Average charges: What you need to know
By Angela Rulffes

In its final RESPA/Truth in Lending Act (TILA) integrated mortgage disclosure form rule, the Consumer Financial Protection Bureau (CFPB) retained the average charge exception originally adopted by the U.S. Department of Housing and Urban Development (HUD). Generally under RESPA, a lender or settlement service provider is prohibited from charging the borrower more for a settlement service than the amount actually paid for the service. Average charge is an exception to that requirement and can be beneficial if used properly.

History

Before the CFPB was granted authority over RESPA, HUD was the regulator in charge. During HUD’s reign, a variety of class action suits were filed under RESPA where the plaintiffs alleged they were overcharged for third-party fees. In some instances, a settlement service provider cannot determine the actual fee for a service at the time the lender or broker is required to disclose the fees to the consumer. Because of this the providers were sometimes charging too much or too little for a third-party service.

For example, let’s say a title agent assumed that a mortgage document will be comprised of 12 pages, and that the recording costs to the consumer will be $2 per page. The total the agent charged the consumer to record the mortgage was $24. Then, it turns out that the mortgage was only 10 pages and only cost $20 to record. The title agent charged the consumer an extra $4. This type of scenario led to class action suits because consumers believed the title agent violated RESPA by charging a fee that exceeded the cost of the actual service.

Of course, there were also instances where a title agent underestimated the fee and would end up paying out of pocket. For example, the title agent assumed the mortgage would cost $24, charged the consumer that amount, but the recording cost was actually $28.

The lenders and title industry went to HUD, arguing that it wasn’t fair that if the client was undercharged, the service provider paid out of pocket and if the client was overcharged, the provider was sued.

In HUD’s 2008 final RESPA rule, it included an exception, allowing settlement service providers to use an average charge on the HUD-1 Settlement Statement, rather than charging the borrower the exact cost of a service. When it released its final rule, HUD said it “determined that this approach balances the settlement service provider’s interest in flexibility in calculating an average charge with the borrower’s interest in preventing excessive settlement charges.”

HUD’s final rule allowed settlement service providers to calculate an average charge using a class of transactions based on the period of time, type of loan and geographic area. The average charge exception went into effect in January 2009.

Current law

Regulation X Section 1024.8(b)(2) states that the average charge for a settlement service cannot be more than the average amount paid for a settlement service by one provider to another provider on behalf of the borrowers and sellers for a particular class of transactions. The rule also provides that the total amount paid by borrowers and sellers for a settlement service based on the use of an average charge cannot exceed the total amounts paid to the provider for that particular class of transactions.

For the purposes of calculating the average charge, the rule states that a settlement service provider can define the class of
transactions as all transactions for:

• A period of time not less than 30 days and not more than six months;
• A geographic area; and
• A type of loan.

The law states that if a provider uses an average charge for a transaction within the class, it must use the same average charge in every transaction within that class.

During Part 1 of October Research’s “Mortgage Disclosure Forms Training Webinar Series,” Phil Schulman, a partner with K&L Gates, reviewed how average charges work.

“What you can do, at least under the federal law, is say, 'For January thru June, the recording fee in this county was on average $20, and so for the next six months, from July thru December, I’m going to charge the consumer $20 for every recording — even though some of those recordings actually cost me $22 and a lot of others only cost me $16,’” Schulman said.

At the end of the six-month period, the settlement service provider must then recalculate what the average charge was and use the new average charge for the following six months. The average charge cannot be used if the charge for the settlement service is based on the loan amount or property value.

All documentation used to calculate the average charge for a particular class of transactions must be retained for at least three years after any settlement for which that average charge was used.

What you can’t do, said Schulman, is pick a high average and try to profit from the deal.

“You have to look at the experience between July and December. If you charged everybody $20, but, in fact, the actual charge was $18, you overcharged consumers on average, so for the next six months, from January thru June, you’ll have to charge $16 to make up for the $2 overage that you made,” Schulman said.

“Doing it that way over a 12 month period, you should come out with some kind of a wash.”

Average charge can be used for certain third-party fees such as recording fees, appraisal fees, credit report fees and courier fees. It cannot be used for a settlement service provider’s own fees, so it cannot be used for title insurance or a lender’s own fees.

