

# 23 Risk Management

## Risk Management Strategies Risk Management Procedures Primary Areas of Risk

**Risk** is the chance of losing something. Its two dimensions are the probability of occurrence and the extent of exposure to monetary or non-monetary consequences. Since most risks are related to judgments and decisions, the real estate licensee, who makes numerous complex decisions every day, faces a high degree of *risk potential*.

**Risk management** is a structured approach to dealing with the uncertainties and consequences of risk. In real estate practice, the aim is to reduce risk to an acceptable level through anticipation and planning.

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### RISK MANAGEMENT STRATEGIES

Avoidance  
Reduction  
Transference  
Retention

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Four well-established strategies for managing risk are:

- ▶ Avoidance (elimination)
- ▶ Reduction (mitigation, sharing)
- ▶ Transference (outsourcing, insuring)
- ▶ Retention (acceptance and budgeting)

Not all of these strategies are always possible or available, but a real estate firm or licensee who fails to make a conscious effort to employ one or more of them increases the likelihood of loss from the many potential risks that are always present in the real estate business.

#### Avoidance

Avoidance includes refraining from an activity that carries risk. One can avoid the risks of being in an automobile accident by not riding in automobiles. Avoiding risks also means missing the opportunity to benefit from the avoided activity. By avoiding automobile travel, one is confined to modes of transportation, such as buses and walking, that do not offer the same high degree of personal freedom and efficiency. Complete avoidance of risk in real estate practice is almost impossible. A broker, for instance, may believe that hiring only experienced affiliates eliminates the risk that affiliates will commit license law violations. However, even experienced practitioners may not know the law, and,

sometimes, people break the law deliberately. The risk may be reduced, but it remains.

## **Reduction**

Reduction involves taking steps to reduce the probability or the severity of a potential loss. However, this strategy may result in reducing risk in one area only to increase it in another. A familiar example is a sprinkler system that dispenses water to reduce the risk of fire but at the same time increases the risk of water damage.

In real estate practice, one risk reduction tactic is to share responsibility for making a decision. The agent provides the consumer with expertise, and perhaps some advice, but lets the consumer decide how much to offer. In this way, the agent gets some relief from the risks inherent in the buyer's decision to purchase.

## **Transference**

Transference means passing the risk to another party, by contract or other means. An insurance policy is the common example, but sometimes the wording of a sales or personal services contract can transfer risk without resorting to insurance.

In the real estate business, transference is typically and most successfully accomplished by means of an errors and omissions (E&O) insurance policy, either on the individuals in a firm or on the firm itself. State law may require such insurance.

## **Retention**

Retention of risk means entering into an activity in spite of known risks and taking full responsibility for the consequences. This is, in effect, self-insurance, the only strategy left when risk cannot be reduced or transferred and one has decided not to avoid it because of the desirability of the potential benefits.

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## **RISK MANAGEMENT PROCEDURES**

### **Education**

### **Disclosure**

### **Documentation and record keeping**

### **Insurance**

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Experience shows that the most practical strategies for risk management in real estate practice are reduction and transference, with procedures focusing on:

- ▶ Education
- ▶ Disclosure
- ▶ Documentation
- ▶ Insurance

## **Education**

Education is the first line of defense against risk. When agents are familiar with the forms provided by the office, how and when to complete them and where to send them, the likelihood of errors is reduced. Likewise, agents need to be able to identify and understand common contract elements, complete contract forms developed by attorneys, and evaluate offers received from co-op agents on their listings without committing a license violation or breach of law.

In most states, brokers have a legal obligation to provide training to affiliated licensees. Licensees also have the obligation to seek out appropriate education and training outside the brokerage to ensure that they know how to comply with the law. In addition, licensees must satisfy legal requirements for continuing education, while those who care about personal excellence will seek further education and training to enhance their professional skills.

## Disclosure

By ensuring that all parties have the information they are entitled to, proper disclosure reduces the risk that clients and customers will accuse a licensee of misleading or inducing them to make a decision with incomplete information. Further, laws in every state require disclosures of one kind or another.

Disclosure may be made in writing or verbally and may or may not require written acknowledgment from the receiving party.

Required disclosures usually include:

- ▶ agency relationships
- ▶ property condition
- ▶ duties and obligations
- ▶ personal interest in the transaction
- ▶ personal interest in referrals

## Documentation and Record keeping

Documentation provides evidence of compliance with laws and regulations. It proves what clients and customers and licensees said and did in a transaction. Some documentation is required by law.

The components of a thoroughly documented paper trail include:

- ▶ Policy and procedure manuals
- ▶ Standard forms
- ▶ Communication records
- ▶ Transaction records
- ▶ Contracts
- ▶ Accounting
- ▶ Other important documents

**Policy manual.** A written and uniformly enforced company policy lets everyone in the firm know what to expect before problems arise. The policy manual should cover the company's rules in such areas as floor duty privileges, assignment of relocation properties to agents, referrals between agents within the company, and requirements for continuing education, sales meeting participation, and property tours.

