

Compensation to Realtors® for Home Warranty Contracts are Kickbacks

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On June 25, 2010 an opinion from General Counsel, Helen R. Kanovsky, of the Department of Housing and Urban Development (“HUD”), appeared in the Federal Register (24 CFR Part 3500 [Docket No. FR-5425-1A-01]). This interpretive rule from HUD essentially states that compensation paid to a real estate broker in connection with the broker’s recommendation of a home warranty company (an “HWC”) for a buyer or a seller, constitutes an illegal kickback in violation of Section 8 of the Real Estate Settlement Procedures Act (“RESPA”) and HUD’s regulations.

Ouch!

In 1996, then Secretary of HUD, Nelson A. Diaz, issued a letter stating that:

“A home warranty is a settlement service covered by RESPA. The RESPA regulations do not prohibit a person [e.g., a REALTOR®] from receiving more than one fee in the transaction. However...the payment must be for services that are actual, necessary and distinct from the services provided by such person. Additionally the fee itself must be reasonably related to services actually performed.”

Since that time, home warranty companies have commonly entered into agreements with Realtors® which were either for administration services or marketing purposes. Compensation has commonly been paid by the home warranty company to the broker for guiding a homeowner or a purchaser to purchase a home warranty contract. Such contracts provide standard protection sought by buyers as part of the closing process. Real estate agents have commonly provided services in completing the forms to issue the home warranty contracts and performing administrative services for which they have received fees from the home warranty companies.

New Interpretive Rule

The opinion of General Counsel, Helen R. Kanovsky dated June 18, 2010, indicates that under Section 8 of RESPA and HUD’s implementing regulations the payment of compensation to a real estate broker or agent who has referred a seller or buyer to a home warranty company constitutes a kickback. Section 8 indicates that “RESPA prohibits a real estate broker or agent from receiving a fee for such a referral, as a referral is not a compensable service.”

The word “referral” is defined in the opinion as:

“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 or 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.”

In substance, HUD’s interpretive rule indicates that “marketing services” performed on behalf of a homeowner warranty service company are not compensable services which are outside of a broker’s usual functions. The interpretive rule states in part that:

“In particular, a real estate broker or agent is in a unique position to refer settlement service business and through marketing can affirmatively influence a homebuyer’s or seller’s selection of an HWC. As a real estate broker and agent hold positions of influence in the real estate transaction, a homebuyer or seller is more likely to accept the broker’s or agent’s promotion or recommendation of a settlement service provider. Therefore, marketing performed by a real estate broker or agent on behalf of an HWC to sell a homeowner warranty to particular homebuyers or sellers is a “referral” to a settlement service provider”.

Compensation Equals an Illegal Kickback

The opinion indicates that an HWC’s compensation payment to a real estate broker or agent for marketing services that are directed to a particular homebuyer or seller would be a payment that violates Section 8 of RESPA. As such, the payment constitutes an illegal kickback for a referral of settlement service business.

Can a Real Estate Broker be Compensated?

The HUD opinion indicates that Section 8(c) of RESPA and HUD’s regulations allow payment for qualified services actually performed. The services performed must fall within specific categories that are atypical of the services that are performed by real estate agents in connection with home warranty contracts. For example, specific services outside the scope of the referral of the home warranty contract can be performed by a real estate agent for the principal. Such services may not be duplicative

of those typically provided by a real estate broker or agent. Evidence of such unusual services would include a homeowner warranty company's designation of a real estate broker as the HWC's legal agent and the assumption by the HWC of responsibility for any representations made by the broker about the warranty contract. Moreover, the real estate broker must fully disclose to the consumer any compensation to be paid to the real estate broker or agent by the HWC. The homeowner must also be made aware that the consumer may purchase the home warranty from other vendors or choose not to purchase any home warranty.

These standards, which are extremely difficult to adhere to, are subject to review "on a case-by-case basis (by HUD) to determine whether compensation provided was a kickback for a referral or legal payment for the compensable services".

Comments from the Realtor® Community

The notice of the interpretive rule published in the Federal Register invited Realtors® and members of the public to comment on this rule. The period for the submission of comments has now expired (July 26, 2010) and it will be interesting to determine whether this rule, which is now binding upon the Realtor® community, will be enforced as stated. In the interim, Realtors® should avoid the receipt of any compensation for recommending or referring buyers or sellers to purchase a home warranty contract of any kind.

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