CFPB final rule

When the CFPB released its final RESPA/TILA integrated mortgage disclosure rule in November 2013, it retained the U.S. Department of Housing and Urban Development’s (HUD) average charge exception.

The bureau said it does not expect lenders or settlement service providers to engage in a cumbersome statistical analysis when determining whether the transaction class is based on an appropriate geographic area and loan type. However, the agency did not believe it to be unreasonably burdensome for lenders or providers to assess whether a geographic area or loan type are defined using a subgroup with distinct cost characteristics.

“The average cost pricing rules are not requirements, but are intended to provide creditors flexibility from the general requirement that the actual amount imposed on the consumer may not exceed the amount received by the settlement service provider,” the bureau said. “To the extent an average charge is imposed that exceeds the cost actually received by a settlement service provider, the bureau believes it is reasonable to expect creditors to ensure the average charge is not derived from distinct markets. Deriving an average charge from a class composed of subgroups that have distinct cost characteristics would mean that a charge could be unfairly inflated and applied in a way that disadvantages certain populations.”

Section 1026.19(f)(3)(i) of the bureau’s final rule states that the amount charged to the consumer cannot exceed the amount actually received by the settlement service provider for that service. The exception to this requirement is contained in Section 1026.19(f)(3)(ii), which allows for average charge.

Under the regulation, a lender or service provider can use an average charge if the following conditions are satisfied:

• The average charge is not more than the average amount paid for the service by all of the consumers and sellers for a class of transactions;
• The lender or provider defines the class of transactions based on an appropriate time period, geographic area and loan type;
• The lender or provider uses the same average charge for every transaction within the class; and
• The lender or provider does not use an average charge:
  o For any type of insurance;
  o For any charge based on the loan amount or property value; or
If doing so is otherwise prohibited by law.

In the official interpretation section of the rule, the bureau explains that the period of time used in defining a class should be between 30 days and six months. This section also includes geographic area and loan type examples.

The agency states that an average charge program cannot be used in a way that inflates the cost for services overall.

The average amount is taken from a prior defined period, so the bureau explains that if a creditor calculates an average tax certification fee based on four-month periods starting Jan. 1 of each year, the fees charged to consumers on May 20 may not exceed the average fee paid from Jan. 1 through April 30.

The bureau indicated, as Schulman also explained, that the provider is responsible for ensuring that the amount collected in fees from consumers does not exceed the amounts the provider paid for the services. If during a time period, the provider receives fees that surpass the amount paid, the provider needs to find a way to even things out. This could be a refund to the affected consumers or a decrease in the average charge for the upcoming period.

All documentation used to calculate the average charge for a particular class of transactions must be retained for at least 3 years under the new regulation.

Even after meeting the bureau’s requirements, it’s important to ensure average charges are not prohibited in your state.

State law

“Keep in mind that some states prohibit using an average charge because their statutes say you must charge the exact fee [and] may not mark it up, so even though the federal law permits it, some states may prohibit it, and you have to make sure you aren’t in violation of state law,” Schulman said.

Regulation X states that average charges are not to be used where they are otherwise prohibited. So, if state law prohibits average charge pricing, then RESPA does not preempt that law — meaning that if the state says it’s illegal, then it’s illegal. RESPA News covered this issue in the past in “Can average charge pricing work for you?” and “A closer look at average charge pricing,” reporting that states like New York, California, Texas, Tennessee, New Jersey and Washington have laws in place that could restrict the use of average charges.

State laws may not expressly prohibit average charges. It is likely there won’t be a state law that says, “average charges are prohibited.” Instead, the laws have stipulations that make average charges illegal, such as prohibiting the lender or service provider from charging the consumer an amount that is more than the cost of the third-party fee. When using average charge pricing, there are times when a consumer may be charged more than the actual cost of the service, so if state law says only the actual price can be charged, then an average charge would violate that law in some instances.

For example, under New York Code Section 38.3(a)(2)(v), any amount that a mortgage broker collects from a consumer that is in excess of the actual cost of the credit report fee and property appraisal fee must be refunded at closing. In that case, the average charge would not work for those types of fees.

Another example is California’s Residential Mortgage Lending Act, which is contained in Division 20 of the California Financial Code. Section 50203(a)(1) states that a licensee cannot require a borrower to pay fees or charges prior to closing except for “actual charges to be incurred by the licensee on behalf of the borrower for services from third parties necessary to process the application.” