

ownership interest and unrelated to referrals of business.

HUD Analysis. A review of the factors reflects an arrangement involving a *bona fide* provider of settlement services. In this example, the real estate brokerage company is not the sole source of referrals to the title agency. However, the title agency continues its exclusive agency arrangement with the title insurance company owner. While this last factor initially may raise a question as to why other title insurance companies are not used for title insurance policies, upon review there appears to be nothing impermissible about these referrals of title business from the title agency to the title insurance company.

This example involves the purchase of stock in an existing full service provider. In such a situation, HUD would carefully examine the investment made by the real estate brokerage company. In this example, the real estate brokerage company pays a fair value contribution for its ownership share and receives a return on its investment that is not based on referrals of business. Since the real estate brokerage provides the CBA disclosure, does not require the use of the title agency and the only return to the brokerage is based on the profits of the agency and not reflective of referrals made, the arrangement meets the CBA exemption requirements. HUD would consider this a *bona fide* controlled business arrangement.

5. A mortgage banker sets up a limited liability mortgage brokerage company. The mortgage banker sells shares in divisions of the limited liability company to real estate brokers and real estate agents. For \$500 each, the real estate brokers and agents may purchase separate "divisions" within the limited liability mortgage brokerage company to which they refer customers for loans. In later years ownership may vary by the amount of referrals made by a real estate broker or agent in the previous year. Under this structure, the ownership distributions are based on the business each real estate broker or real estate agent refers to his/her division and not on the basis of their capital contribution to the entity as a whole. The limited liability mortgage brokerage company provides all the substantial services of a mortgage broker. It does not contract out any processing to its mortgage banker owner. It sends loan packages to its mortgage banker owner as well as other lenders.

HUD analysis. Although HUD would consider the mortgage brokerage company to be a *bona fide* provider of mortgage brokerage services, this example illustrates an arrangement that fails to meet the third condition of the CBA exception. 12 U.S.C. 2607(c)(4)(C). Here, the capitalization, ownership and

payment structure with ownership in separate "divisions" is a method in which ownership returns or ownership shares vary based on referrals made and not on the amount contributed to the capitalization of the company. In cases where the percent of ownership interest or the amount of payment varies by the amount of business the real estate agent or broker refers, such payments are not *bona fide* returns on ownership interest, but instead, are an indirect method of paying a kickback based on the amount of business referred. 24 CFR 3500.15(b)(3).

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 96-14331 Filed 6-6-96; 8:45 am]

BILLING CODE 4210-27-P

24 CFR Part 3500

[Docket No. FR-3638-N-05]

Office of the Assistant Secretary for Housing-Federal Housing Commissioner; Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation.

SUMMARY: This statement sets forth the Department's interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and its implementing regulations with regard to the rental of office space, lock-outs and retaliation. It is published to give guidance and to inform interested members of the public of the Department's position on enforcement of this section of the law.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director of the Office of Consumer and Regulatory Affairs, Room 5241, telephone: (202) 708-4560. For legal enforcement questions, Peter Race, Assistant General Counsel for Program Compliance, or Rebecca J. Holtz, Attorney, Room 9253, telephone: (202) 708-4184. (The telephone numbers are not toll-free.) For hearing- and speech-impaired persons, this number may be accessed via TTY (text telephone) by calling the Federal Information Relay Service at 1-800-877-8339. The address for the above-listed persons is: Department of Housing

and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

SUPPLEMENTARY INFORMATION:

General Background

Section 8 (a) of the Real Estate Settlement Procedures Act (RESPA) prohibits any person from giving or accepting any fee, kickback, or thing of value for the referral of settlement service business involving a federally related mortgage loan. 12 U.S.C. 2607(a). Congress specifically stated it intended to eliminate kickbacks and referral fees that tend to increase unnecessarily the costs of settlement services. 12 U.S.C. 2601(b)(2).

Since July 1993, the Department has been seeking comments and advice concerning the final rule of November 2, 1992, implementing Section 8 of RESPA. On July 21, 1994, the Department published a new proposed rule on certain Section 8 issues. Simultaneously with the issuance of this Statement of Policy, HUD is publishing a final rule in that rulemaking. As part of that rulemaking process, the Department received comments concerning the application of Section 8 of RESPA to the rental of office space, lock-outs and retaliation in connection with real estate brokerage office practices. In addition, the Department's enforcement officials have received numerous complaints dealing with these same issues.

