

Disclosure of Ancillary Services Compensation

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Ancillary business services have become a significant component of some real estate brokerage business models. Two key components of these ancillary business services are title insurance and mortgage brokerage. This article is not a "how to" article but rather it takes a look at the legal requirements in Illinois with regard to disclosure of compensation from those ancillary businesses.

Section 10-10 of the Real Estate License act of 2000 (the "Act") deals with disclosure of compensation by licensees. Subparagraphs (b) and (c) of Section 10-10 deal with issues related to compensation from ancillary businesses. Subparagraph (b) deals with the situation in which the licensee not only receives compensation as a result of the sale, purchase or lease of real estate for or on behalf of a client, but also receives compensation from third parties. An example of this would be the receipt of compensation by a licensee in a transaction from a title company or mortgage broker in connection with services provided by the licensee ancillary to the transaction. The Act does not provide any specific form for the disclosure but only provides that the licensee disclose "all sources of compensation related to the transaction received by the licensee from a third party."

Section 1450.185 of the Rules under the Act further describes the disclosure that must be made under Section 10-10 (b) of the Act. The disclosure must be in writing and disclose the compensation the licensee expects to receive or knows the sponsoring broker will receive. Section 1450.185 also provides that referrals to home inspectors or insurance brokers can be subject to the disclosure requirements. The rule also provides that the disclosure must indicate any relationship between the licensee or sponsoring broker and the third party.

Section 10-10 (c) of the Act also deals with disclosure of compensation ancillary to the transaction. However, Section 10-10 (c) deals with referrals to third parties, such as title companies or mortgage brokerage companies, in which the licensee has an ownership or financial interest. The key in determining whether Section 10-10 (c) applies is to analyze whether (1) the licensee has a one percent or greater ownership interest in an entity or (2) the licensee receives dividends or some other type of profit-sharing distribution from the entity. If either one of these is the case and the licensee refers a client to that third party entity for title insurance services, mortgage brokerage services, or other similar services ancillary to the transaction, then disclosure of these facts must be made to the client at the time of the referral. The Act does not prescribe any particular form for this disclosure. Also, the disclosure does not extend to referrals to publicly held or traded companies.

Although the Act does not dictate the form of disclosure, other statutory or regulatory provisions provide for required disclosure formats. Generally, under the Real Estate Settlement and Procedures Act (RESPA) and its regulations there are required disclosures to be made if referring a party to a real estate transaction to a third party in which you have an ownership interest for settlement services, such as title insurance or mortgage brokerage services. Similarly, under the Illinois Title Insurance Act there are required disclosures to be made if referring a party to a transaction to a title agent or company in which you have an ownership interest. In fact, there are forms prescribed by the Department of Financial and Professional Regulation on which those disclosures are to be made. The Illinois title insurance disclosure forms are intended to be compliant with the RESPA requirements. Using the RESPA or Illinois formats for disclosure will be satisfactory for purposes of meeting the requirements of Section 10-10 (c) of the Act.

Recently, there were also changes made to the Residential Mortgage License Act requiring the registration of loan originators. If a licensee is receiving compensation from a mortgage broker for services rendered, the licensee also needs to be registered as a loan originator. This is in addition to the disclosure the licensee would make under Section 10-10 (b) of the Act. The mortgage broker is required to disclose in a loan brokerage agreement between the mortgage broker and the potential borrower the name of any loan originator, such as a real estate licensee, assisting in providing services to the borrower for compensation.

This article presumes that the compensation received by the licensee is permissible under RESPA. However, once you have assured yourself that the payments are RESPA compliant, the disclosures discussed in this article need to be made if not already disclosed in conjunction with RESPA requirements.

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