

# **Broker Compliance Evaluation Manual**



***SUMMER 2019***

# **Broker Compliance Evaluation Manual**

*This Broker Compliance Evaluation Manual was prepared primarily to assist the real estate broker conducting residential sales in ascertaining compliance with Department of Real Estate requirements. It contains many of the questions that a broker would be asked if visited by a Department of Real Estate representative.*

*This manual was not designed to encompass all of a broker's obligations and responsibilities under the Real Estate Law but rather as one of the tools a broker may use when reviewing records and office procedures. We hope that it will assist brokers.*

*This Broker Compliance Evaluation Manual may be used in conjunction with the RE 540 Broker Self-Evaluation Compliance Checklist.*

## SECTION 1 - General Business Practices

### 1. Are the broker's salespersons and broker associates properly licensed?

Correct Procedure:

All persons performing activities requiring a real estate license for compensation must hold a valid real estate license.

The broker should have some procedure in place to monitor the expiration dates of the licenses of the broker's salespersons and broker associates. Real estate broker and salesperson licenses expire four years after issuance. Under certain conditions, however, licensees may be suspended during the license term for delinquent child support payments, recovery fund payouts, or failure to comply with the terms of a citation or pay a fine, or be barred from holding any position of employment in the real estate industry. With this in mind, brokers should periodically check the license status of their salespersons and broker associates on the Department of Real Estate's website.

Once the license has expired, no licensed activity can be performed by the licensee until the license has been renewed. The late renewal period - often referred to as the "grace" period - simply allows the licensee to renew on a late basis without retaking the examination; it does not allow the licensee to conduct licensed activity during the late renewal period.

It is unlawful for any broker to retain or compensate, directly or indirectly, any person for performing licensed activity unless that person is a licensed broker or a salesperson or broker associate licensed to the broker. A salesperson may not accept compensation for licensed activity nor pay compensation for licensed activity except through the broker under whom the person is at the time licensed.

It is a misdemeanor, punishable by a fine of \$100 for each offense, for any person, whether obligor, escrow holder, or otherwise, to pay or deliver to anyone compensation for performing any licensed acts who is not known to be or who does not present evidence that the person is a licensed real estate broker at the time such compensation is earned.

*Reference:*

*Real Estate Law Book, Sections 10015.3, 10016, 10130, 10131, 10137, 10138, 10153.4 (Unless otherwise noted, all "Section" references are to the Business and Professions Code.)*

**2. Does the broker notify the Department of Real Estate upon the hiring and termination of real estate licensees?**

Correct Procedure:

Whenever a real estate salesperson enters an affiliation with a real estate broker, or whenever a real estate broker enters into a written agreement to act in the capacity of a broker associate, the responsible broker must notify the Commissioner of that fact within five days. This notification must be given on a form prepared by the Department and must be signed by the responsible broker and the salesperson or broker associate. The form of notification must include at least the following information:

- a) Name and business address of the broker.
- b) Mailing address of the licensee, if different from the business address.
- c) Date when the licensee entered an affiliation with the broker.
- d) Certification by the licensee that the licensee has complied with the provisions of Section 10161.8(e) of the Business & Professions Code.
- e) Name and business address of the real estate broker to whom salesperson or broker associate was last licensed and the date of termination of that relationship.

A broker may add or remove a real estate licensee from an affiliation by completing a Salesperson Change Application (RE 214) if a salesperson, a Broker-Associate Affiliation Notification (RE 215) if a broker, or by completing the transaction online through the eLicensing System. Instructions for using this system can be found on the Department's website at [www.dre.ca.gov](http://www.dre.ca.gov) and then by searching for the eLicensing Tutorial.

As an acceptable alternative to e. and f. above, the form (RE 214 or RE 215) may be utilized by the predecessor broker to give notice of the termination of the broker/salesperson relationship as required by Section 10161.8(d) of the Business & Professions Code if this notice is mailed to the commissioner not more than ten days following such termination.

*Reference: Real Estate Law Book, Section 10161.8; Regulation 2752*

**3. Does the broker have a written broker-salesperson agreement with each salesperson and broker associate?**

Correct Procedure:

Every broker must have a written agreement with each retained licensee, whether licensed as a salesperson or as a broker. The agreement must be dated and signed by the parties and must cover material aspects of the relationship between the parties, including supervision of licensed activities, duties, and compensation.