**Procedures manual.** A company procedures manual should spell out how to handle every aspect of the company's business that agents and brokers need to know—from handling consumers' funds and documents, conducting consumer transactions, dealing with MLS-related matters, and placing signage, to all procedures prescribed by state or federal law, especially license, banking and fair housing laws. Adherence to a procedures manual reduces the risk that an individual will inadvertently commit an unlawful act. Whenever changes are

made to the policy or procedures manual, each agent should sign the revised manual as evidence that the agent has examined it.

**Standard forms.** Standard forms save time and protect against the unauthorized practice of law. Since they are most often prepared by lawyers familiar with the market area, they can address contingencies that are common in the area in a manner that reflects the real estate laws of the state. On the other hand, a licensee often needs to adapt a standardized form for a client by assisting with filling in blanks, modifying terms, and attaching addenda. The licensee must always remain aware of the limitations the state has placed on such activities.

Here are a few of the standard forms a brokerage should provide for its agents and affiliates:

- ▶ buyer and seller representation agreements, exclusive and non-exclusive
- ▶ agreement to show property
- ▶ purchase and sale agreement
- ▶ agency disclosure form
- ▶ property condition disclosure, disclaimer, and exemption form
- ▶ lease agreement
- ▶ personal interest disclosure form
- ▶ referral for service disclosure form
- ▶ lead-based paint disclosure form
- ▶ special disclosure forms (mold, radon, subsurface sewage system, impact fees/adequate facilities taxes, etc.)
- ▶ referral agreement
- ▶ independent contractor agreement
- ▶ closing checklist

**Communication records.** Some communications with transaction parties are good and necessary for business. Others are required by law, such as certain disclosures. A transaction checklist is a good tool for managing risk associated with the failure to make required communications to all principals and for keeping track of required communications from co-op agents.

Retaining evidence that information has been communicated is a necessary procedure. Electronic communications should be archived on suitable electronic media. Copies of mailed or faxed communications should be maintained in the transaction folder.

It is always difficult to document telephone or face-to-face conversations, especially with the constant use of cell phones from a variety of locations. It is a good practice to make brief notes at the time and then write them up later for mailing or faxing to the other party. Be sure, however, that you can produce these notes on demand, lest you be accused later of withholding documentation that has been promised.

Maintaining a good record of communications is useful for resolving disagreements where parties dispute what has been said because it allows the agent to produce a dated document that resolves the issue definitively.

**Transaction records.** State laws require licensees to document transactions. Firms are required to keep written records of all real estate transactions for a number of years (usually three to five) after closing or termination. Required records typically include:

- ▶ listing agreements
- ▶ offers
- ▶ contracts
- ▶ closing statements
- ▶ agency agreements
- ▶ disclosure documents
- ▶ correspondence and other communication records
- ▶ notes and any other relevant information

**Accounting.** In addition to other accounting records, there is the requirement to maintain written accounting of escrow funds. For each transaction, property, and principal, escrow records will include:

- ▶ depositor
- ▶ date of deposit
- ▶ date of withdrawal
- ▶ payee
- ▶ other information deemed pertinent by the real estate commission

**Other documents.** Additional documents may be required by law or regulation, or should be kept simply as protection in case of disputes and lawsuits. These would include copies of advertising materials, materials used in training agents, records of compliance with continuing education requirements, safety manuals, and anything else that shows how the firm conducts its business and safeguards its staff as well as the rights of consumers.

## Insurance

Many forms of insurance are available for property owners and managers. Some of these types are also used to manage certain risks of brokers and licensees.

**General Liability.** General liability insurance provides coverage for risks incurred by a property owner when the public or a licensee enters the owned property (**public liability**). The insurer pays the covered claim and legal fees, costs, and expenses, including medical expenses, resulting from owner negligence or other causes. This type of insurance does not cover **professional liability**, for which an Errors & Omissions policy is necessary.

**Errors and Omissions.** Professional liability is of two general types:

1. Unprofessional conduct – a claim that one has failed to carry out fiduciary duties and provide an acceptable standard of care
2. Breach of contract – a claim that one has failed to perform services under the terms of a contract in a timely manner

The primary method for transferring the professional liability risks of brokers, managers, and licensees is Errors & Omissions (E&O) insurance. A standard E&O policy provides coverage for “damages resulting from any negligent act,

error or omission arising out of Professional Services.” A standard policy does NOT cover:

- ▶ violations of law
- ▶ fraudulent, dishonest, criminal or malicious acts
- ▶ mishandling of escrow moneys, earnest money deposits, or security deposits
- ▶ antitrust violations
- ▶ sexual harassment
- ▶ Fair Housing violations
- ▶ agent-owned properties
- ▶ environmental violations
- ▶ failure to detect or disclose environmental conditions, including mold
- ▶ acts committed prior to licensure or after termination of active status
- ▶ activities as an appraiser if licensing other than a real estate license is required

E&O insurance, in short, covers “mistakes” but not crimes.

**Fire and hazard.** The risks of property damage caused by fire, wind, hail, smoke, civil disturbance, and other such causes are covered by fire and hazard insurance.

**Flood.** The risks of property damage caused by floods, heavy rains, snow, drainage failures, and failed public infrastructures such as dams and levies are covered by a specialized flood policy. Regular hazard policies do not include flood coverage.

**Other insurance.** Other common types of insurance coverage for income and commercial properties include:

- ▶ **casualty**—coverage for specific risks, such as theft, vandalism, burglary, illness and accident, machinery damage
- ▶ **workers’ compensation**—hospital and medical coverage for employees injured in the course of employment, mandated by state laws
- ▶ **contents and personal property**—coverage for building contents and personal property when they are not actually on the building premises
- ▶ **consequential loss, use, and occupancy**—coverage for the business losses resulting from a disaster, such as loss of rent and other revenue, when the property cannot be used for business
- ▶ **surety bond**—coverage against losses resulting from criminal or negligent acts of an employee

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## PRIMARY AREAS OF RISK

Agency  
Property disclosures  
Listing and selling process  
Contracting process  
Fair Housing  
Antitrust  
Rules and regulations  
Misrepresentation  
Recommending providers  
Financing and closing  
Trust fund handling  
Safety And security

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Risks for licensees are present every day in business transactions. Many of these risks carry legal implications as well as possible financial and professional consequences.

### Agency

The risks of agency will occur in one of two areas:

- ▶ the requirement to inform and disclose
- ▶ the requirement to carry out an agency duty.

Most states require agency relationships to be in writing and to be disclosed to all parties to a transaction. State law may spell out agency duties, or the duties may be a part of general agency law. In states that do not use agency, there is still the obligation to explain and disclose the nature of the relationship.

**Disclosure requirements.** A licensee may be acting in a transaction as facilitator, agent, subagent, designated agent, single agent, dual agent, non-agent or in some capacity. Regardless of status, the licensee must follow state disclosure requirements. These are, typically, to:

- ▶ disclose status **verbally** to other licensees on initial contact
- ▶ disclose status **verbally** to buyer and seller before providing real estate services
- ▶ confirm the disclosure **in writing** before signing a listing agreement or presenting a purchase offer (to an unrepresented seller) or before preparing a purchase offer (to an unrepresented buyer)
- ▶ get a **signed receipt** indicating the written disclosure has been made

Carrying out the duties of agency also require disclosures of :

- ▶ personal interest the agent has in a transaction (such as owner or buyer)
- ▶ personal benefit the agent will derive from a service referral
- ▶ required property and market information
- ▶ information about customers a client is entitled to have

**Duties.** A licensee who acts for a principal in a real estate transaction is required by law to assume certain responsibilities toward the parties to the transaction. Whether a state applies the fiduciary duties of agency law or specifies its own duties toward clients and consumers, the basic duties remain:

**To all parties**

- ▶ honesty
- ▶ fairness
- ▶ reasonable care and skill
- ▶ disclosures

**To clients**

- ▶ skill
- ▶ care
- ▶ diligence
- ▶ loyalty
- ▶ obedience
- ▶ confidentiality
- ▶ accounting
- ▶ full disclosure

The duty to exercise **skill, care and diligence** means that licensees may not be casual or negligent in their actions. Licensee negligence is actionable when principals are harmed by the licensee's failure.

The duty of **loyalty** requires the agent to *put the client's interests above those of everyone else*, including his or her own.

The duty of **obedience** requires the agent to act on the principal's wishes regarding the transaction as long as they do not result in any illegal action. The duty of obedience never overrides the legal obligation of agents to deal fairly and honestly with all parties.

The duty of **confidentiality** requires the agent to hold in confidence any information that would harm the client's interests or bargaining position or anything else the client wishes to keep secret, unless the law requires disclosure. The duty of confidentiality survives the termination of the listing contract.

The duty of **accounting** applies to all funds involved in a real estate transaction. Accounts must be maintained as required by law, and escrow funds are to be handled strictly in accordance with the law.

The duty of **disclosure** applies to both parties to a transaction, although usually with some differences. Proper disclosure to customers primarily concerns agency, property condition, and environmental hazards. To the client, it generally concerns all known facts regarding the property and the transaction, including information about the other transaction party. State laws prescribe what may, must, and must not be disclosed. Licensees must be vigilant to avoid oversights and conflicts of interest that can lead to a disclosure to the wrong party or disclosure of information that is confidential.



**Conflicts of interest.** Conflicts of interest arise when an agent forgets to put the best interests of a client ahead of those of everyone else. This can happen in situations involving undisclosed dual agencies, broker-owned listings, licensees buying for their own account, vendor referrals, and property management subcontracting of services, among many others. Even ordinary, everyday transactions carry a built-in risk of conflict of interest. Consider the fact that a licensee usually receives no compensation for a failed transaction. Therefore, it is in the licensee's interest to see the transaction completed, even if it may not be in the client's best interest. A negative result from a home inspection or other test has the potential to cause a buyer to back out of a contract. A licensee who has forgotten whose best interest should be primary might be tempted to recommend inspectors who will overlook problems in exchange for receiving referrals. Licensees must always disclose any self-interest they have in a transaction, and always remember their duties to clients and consumers.

**Confidentiality.** Licensees have a responsibility to maintain the confidentiality of certain kinds of information they obtain concerning clients and customers. The duty to maintain confidentiality generally survives the termination of a listing agreement into perpetuity. If it seems that revealing confidential information might benefit the client, the licensee should obtain the client's written permission to proceed.

Confidential information generally includes information about a client's motivations in a transaction, financial and personal details, and information specifically designated as confidential by the client. Public information, such as that contained in public records, information that becomes known without the licensee's participation, or that the client reveals to another, is not considered confidential.