Rental of Office Space

In the last few years, the Department has received numerous complaints alleging that certain settlement service providers, particularly lenders, are leasing desks or office space in real estate brokerage offices at higher than market rate in exchange for referrals of business. In HUD's rulemaking docket, number R-94-1725 (FR-3638), many commenters argued that HUD should scrutinize this rental practice. The concern expressed is that real estate brokers charge, and settlement service providers pay, high rent payments for the desk or office space to disguise kickbacks to the real estate broker for the referral of business to the settlement service provider. In this Statement of Policy, the Department sets forth how it distinguishes legitimate payments for rentals from payments that are for the referral of business in violation of Section 8.

Lock-outs

The Department also received comments and complaints alleging that settlement service providers were being excluded from, or locked-out of, places of business where they might find

potential customers. The most common occurrence cited was where a real estate brokerage company had leased space to a particular provider of services, and had prevented any other provider from entering its office space.

As part of the July 21, 1994, rulemaking, a Nebraska lender commented:

We are experiencing a rapid growth of lender lock-out relationships wherein real estate companies lease office space within their sales offices to a particular mortgage company. A part of the agreement is that other lenders are not allowed in the sales offices to solicit business. This clearly prevents free competition in financing to the home buyer.

* * * * *

* * * [I]t is very clear that the [real estate] office managers are exerting a lot of control to keep all other lenders out. This would not be done without proper incentive (\$\$\$)
* * *.

Several other commenters alleged that real estate office space arrangements with particular lenders, coupled with limiting or denying rival lenders access to customers, were being used in their communities to eliminate competition. These commenters called for special RESPA rules to ban these practices.

Retaliation

The Department also has received complaints concerning retaliation practices used to influence consumer referrals. In one complaint, financial service representatives in a real estate broker's office were given specific quotas of referrals of home buyers to an affiliated lender and were threatened with the loss of their jobs if they did not meet the quotas.

Commenters on the proposed rules also alleged that some employers were engaging in practices of retaliation or discrimination against employees and agents who did not refer business to affiliated entities. Reprisals could range from loss of benefits, such as fewer sales leads, higher desk fees, less desirable work space, and ultimately, loss of job. Some commenters requested that the Department issue guidelines or other regulatory provisions to restrict such retaliatory activities.

The Coalition to Retain Independent Services in Settlement (CRISIS) called for a rule prohibiting retaliation against employees and agents who refer business to non-affiliated entities as most consistent with the language of the RESPA statute. CRISIS suggested strong language to prohibit negative actions against employees and agents who refer business to non-affiliated entities, including prohibitions against more

subtle actions, such as loss of work space or increases in desk fees.

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To give guidance to interested members of the public on the application of RESPA and its implementing regulations to these issues, the Secretary, pursuant to Section 19(a) of RESPA and 24 CFR 3500.4(a)(1)(ii),¹ hereby issues the following Statement of Policy.

Rental of Office Space

Section 8 of RESPA prohibits a person from giving or from accepting any fee, kickback or thing of value pursuant to an agreement that business incident to a settlement service involving a federally related mortgage loan shall be referred to any person. 12 U.S.C. § 2607(a). An example of a thing of value is a rental payment that is higher than that ordinarily paid for the facilities. The statute, however, permits payments for goods or facilities actually furnished or for services actually performed. 12 U.S.C. § 2607(c)(2). Thus, when faced with a complaint that a settlement service provider is paying a high rent for referrals of settlement service business, HUD analyzes whether the rental payment is bona fide or is really a disguised referral fee.

HUD's regulations implement the statutory provisions at 24 CFR 3500.14 and give greater guidance to this analysis. Section 3500.14(g)(2) of the regulations provides that the Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. It states: "If the payment bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided * * *. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services." *Id.*

Thus, under existing regulations, when faced with a complaint that a person is renting space from a person who is referring business to that person, HUD examines the facts to determine whether the rental payment bears a reasonable relationship to the market value of the rental space provided or is a disguised referral fee. The market value of the rental space may include an appropriate proportion of the cost for office services actually provided to the

tenant, such as secretarial services, utilities, telephone and other office equipment. In some situations, a market price rental payment from the highest bidding settlement service provider could reflect payments for referrals of business to that settlement service provider from the person whose space is being rented. Thus, to distinguish between rental payments that may include a payment for referrals of settlement service business and a payment for the facility actually provided, HUD interprets the existing regulations to require a "general market value" standard as the basis for the analysis, rather than a market rate among settlement service providers.

In a rental situation, the general market value is the rent that a non-settlement service provider would pay for the same amount of space and services in the same or a comparable building. A general market value standard allows payments for facilities and services actually furnished, but does not take into account any value for the referrals that might be reflected in the rental payment. A general market standard is not only consistent with the existing regulations, it furthers the statute's purpose. Congress specifically stated that it intended to protect consumers from unnecessarily high settlement charges caused by abusive practices. 12 U.S.C. § 2601. Some settlement service providers might be willing to pay a higher rent than the general market value to reflect the value of referrals of settlement service business. The cost of an above-general-market-rate rental payment could likely be passed on to the consumer in higher settlement costs. If referrals of settlement service business are taking place in a given rental situation, and the rental payment is above the general market value, then it becomes difficult to distinguish any increase in rental payment over the general market from a referral fee payment.

HUD, therefore, interprets Section 8 of RESPA and its implementing regulations to allow payments for the rental of desk space or office space. However, if a settlement service provider rents space from a person who is referring settlement service business to the provider, then HUD will examine whether the rental payments are reasonably related to the general market value of the facilities and services actually furnished. If the rental payments exceed the general market value of the space provided, then HUD will consider the excess amount to be for the referral of business in violation of Section 8(a).

¹ All citations in this Statement of Policy refer to recently streamlined regulations published on March 26, 1996 (61 FR 13232), in the Federal Register (to be codified at 24 CFR part 3500).

As an additional consideration, HUD will examine whether the rent is calculated, in whole or in part, on a multiple of the number or value of the referrals made. If the rental payment is conditioned on the number or value of the referrals made, then HUD will consider the rental payment to be for the referral of business in violation of Section 8(a).

In its RESPA enforcement work, HUD has also encountered "bogus" rental arrangements that are really agreements for the payment of referral fees. For example, one case involved a title insurance company that paid a "rental fee" to a real estate broker for the "per use rental" of a conference room for closings. The title insurance company paid a \$100 fee for each transaction. This "rental fee" was greater than the general market value for the use of the space. In addition, the facts revealed that the room was rarely actually used for closings. In this case, HUD examined whether a "facility" was actually furnished at a general market rate. HUD concluded that this was a sham rental arrangement; the "rent" was really a disguised referral fee in violation of Section 8(a).

Lock-outs

A lock-out situation arises where a settlement service provider prevents

other providers from marketing their services within a setting under that provider's control. A situation involving a rental of desk or office space to a particular settlement service provider could lead to other, competing, settlement service providers being "locked-out" from access to the referrers of business or from reaching the consumer. The existence of a lock-out situation could, therefore, give rise to a question of whether a rental payment is *bona fide*. A lock out situation without other factors, however, does not give rise to a RESPA violation.

The RESPA statute does not provide HUD with authority to regulate access to the offices of settlement service providers or to require a company to assist another company in its marketing activity. This interpretation of RESPA does not bear on whether State consumer, antitrust or other laws apply to lock-out situations. Of course, Section 8 still applies to any payments made to a referrer of business by a settlement service provider who is not "locked out" of the referrer's office and receives referrals of settlement service business from that office.

Retaliation

Section 8 of RESPA expressly prohibits giving positive incentives, "things of value," for the referral of

settlement service business. 12 U.S.C. 2607(a). The Act is silent as to disincentives. If HUD were to find that Section 8 also prohibited disincentives for failure to make referrals, HUD would find itself being called upon to resolve numerous employment disputes under RESPA. HUD does not believe that Congress intended that RESPA reach these matters. Retaliatory actions against employees are more appropriately governed by State labor, contract, and other laws. However, the Department will continue to examine for possible violations of Section 8 whether payments or other positive incentives are given employees or agents to make referrals to other settlement service providers.

New RESPA regulations are being issued simultaneously with this Statement of Policy. With regard to this area, the public should note the new exemptions for payments to employees in 24 CFR 3500.14.

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

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[FR Doc. 96-14332 Filed 6-6-96; 8:45 am]

BILLING CODE 4210-27-P