*Reference: Real Estate Law Book, Regulation 2726*

#### **4. Is the broker properly supervising?**

Correct Procedure:

A broker must exercise reasonable supervision over the activities of salespersons and broker associates. Reasonable supervision includes, as appropriate, the establishment of policies, rules, procedures, and systems to review, oversee, inspect, and manage:

- a) Transactions requiring a real estate license.
- b) Documents which may have a material effect upon the rights or obligations of a party to the transaction.
- c) Filing, storage, and maintenance of such documents.
- d) The handling of trust funds.
- e) Advertising of any service for which a license is required.
- f) Familiarizing salespersons with the requirements of federal and state laws relating to the prohibition of discrimination.
- g) Regular and consistent reports of licensed activities of salespersons.

The form and extent of such policies, rules, procedures, and systems must take into consideration the number of salespersons and broker associates retained and the number and location of branch offices.

A broker must establish a system for monitoring compliance with such policies, rules, procedures, and systems. A broker may use the services of brokers and salespersons to assist in administering the provisions of this section so long as the broker does not relinquish overall responsibility for supervision of the acts of salespersons and broker associates licensed to the broker. A broker may appoint a licensee as a manager of a branch office or division of the broker's real estate business and delegate to that manager responsibility to oversee and supervise operations and licensed activities. An appointment of a branch or division manager must include a written contract whereby the manager accepts the delegated responsibilities.

*Reference: Real Estate Law Book, Section 10164; Regulation 2725*

#### **5. Does the broker retain copies of all documents?**

Correct Procedure:

A licensed broker must retain for three years copies of all listings, deposit receipts, canceled checks, trust account records, and other documents executed by or obtained by the broker in connection with any transaction for which a license is required. The retention period runs from the date of the closing of the transaction or from the date of the listing if the transaction is not consummated. After reasonable notice, the books, accounts, and records must be made available for audit, examination, inspection, and copying by a Department representative during regular business hours.

*Reference: Real Estate Law Book, Section 10148*

## 6. Do the documents disclose the negotiability of commissions?

Correct Procedure:

Any printed or form agreement that initially establishes, or is intended to establish, or alters the terms of any agreement that previously established a right to compensation to be paid to a licensee for the sale of residential real property containing not more than four residential units, or for the sale of a mobile home, must contain the following statement in not less than 10-point boldface type immediately preceding any provision of such agreement relating to compensation of the licensee:

**Notice: The amount or rate of real estate commissions is not fixed by law. They are set by each broker individually and may be negotiable between the seller and broker.**

As used above, "alters the terms of any agreement which previously established a right to compensation" means an increase in the rate of compensation, or the amount of compensation if initially established as a flat fee, from the agreement which previously established a right to compensation.

The broker must make certain that agreements and forms are not preprinted with any amount or rate of compensation.

*Reference: Real Estate Law Book, Section 10147.5*

## 7. Does the broker have a license for each business location?

Correct Procedure:

A broker is authorized to conduct business only at the address listed on the broker's license. If the broker maintains more than one place of business within the State, the broker must apply for and obtain an additional license for each branch office so maintained. The application for a branch office license must state the name of the person and the location of the place or places of business for which the license is desired.

*Reference: Real Estate Law Book, Section 10163*

## 8. Is the broker using a fictitious name?

Correct Procedure:

A broker may not use a fictitious name in the conduct of any activity requiring a real estate license unless the broker first obtains a license bearing the fictitious name. (A fictitious business name is frequently referred to as a "dba" - doing business as.)

To obtain a license bearing a fictitious name, the licensee must apply to the Department and attach a certified copy of the fictitious business name statement filed with the county clerk.

The Real Estate Commissioner may refuse to issue a license bearing a fictitious name to a broker if the fictitious name:

- a) is misleading or would constitute false advertising;
- b) implies a partnership or corporation when a partnership or corporation does not exist;
- c) includes the name of a real estate salesperson;
- d) constitutes a violation of the provisions of Sections 17910, 17910.5, 17915 or 17917 of the Code (these Sections provide the procedures for issuance of a fictitious business name); or
- e) is the name formerly used by a licensee whose license has since been revoked.