State laws often require businesses to provide security for the personal information they obtain about consumers. Security procedures should protect personal information from unauthorized access, destruction, use, modification, or disclosure. Confidential information, when it is not to be retained, must be disposed of in a secure manner.

**Penalties.** Possible penalties for breach of agency relationships include:

- ▶ rescission of transaction
- ▶ loss of compensation
- ▶ fees and costs
- ▶ punitive damages
- ▶ ethics discipline
- ▶ license discipline

## Property disclosures

**Property condition.** Most states require the seller of a residential property to deliver to the buyer a written disclosure or disclaimer about the property's condition, including any material defects the owner knows about. The disclosure is usually required before any purchase contract is accepted.. A second disclosure may be required at closing. The licensee should always obtain the parties' signatures acknowledging receipt of these disclosures.

Depending on the state, the licensee may have no further duty to disclose property condition after properly informing parties of their rights and obligations. However, the licensee may still be subject to legal action for

- ▶ deliberately distorting the facts (intentional misrepresentation)
- ▶ cheating any party (fraud)
- ▶ concealing or failing to disclose adverse facts which the licensee knew about or should have known about (intentional or unintentional misrepresentation)

**Lead-based paint and other disclosures.** Federal law requires sellers of houses built before 1978 to make a lead-based paint disclosure before accepting an offer to purchase. The licensee must tell the seller about this requirement, give the seller the proper disclosure form, and make sure that the buyer receives it.

The licensee must also make sure the seller discloses any other circumstances the situation and the law require, which may include:

- ▶ wood infestation inspection report
- ▶ soil test report
- ▶ subsurface sewage disposal system permit disclosure
- ▶ impact fees or adequate facilities taxes disclosure
- ▶ mold and radon reports or treatments

## **Listing and selling process**

**Nature and accuracy of the listing agreement.** In most states, a listing agreement is enforceable only if it is in writing. Most states forbid net listings, because they violate the requirement that a valid listing agreement must specify a selling price and the agent's compensation. The licensee, in accordance with the duty of due diligence, must verify the accuracy of the statements in the listing regarding the property, the owner, and the owner's representations. Especially important facts for a broker or agent to verify are:

- ▶ the property condition
- ▶ ownership status
- ▶ the client's authority to act

An agent who does not act with a reasonable degree of due diligence in these matters may be exposed to liability if it turns out that the property is not as represented or the client cannot perform the contract as promised.

**Comparative Market Analysis (CMA).** In preparing a Comparative Market Analysis, licensees should guard against using the terms "appraisal" and "value," which are reserved for the use of certified appraisers. Misuse of these terms could lead to a charge of misrepresenting oneself as an appraiser. In discussing listed properties with clients or customers, real estate licensees should be careful to use guarded terms such as "recommended listing price," "recommended purchase price," and "recommended listing price range."

Agents should make every effort to help the sellers find a reasonable listing price based on the current market. If the CMA leads the seller to list at a price that is too high, the seller may blame the agent when the transaction fails because of an appraisal that comes in below the selling price. To minimize this risk, it is best to

be conservative in the CMA and retain documentation that the seller went above the recommended price in spite of the agent's advice.

**Estimate of Closing Costs.** In preparing an estimate of closing costs for a seller or buyer, there is the risk of forgetting something, leading to an unpleasant surprise when the consumer suddenly faces unexpected costs or conditions. Licensees should use their broker's form, if there is one, and make it clear to the consumer that it is only an estimate of likely costs, not a statement of actual costs. In some states, brokers and agents do not prepare closing cost estimates, leaving that task to the lender.

**Advertising.** State and federal laws regulate advertising, including the federal Fair Housing laws as they pertain to discriminatory advertising and providing of services. Advertising includes electronic communication, social media/networking, and internet marketing. Usage must be consistent with company image and legal requirements. The license laws of most states list illegal advertising actions subject to discipline such as:

- ▶ making any substantial and intentional misrepresentation
- ▶ making any promise that might cause a person to enter into a contract or agreement when the promise is one the licensee cannot or will not abide by
- ▶ making continued and blatant misrepresentations or false promises through affiliate brokers, other persons, or any advertising medium
- ▶ making misleading or untruthful statements in any advertising, including using the term "Realtor" when not authorized to do so and using any other trade name, insignia or membership in a real estate organization when the licensee is not a member.

Committing such acts may result in license suspension or revocation.

**Authorizations and Permissions.** Licensees should stay within the bounds of the authority granted by the agency agreement or must not do anything requiring permission without first getting that permission in writing. For instance, permission should be obtained before doing any of the following unless the listing agreement specifically grants the authority:

- ▶ post a sign on the property
- ▶ remove other signs
- ▶ show the property
- ▶ hand out the property condition disclosure
- ▶ distribute marketing materials
- ▶ advertise in various media
- ▶ use a multiple listing service
- ▶ cooperate with other licensees
- ▶ divide the commission or negotiate a commission split
- ▶ share final sales data with the MLS
- ▶ place a lock box on the property

- ▶ appoint subagents
- ▶ appoint a designated agent
- ▶ change agency status

**Scope of expertise.** Real estate licensees are not, by nature, financial consultants, accountants, appraisers, soil scientists, well diggers, lawyers, decorators, contractors, builders, plumbers, carpenters, inspectors, prognosticators, and a number of other kinds of expert. However, in today's competitive environment, consumers often demand much more from a licensee than the traditional basic services. An agent who fails to live up to prevailing standards may be held liable for negligence, fraud, or violation of state real estate license laws and regulations. At the same time, agents must be particularly careful about the temptation to misrepresent themselves as experts and offer inappropriate expert advice. Disclaimer and referral are always the best risk control procedures to forestall an accusation of misrepresentation from a consumer who claims to have been harmed by reliance on the licensee's non-existent expertise. The exact nature of the services to be provided should be stated as clearly as possible in the listing agreement.

**Contracting process** According to the Statute of Frauds, all contracts for real estate must be in writing to be enforceable. Contracts that contain incorrect information or are inadequately prepared can pose a serious liability for a licensee. To avoid such a situation, it is imperative for the contract to reflect the terms that the parties have agreed upon in the most accurate and honest manner. The agent must also be careful to comply with the letter of the real estate law. Violations can jeopardize the enforceability of a listing or sales contract, in addition to resulting in criminal prosecution.

Common risks and errors in the contracting process include:

- ▶ using an illegal form

A licensee may be punished for using any real estate listing agreement form, sales contract form, or offer to purchase form that lacks a *definite termination date*.

- ▶ failing to state inclusions and exclusions

The parties should identify as included in or excluded from the transfer any ambiguous items. Unwritten agreements between the parties are a source of later dispute and trouble.

- ▶ failing to track the progress of contingency satisfaction

The time period for completing contingencies such as inspections is specific and limited. Failure to meet or waive a condition may terminate the contract. A "time is of the essence" clause in the standard agreement makes the time period for contingencies critical.

- ▶ mistakes in entering data in a form

All data should be checked and verified: dates, times, amounts,

warranties, descriptions, names, representations, promises, procedures, authority, etc. One way to reduce risk in the contracting process is to use a checklist that covers all the contract items.

**Unauthorized practice of law.** The unintentional practice of law without a license is a great risk in the contracting process, as well as in the representation process. It is illegal for real estate professionals who are not attorneys to draw up contracts for transactions they are not involved in or to charge a separate fee for preparing a contract.

Such licensees may fill in blanks or make deletions on a preprinted contract form prepared by a lawyer. While a licensee may make deletions, additions to a form should be drafted by an attorney. The principals themselves can make changes as long as each change is signed or initialed by all signers. Preprinted riders can often be attached as addenda to a contract without an attorney.

It is also illegal for real estate licensees who are not lawyers to give legal advice or interpret contract language. Licensees, however, may express opinions. For instance, if a licensee believes that a party has grasped the meaning of a contract, it is permissible to say something like, "Though I am not an attorney, in my opinion your understanding of this contract is correct." It would be questionable to make a definitive statement like, "That's correct."

## Fair Housing

The risk of violating fair housing laws can be minimized through ongoing education that addresses both the content and the intent of the laws. It is especially necessary for paperwork and documentation to be accurate and concise in a situation where a fair housing issue could arise.

**Advertising.** The Fair Housing Act forbids real estate advertising that mentions race, color, religion, national origin, sex, handicap, or familial status in any way that suggests preference or discrimination. State laws may add other protected categories, such as creed and age.

Risk can be reduced by the use of street names or other non-biased geographical references when stating where the property is located, and by describing the property rather than the type of persons who might live in or around it. Even if a home appears "ideal for a young family," it is best not to advertise it as such. Such advertising would exclude other groups such as singles, the elderly, and older families.

In advertising the sale or rental of housing covered by the Fair Housing Act, HUD recommends using the Fair Housing Logo or phrase "Equal Housing Opportunity."

**Answering questions.** When faced with questions that might lead to a *steering* charge or other violation of fair housing laws, it is best for the licensee to limit the response to features of the home and to the process of selling, buying, and listing properties, and refer the questioner to someone else to answer questions about such matters as the demographic make-up of the neighborhood. It is illegal for the licensee to voice an opinion based on race, religion, color, creed, national origin, sex, handicap, elderliness, or familial status. The agent should explain this fact to

the buyer and be wary of any situation where the agent's behavior might be construed as discriminatory..

**Listing agreements.** Before entering into a listing agreement, a licensee should explain that it is necessary to comply with fair housing laws and obtain the potential client's acknowledgment and agreement. The agent should make it clear that the agent will

- ▶ reject the use of terms indicating race, religion, creed, color, national origin, sex, handicap, age or familial status to describe prospective buyers.
- ▶ terminate the listing if the seller uses race, religion, creed, color, national origin, sex, handicap, age, or familial status in the consideration of an offer.
- ▶ inform the broker if the seller makes any attempt to discriminate illegally.

**Offers.** A seller cannot refuse to sell a property to an individual based on the individual's belonging to a protected class, and if this is attempted, the real estate professional must not be involved. If the seller asks about the color, religion, creed, national origin, ethnicity, age, or familial status of a buyer, the agent must explain that it is illegal to give out such information. The best risk reduction procedure is to treat all buyers and sellers equally, showing no preference for one over another.

