upon such referrals.

II. Compliance of an AfBA Disclosure Statement with Appendix D

As noted above, Appendix D to 12 C.F.R. 1024 provides the format to be used for providing an Affiliated Business Arrangement Disclosure Statement. It can be viewed at:

https://www.law.cornell.edu/cfr/text/12/appendix-D_to_part_1024

Under these requirements, a Disclosure Statement must:

1. Be a separate document ("piece of paper"), not part of or combined with any other document or disclosure to be presented to a recipient;

2. State that the referring party has a business relationship with the settlement provider in question (the "Affiliated Business"), and may receive a financial or other benefit as a result of the referral;

3. If the referring party is associated with a separate person or entity that has the business relationship, identify the association;

4. Provide a description of the nature of the relationship including nature and percentage of ownership interest in the Affiliated Business;

5. Provide a description of the estimated charges or range of charges for the settlement services from the Affiliated Business;

6. State that the recipient is NOT required to use the listed provider(s) as a condition for (as applicable) settlement of the loan or purchase, sale or refinance of the property; and in all-caps, that "THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES."

Appendix D, 12 C.F.R. 1024.

Additional / Miscellaneous

The Disclosure Statement must be provided no later than the time of referral. 12 C.F.R. 1024.15(b)(2). Therefore it should be provided prior to or at the time of any such emails or conversations that would constitute a referral to the Affiliated Business.

As noted above, the Disclosure Statement should be a "separate piece of paper," therefore it should be a separate document, not combined with other disclosures or documents.

The Disclosure Statement must be updated as needed to correctly show the charges and services and any changes to same.

Copies of any Disclosure Statement(s) provided must be retained for a period of 5 years after the date of execution. 12 CFR 1024.15(d). See also A.R.S. § 32-2151.01(A).

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