A responsible broker may, by contract, permit a salesperson to do all of the following:

- a) File an application on behalf of a responsible broker with a county clerk to obtain a fictitious business name.
- b) Deliver to the Department an application, signed by the responsible broker, requesting the Department's approval to use a county approved fictitious business name that must be identified with the responsible broker's license number.
- c) Pay for any fees associated with filing an application with the county or the Department to obtain or use a fictitious business name.
- d) Maintain ownership of a fictitious business name, as defined in paragraph (2) of subdivision (a) of Section 10159.7, that may be used subject to the control of the responsible broker.

The exemption to the licensing requirement of a fictitious name is the use of a Team Name. To meet this exemption, the following must be true of the Team Name:

- a) The name is used by two or more real estate licensees who work together to provide licensed real estate services, or who represent themselves to the public as being a part of a team, group, or association to provide those services;
- b) The name includes the surname of at least one of the licensee members of the team, group, or association in conjunction with the term "associates," "group," or "team"; and
- c) The name does not include any term or terms, such as "real estate broker," "real estate brokerage," "broker," "brokerage," or any term that would lead a member of the public to believe that the team is offering real

estate brokerage services, that imply or suggest the existence of a real estate entity independent of a responsible broker.

*Reference: Real Estate Law Book, Section 10159.5, 10159.7; Regulation 2731*

Note: The general California statute governing fictitious business names is contained in Section 17900 of the Business and Professions Code. As the provisions of this section apply to real estate licensing in the case of an individual licensee, a name is fictitious when it does not contain the surname of the individual conducting the business, or when it implies that there is more than one owner. A name that suggests the existence of additional owners is one that includes such words as "Company," "& Company," "& Son," "& Sons," "& Associates," "Brothers," "Team," and the like. A name is not fictitious if it sets forth an individual's surname and the words merely describe the business being conducted, such as "Realty," "Loans," "Property Management," and other words relating to the type of business in which an individual is engaged.

Where a licensee is a natural person, the use of a nickname in place of the licensee's legal given name (first name) does not constitute a fictitious name for purposes of this section, provided that where the nickname is used the licensee also uses the surname (last name) as it appears on the real estate license and includes the real estate license identification number as required by Section 10140.6 of the Code.

In the case of a domestic or foreign corporation, a fictitious business name would be anything other than the actual name of the corporation as contained in the articles of incorporation filed with the California Secretary of State.

It should be noted that real estate salespersons are not eligible to apply for fictitious business names under their license. Pursuant to the Real Estate Law, fictitious business names may only be licensed to real estate brokers.

## **9. Is the broker providing the Real Estate Transfer Disclosure Statement?**

Correct Procedure:

The obligation to prepare and deliver the Real Estate Transfer Disclosure Statement (TDS) to the prospective buyer is imposed upon the seller and the seller's agent and any broker acting in cooperation with the seller's agent. If more than one broker is involved in the transaction, the broker obtaining the offer is required to deliver the TDS to the prospective buyer, unless instructed otherwise by the seller.

The TDS must be given to the prospective buyer as soon as practicable before the transfer of title, or, in the case of a lease option, sales contract, or ground lease, as soon as practicable before the execution of the contract. If the TDS or amended TDS is delivered after the execution of an offer to purchase, the buyer has three days after delivery in person, or five days after delivery by deposit in the mail or five days after delivery of electronic record, to terminate the offer by delivering a written notice of termination to the seller or to the seller's broker.

The listing agent has the duty to inquire with the seller as to the condition of the property. The listing agent and the buyer's agent each have the duty to conduct a reasonably competent and diligent visual inspection of the property and to disclose to a prospective buyer all material facts affecting the value or desirability of the property that an investigation would reveal.

*Reference: Civil Code Sections 1102 et seq. and 2079; Real Estate Law Book, Section 10176.5*

## **10. Is the broker maintaining pest control documentation?**

Correct Procedure:

In a real estate transaction subject to the provisions of Section 1099 of the Civil Code, the real estate broker acting as agent for the seller in the transaction must make certain the inspection report, certification, and the notice of work completed, if any, are delivered to the buyer in accordance with said section.

If more than one real estate broker licensee is acting as an agent of the seller in the transaction, the broker who has obtained the offer made by the buyer must make certain the required documents are delivered to the buyer, unless the seller has given written directions to another real estate broker licensee acting as agent of the seller in the transaction to effect delivery.

If the agent cannot obtain the required documents to deliver to the buyer and does not have written assurance from the buyer that all of said documents have been received, the agent must advise the buyer in writing of the buyer's rights under Section 1099.

The broker must maintain a record of the action taken to effect compliance with this regulation in accordance with Section 10148 of the Business and Professions Code.

Section 1099 of the Civil Code sets forth the requirements for delivery of a Structural Pest Control Inspection Report and any Notice of Work Completed, if certification or preparation of a report is a condition of the contract effecting the sale, or is a requirement imposed as a condition of financing.

*Reference: Civil Code Section 1099; Real Estate Law Book, Regulation 2905*

## **11. Is the broker conducting escrows?**

Correct Procedure:

Section 17006(a)(4) of the Financial Code exempts a licensed broker from licensure under the Escrow Law when the broker is performing acts in the course of or incidental to a real estate transaction in which the broker is an agent or a party to the transaction and in which the broker is performing an act for which a real estate license is required. The exemption is personal to the broker, and the broker cannot delegate any duties other than duties performed under the direct supervision of the broker.

The broker's exemption provided for above is not available for any arrangement entered into for performing escrows for more than one business.

Section 17403.4 of the Financial Code requires all written escrow instructions executed by a buyer or seller to contain a statement in not less than 10-point type which must include the licensed name and the name of the department issuing the license or authority under which the person is operating. This section does not apply to supplemental escrow instructions or modifications to escrow instructions.

Real Estate Commissioner's Regulation 2950 sets forth acts that are prohibited and may be grounds for disciplinary action:

- a) Soliciting or accepting an escrow instruction (or amended or supplemental escrow instruction) containing any blank to be filled in after signing or initialing of such escrow instruction (or amended or supplemental escrow instruction).
- b) Permitting any person to make any addition to, deletion from, or alteration of an escrow instruction (or amended or supplemental escrow instruction) received by such licensee, unless such addition, deletion, or alteration is signed or initialed by all persons who had signed or initialed such escrow instruction (or amended or supplemental escrow instruction) prior to such addition, deletion, or alteration.
- c) Failing to deliver at the time of execution of any escrow instruction or amended or supplemental escrow instruction a copy thereof to all persons executing the same.
- d) Failing to maintain books, records, and accounts in accordance with accepted principles of accounting and good business practice.
- e) Failing to maintain the office, place of books, records, accounts, safes, files, and papers relating to such escrows freely accessible and available for audit, inspection, and examination by the Commissioner.
- f) Failing to deposit all money received as an escrow agent and as part of an escrow transaction in a bank trust account or escrow account on or before the close of the next full working day after receipt thereof.
- g) Withdrawing or paying out any money deposited in such trustee account or escrow account without the written instruction of the party or parties paying the money into escrow.
- h) Failing to advise all parties in writing if the licensee has knowledge that any licensee acting as such in the transaction has any interest as a stockholder, officer, partner, or owner of the agency holding the escrow.
- i) Failing upon closing of an escrow transaction to render to each principal in the transaction a written statement of all receipts and disbursements together with the name of the person to whom any such disbursement is made.

- j) Delivering or recording any instrument which purportedly transfers a party's title or interest in or to real property without first obtaining the written consent of that party to the delivery or recording.

Brokers who engage in broker-controlled escrow activities pursuant to the exemption from the Escrow Law for five or more transactions or whose escrow activities exceed one million dollars in a calendar year must, within 60 days after the end of the calendar year in which this activity threshold was met, file the Escrow Activity Report with the Department of Real Estate.

*Reference: Financial Code Sections 17006(a)(4) and 17403.4; Real Estate Law Book, Section 10141.6; Regulation 2950*

## SECTION 2 - Trust Fund Handling

Additional detail and illustrations for trust fund handling can be found in the Department of Real Estate's RE 13 booklet entitled "Trust Funds"

### Trust Fund Handling Questionnaire

1. **Is the bank account used for trust fund handling in the name of the broker as trustee or appropriately designated as a trust account?**

Correct Procedure:

The broker's trust account should be set up in the broker's name, or in the name of a fictitious business name if the broker is the holder of a license bearing such fictitious name, and either be designated a "Trust Account" or be in the name of the broker, or licensed fictitious name, as trustee.

Example 1: If the individual broker's name is John Doe and the broker has the name 25th Century Realty as a fictitious business name, the following designations would be compliant for the broker's trust account:

*John Doe Trust Account*  
*John Doe as Trustee*  
*25th Century Realty Trust Account*  
*25th Century Realty as Trustee*

Example 2: If the corporate broker's name is ABC, Inc. and the broker has the name ABC Realty as a fictitious business name, the following designations would be compliant for the broker's trust account:

*ABC, Inc. Trust Account*  
*ABC, Inc. as Trustee*  
*ABC Realty Trust Account*  
*ABC Realty as Trustee*

*Reference: Real Estate Law Book, Regulation 2832*

**2. Is the bank account used for trust fund handling an interest-bearing account?**

Correct Procedure:

Trust funds may, at the request of the owner of the funds, be placed into an interest-bearing account at a bank or savings and loan association if the following requirements are met:

- a) The account is in the name of the broker as trustee for the designated beneficiary or principal of a transaction or series of transactions.
- b) All of the funds in the account are covered by insurance provided by an agency of the United States.
- c) The funds in the account are kept separate, distinct, and apart from funds belonging to the broker or to any other person for whom the broker holds funds in trust.
- d) The broker discloses to the person from whom the trust funds are received, and to a beneficiary whose identity is known to the broker at the time of establishing the account, the nature of the account, how interest will be calculated and paid under various circumstances, whether service charges will be paid to the depository and by whom, and the possible notice requirements or penalties for withdrawal of funds from the account.
- e) Interest earned on funds in the account may not inure directly or indirectly to the benefit of the broker or to any person licensed to the broker.
- f) In an executory sale, lease, or loan transaction in which the broker accepts funds in trust to be applied to the purchase, lease, or loan, the parties to the contract must have specified in the contract or by collateral written agreement the person to whom interest earned on the funds is to be paid or credited.

It should be noted that this would require the broker to maintain a separate bank account for each beneficiary who wishes to earn interest.

*Reference: Real Estate Law Book, Section 10145(d) (1)-(6)*

**3. Are control records complete and accurate?**

Correct Procedure:

Every broker must keep a record of all trust funds received, including uncashed checks.

- a) If a broker does not maintain a trust account or maintains a trust account but forwards all trust funds received to either the escrow or to the owner of the funds, then the broker must maintain a Record of Trust Funds Received but not Deposited to the Trust to include:

- i. Date funds received;
- ii. Form of payment;
- iii. Amount received and from whom received;
- iv. Description of property or other identification;
- v. Identity as to whom funds were forwarded; and
- vi. Date of disposition.

However, a broker is not required to keep the above records of passing through checks made payable to service providers (e.g., escrow, credit, and appraisal services) when the total of such checks from any one principal for any transaction does not exceed \$1,000. Upon request of the Department or the maker of such checks, a broker must account for the receipt and distribution of such checks. A broker must retain for three years copies of receipts issued or obtained in connection with the receipt and distribution of such checks.

- b) If a broker does maintain a trust account, the broker must maintain a Columnar Record of all Trust Funds Received and Paid Out of the Trust Fund Bank Account (for example, DRE Form RE 4522). This record should show the following in chronological sequence:
  - i. Date funds received;
  - ii. From whom funds received;
  - iii. Amount received;
  - iv. Date of deposit;
  - v. Check number and date of related disbursement; and
  - vi. Daily balance of trust bank account.

*Reference: Real Estate Law Book, Regulation 2831*

#### **4. Are the separate transaction records complete and accurate?**

Correct Procedure:

Brokers must maintain a Separate Record for Each Beneficiary or Transaction (for example, DRE Form RE 4523). This record accounts for the funds received from, or for the account of, each beneficiary or each transaction and deposited to the trust fund bank account. These records are necessary for the broker to ascertain the total owed to each of the beneficiaries. The record should show in chronological sequence the following:

- a) Date of deposit;
- b) Amount of deposit;
- c) Date of each related disbursement;
- d) Check number of each related disbursement;
- e) Amount of each related disbursement;

- f) If applicable, dates and amounts of interest earned and credited to the account; and
- g) Balance after posting transactions on any date.