## Antitrust

Antitrust laws forbid brokers to band together to set a price on their services in listing and selling property. Even being overheard discussing commission rates or being present at such a conversation can lead to charges of *price fixing*.

The law recognizes that some cooperative arrangements between firms – such as joint development projects – may help consumers by allowing these firms to compete more effectively against each other. Even so the government does not prosecute all agreements between companies, but only those that will raise prices for the public or deny the public new and better products.

**Sherman Antitrust Act.** The *Sherman Antitrust Act* makes illegal all contracts, agreements, and conspiracies among competitors that would unfairly restrict interstate trade by fixing prices, rigging bids, or other means. An unlawful monopoly is created when one company becomes the only supplier of a product or service by getting rid of competition via secret agreements with other companies.

**Clayton Act.** The *Clayton Act* prohibits mergers or acquisitions that are likely to lessen competition and increase prices to consumers. The Act also prohibits certain other business practices that under certain circumstances may harm competition. Private parties injured by an antitrust violation may sue in federal court for three times their actual damages, plus court costs and attorneys' fees.

**Federal Trade Commission Act.** The *Federal Trade Commission Act* forbids unfair competition in interstate commerce but establishes no criminal penalties.

**Enforcement.** Federal antitrust laws are enforced in three main ways:

- ▶ the Antitrust Division of the Department of Justice (DOJ) brings criminal and civil enforcement actions
- ▶ the FTC brings civil enforcement actions
- ▶ private parties bring lawsuits claiming damages

To collect evidence, Department of Justice lawyers often work with the Federal Bureau of Investigation (FBI) on court-authorized searches of a business, monitoring phone calls and employing informants equipped with secret listening devices.

State attorneys general may sue under the Clayton Act on behalf of injured consumers in their states, and groups of consumers often bring lawsuits on their own.

Anyone associated with an organization found guilty of an antitrust violation and determined to have had knowledge of that violation may also suffer legal consequences.

**Penalties.** Penalties for Violation of Antitrust Laws include:

- ▶ fines for individuals and corporations, as well as possible imprisonment.
- ▶ Under the Clayton Antitrust Act, parties can sue antitrust violators and recover three times the damages they incurred plus court costs and attorneys' fees.

## Rules and regulations

State real estate laws and commissioners' rules and regulations attempt to cover every possible risky situation. Non-compliance poses a direct threat to the legal and financial status of licensee and license in the following general ways:

- ▶ license expiration
- ▶ license revocation or suspension
- ▶ licensee discipline
- ▶ suit for damages

**License expiration.** Licenses expire because licensees neglect to:

- ▶ maintain E & O insurance when required
- ▶ meet education requirements
- ▶ observe correct renewal procedures

**License revocation or suspension.** Licenses are typically revoked or suspended when a licensee is found guilty of:

- ▶ obtaining a license under false pretenses
- ▶ committing a “prohibited act”
- ▶ neglecting to present every written offer as required
- ▶ neglecting to deliver signed copies of accepted offers to transaction parties as required
- ▶ failing to make sure that all required terms and conditions are present in a contract to purchase
- ▶ handling earnest money and other escrow funds improperly

**Licensee discipline.** A state real estate commission may assess a civil penalty for violations of a statute, rule, or order. Licensees are disciplined for:

- ▶ acting without a license when a license is required
- ▶ demanding a referral fee without reasonable cause
- ▶ entering into a net listing
- ▶ trying to induce another licensee’s client to end or change an existing agency contract
- ▶ paying a commission to an unlicensed individual or company
- ▶ receiving an illegal referral fee, rebate or kickback
- ▶ practicing with an expired license

**Licensee lawsuits.** A licensee may be sued by the Department of Justice, Federal Trade Commission, a state real estate commission, a human rights commission, another licensee or firm, or an individual consumer. Licensees are mainly sued for:

- ▶ fair housing violations
- ▶ antitrust violations
- ▶ license law and other state law violations
- ▶ breach of contract
- ▶ agency duty violations
- ▶ illegal practice of law
- ▶ failures to disclose
- ▶ customer or client dissatisfaction
- ▶ fraud
- ▶ theft

**Misrepresentation**      Misrepresentation may be unintentional or intentional.

**Unintentional misrepresentation.** This type of misrepresentation occurs when a licensee unknowingly conveys inaccurate information to a consumer concerning a property, financing or agency service. False or inaccurate information that the licensee, as a professional, should have known to be false or inaccurate may be included in the definition. Those found guilty generally have to pay fines and may be disciplined by state real estate regulators and professional organizations.



Risky areas for unintentional misrepresentation include:

- ▶ making and reporting measurements
- ▶ describing property
- ▶ offering opinions about future growth and development of a neighborhood or neighboring property
- ▶ making declarative statements about the presence or absence of hazardous materials

The risks of unintentional misrepresentation are reduced if an agent

- ▶ learns to measure and calculate areas accurately
- ▶ relies on measurements reported by others only with extreme caution and specific disclaimers
- ▶ refrains from exaggeration
- ▶ avoids stating opinions a consumer might take for expertise

**Intentional misrepresentation.** Also known as fraud, this kind of misrepresentation occurs when a licensee *knowingly* conveys false information about a property, financing or service. Fraud is a criminal act that may result in fines and incarceration, in addition to discipline from state regulators and professional organizations.

## Recommending providers

There are several risks attending the recommendation of vendors and service providers to a consumer. First, the consumer may not be satisfied with the performance of the recommended party and blame the licensee. Second, in cases where a recommended provider performs illegal acts, there may be legal consequences for the licensee. Third, if a licensee has a business relationship with a recommended vendor or provider and neglects to disclose the fact, there are license violation consequences.

The major risk management technique is to shift the responsibility for choosing a vendor to the consumer. This can be done by refusing to recommend vendors at all; by presenting a broad range of choices and allowing the consumer to select; or by presenting a short list of thoroughly vetted vendors and allowing the consumer to make the decision, always with the disclaimer that *to the best of the licensee's knowledge*, the vendors on the list are competent and honest, but that the consumer is responsible for investigating and making his or her own judgment before hiring or buying.

## Financing and closing

In the financing and closing phases of a transaction, a consumer may feel that a licensee has been incompetent or misleading. Licensees have an obligation to inform and educate their clients throughout the transaction process. Surprises and accusations of incompetence or misrepresentation are among possible results of failing to keep the party informed.

**Discrimination.** Of course, it is important to comply with relevant laws. Licensees must be mindful of the requirements of ECOA and refrain from participating in any manner of discriminatory lending. It is illegal to:

- ▶ threaten, coerce, intimidate or interfere with a person who is exercising a fair housing right or assisting another other to exercise that right.
- ▶ indicate a limitation or preference based on race, color, national origin, religion, sex, familial status, or handicap in any advertisement or communication. Single-family and owner-occupied housing that is otherwise exempt from the Fair Housing Act is subject to this prohibition against discriminatory advertising.

**Progress reporting.** All inspections and tests must comply with local and state laws and with the purchase contract. Progress reports should be accurate, timely, in writing, and free of speculation. If a consumer has a question about the meaning of something in an inspection report, the licensee should refer the consumer to the person who wrote the report rather than trying to explain it. This method transfers some of the risk inherent in interpreting the report.

**Qualifying buyers.** Many transactions fail because a buyer has been improperly qualified before the offer is presented. Using a lender to qualify the buyer saves time and protects the agent against leading a seller to believe a purchaser is fully qualified when this may not be the case. Also, lenders and loan agents are better able to look into the buyer's qualifications than a real estate licensee is. If it becomes necessary to show a property to a potential buyer who has not been qualified by a lender, the licensee can gain some protection by performing an informal qualification and documenting the fact that it was based on the information provided by the buyer. The buyer's signature on this documentation indicates the buyer's acceptance of at least partial responsibility for the qualification.

**Lending fees disclosure.** The licensee should explain loan fees, charges,

amounts, timing, and responsibilities. Agents can assist in the loan decision by explaining how to compare loans with differing charges and interest rates. The fact that a high origination fee and points may make a loan with a low interest rate unattractive to a borrower is important information for the agent to provide, and providing it may protect the agent against a later complaint that the buyer suffered a loss because of the agent's failure to inform.

**Appraisal problems.** Delays and appraised value are the typical problem areas. Failure to inform parties about delays can compromise the transaction. An under-appraisal will require the buyer to make a larger down payment or the seller to lower the price. If the property appraises for more than the purchase price, the seller may blame the agent for suggesting the lower price. In such a case, the seller's agent's defense is that the seller agreed to the listing price and that the price was a factor in attracting the buyer to the property.

**RESPA Violations.** The **Real Estate Settlement and Procedures Act (RESPA)** stipulates that the parties to certain purchase transactions must be given accurate

information reflecting their closing costs. It also prohibits certain business practices that are not considered to be in the consumer's best interest.

The licensee's risks regarding RESPA primarily relate to

- ▶ failing to ensure that the consumer is informed about his or her rights under the law
- ▶ giving or receiving an illegal kickback.

RESPA currently requires lenders to:

- ▶ give a copy of a Consumer Financial Protection Bureau loan information booklet to the applicant. The booklet explains RESPA provisions, general settlement costs, and the required **Closing Disclosure** form. The lender must provide the estimate of closing costs within three business days following the borrower's application.
- ▶ give the applicant a Loan Estimate (Form H-24) of expected closing costs within three business days of receiving the application. Actual closing costs may not vary from the estimate beyond certain limits.
- ▶ give the buyer the Closing Disclosure (Form H-25) specifying costs to be paid by buyer and seller at closing three business days before consummation.
- ▶ give the **buyer** the opportunity to review the final settlement statement *one business day prior to closing*.

RESPA specifically **prohibits** any fee or kickback paid to a party for a service when the party has not actually rendered the service. For example, it is prohibited for an insurance company to pay a real estate agent or a lender for referring a client.

Fees for referring clients to the following services are strictly forbidden:

- ▶ title services (search, insurance)
- ▶ appraisals
- ▶ inspections
- ▶ surveys
- ▶ loan issue
- ▶ credit report
- ▶ attorney services

The sharing of commissions and the payment of referral fees among cooperating brokers and multiple-listing services are not RESPA violations.