*Reference: Real Estate Law Book, Regulation 2831.1*

**5. Is monthly reconciliation of the control records and separate records performed and documented?**

Correct Procedure:

The balance of all separate beneficiary or transaction records (for example, DRE Form RE 4523) must be reconciled with the record of all trust funds received and disbursed (for example, DRE Form RE 4522) at least once a month. A record of reconciliation must be maintained and it must identify the following:

- a) Bank account name;
- b) Account number;
- c) Date of reconciliation;
- d) Name of beneficiary; and
- e) Trust fund liabilities of the broker to each beneficiary.

For example:

*ABC Realty, Inc. Trust Account*  
 0339-000011  
 5/31/2019

Balances per Separate Beneficiary Records:	
Jones	\$500.00
Smith	\$250.00
Thompson	<u>\$100.00</u>
Total of Separate Records:	<u>\$850.00</u>
Balance per Record of All Trust Funds Received:	<u>\$850.00</u>
Difference (if any, should be fully explained):	<u>\$0.00</u>

*Reference: Real Estate Law Book, Regulation 2831.2*

**6. Are trust funds deposited in a timely manner?**

Correct Procedure:

Unless otherwise specified in writing by the beneficiary of the funds, a broker is required to do one of the following three things with trust funds no later than three business days following receipt of the funds by the broker or the broker's salesperson or broker associate:

- a) Deposit the funds into a neutral escrow depository;
- b) Place funds accepted on behalf of the owner into the hands of the owner of the funds; or
- c) Deposit the funds into a trust fund bank account maintained by the broker.

A real estate broker who is not licensed under the Escrow Law (Section 17000 et seq. of the Financial Code), when acting in the capacity of an escrow holder in a real estate transaction in which the broker is performing acts for which a real estate license is required, must place all funds accepted on behalf of another into one of the three places listed above **not later than the next business day** following receipt of the funds by the broker or the broker's salesperson or broker associate.

*Reference: Real Estate Law Book, Regulation 2832*

**7. Are authorized signatories either licensed to the broker or unlicensed but bonded/insured?**

Correct Procedure:

Withdrawals may be made from the trust account only upon the signature of the broker or one or more of the following persons with written authorization from the broker:

- a) A salesperson licensed to the broker.
- b) A person licensed as a broker who has entered into a written agreement with the responsible broker.
- c) An unlicensed employee of the broker with fidelity bond or insurance coverage at least equal to the maximum amount of trust funds to which the employee would have access.

Withdrawals may be made from the trust account of a corporate broker only upon the signature of an officer through whom the corporation is licensed or one of the persons detailed above. The designated officer of the corporate broker should always be a signatory on the trust account.

Concerning an unlicensed employee with fidelity bond coverage or insurance, it is recommended that the fidelity bond/insurance specifically identify the trust account that is being covered. The fidelity bond can include a deductible clause; however, the deductible is limited to an amount of up to five percent of the coverage amount and the broker must have evidence of financial responsibility for the deductible. Evidence of financial responsibility can include the following:

- a) Separate bond or insurance coverage adequate to cover the amount of the deductible.
- b) A cash deposit held in a separate account, apart from other funds of the broker, the broker's employee, or the broker's principals adequate to cover

the amount of the deductible and held exclusively and solely for the purpose of paying the deductible.

*Reference: Real Estate Law Book, Section 10145(a); Regulation 2834*

## **8. Are broker's funds separated from trust funds?**

Correct Procedure:

Funds belonging to a broker should not be commingled with trust funds. Common examples of commingling are:

- Personal or company funds deposited into the trust fund bank account.
- Trust funds deposited into the general or personal bank account;.
- Funds collected on real property wholly owned by the broker handled through the trust account.

A broker, however, is allowed to maintain up to \$200 of personal funds in a trust account to cover checking account service fees and other bank charges.

Commissions, fees, other income earned by a broker, and funds belonging in part to the broker's principal and in part to the broker when it is not reasonably practicable to separate such funds, must be withdrawn from the trust account within 25 days from the date of deposit.

*Reference: Real Estate Law Book, Section 10176(e); Regulation 2835*