### Trust fund handling

State laws prescribe how licensees must handle any escrow or earnest money deposits they receive. Those laws usually state that a broker must hold money

received in connection with the purchase or lease of real property in a trust fund account. The type of account and financial depository are specified. The broker must record receipt of the money and place that money in the trust account within a specified time period. Usually, the law allows the broker to hold an earnest money check uncashed until the offer is accepted, provided the buyer gives written permission and the seller is informed.

Typical trust fund handling requirements include:

- ▶ the broker named as trustee of the account
- ▶ a federally-insured bank or recognized depository located in the state
- ▶ an account that is not interest-bearing if the financial institution ever requires prior written notice for withdrawals
- ▶ maintenance of records in a particular accounting format
- ▶ separate records kept for each beneficiary, property, or transaction
- ▶ records of funds received and paid out regularly reconciled with bank statements
- ▶ withdrawals only by the broker-trustee or other specifically authorized person

**Commingling and conversion.** Mixing of personal or company funds with client funds is grounds for the revocation or suspension of a real estate license. Depositing client funds in a personal or business account, or using them for any purpose other than the client's business, is also grounds for suspension or revocation of a license. It is important for the broker to remove commissions, fees or other income earned by the broker from a trust account within the period specified by law to avoid committing an act of commingling.

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## Risk Management Snapshot Review

### RISK MANAGEMENT STRATEGIES

- two dimensions of risk: size, probability; risk management: structured approach to uncertainty
- Avoidance**
  - refrain from risky activity
- Reduction**
  - reduce probability; share responsibility
- Transference**
  - pass risk by contract; insurance
- Retention**
  - accept risk; self-insurance

### RISK MANAGEMENT PROCEDURES

- Education**
  - train in laws, forms and procedures, job performance
- Disclosure**
  - provide information to reduce misunderstanding & lawsuits; agency, property condition, duties, personal interest
- Documentation and record keeping**
  - maintain evidence of compliance; manuals, forms, records, contracts, accounting, other documents
- Insurance**
  - general liability, E & O, fire and hazard, flood, casualty, workers, personal property, consequential loss, surety bond

### PRIMARY AREAS OF RISK

- Agency**
  - main failures: to inform and disclose, to fulfill duties
  - disclosures: verbal, written, signed receipt; agency relationship and duties; personal interest in transaction; required information
  - duties: to all— honesty, fairness, care, skill, required disclosures; additional to clients— diligence, loyalty, obedience, confidentiality, accounting, full disclosure
  - conflicts of interest arise from failing to put client's interest first
  - confidentiality duty lasts forever; laws define what is confidential, how to treat and dispose of information
  - penalties include loss of transaction, compensation, fees and costs, damages, license
- Property disclosures**
  - property condition, lead-based paint, other conditions; disclosure may discharge liability; failure to disclose may be construed as misrepresentation
- Listing and selling process**
  - areas of risk include listing agreement accuracy, Comparative Market Analysis results, closing cost estimates, advertising, authorizations and permissions, exceeding expertise
- Contracting Process**
  - contracts for real estate must be in writing; inaccuracy endangers contract; other risks: illegal form, omitted elements, lapsed contingencies, wrong data
  - unauthorized practice of law: non-lawyers may fill in blanks and delete words on standard contract forms; no legal advice to public allowed
- Fair Housing**
  - advertising may not state preference, limitation or discrimination based on race, color, religion, national origin, sex, handicap, familial status
  - agent must not be involved with discriminatory actions of a client or customer

<b>Antitrust</b>	<ul style="list-style-type: none"> <li>government prosecutes cooperative arrangements that raise prices or reduce consumer choices: Sherman Antitrust Act outlaws restraint of trade; Clayton Act outlaws practices that harm competition; Federal Trade Commission Act outlaws unfair methods of competition</li> <li>violations punishable by government criminal and civil actions as well as by private lawsuits; fines, damages, and imprisonment possible</li> </ul>
<b>Rules and regulations</b>	<ul style="list-style-type: none"> <li>violators of state rules and regulations risk license expiration, revocation, suspension, and other discipline</li> <li>prime causes of discipline include commission of prohibited acts, practicing with an expired license, disclosure failures, earnest money mishandling</li> </ul>
<b>Misrepresentation</b>	<ul style="list-style-type: none"> <li>unintentional: inaccurate information conveyed unknowingly; subject to fines and license discipline; occurs most often in measurements, property descriptions</li> <li>intentional: fraud, knowingly conveying false information; criminal act subject to fines, license discipline, and incarceration</li> </ul>
<b>Recommending providers</b>	<ul style="list-style-type: none"> <li>risks include consumer dissatisfaction, possible vicarious liability for illegal acts committed by a recommended provider, undisclosed business relationship (RESPA violation as well as license violation)</li> <li>best practice: do not recommend any vendors, or provide a list of trusted vendors with no recommendation and a disclaimer</li> </ul>
<b>Financing and closing</b>	<ul style="list-style-type: none"> <li>risk areas include fair housing and ECOA violations; failed transactions because of agent failure to monitor contingency period; failure to ensure proper disclosure of closing costs; RESPA violations</li> </ul>
<b>Trust fund handling</b>	<ul style="list-style-type: none"> <li>risk areas include mishandling of earnest money deposits; commingling and conversion of trust funds; errors in use of trust accounts</li> </ul>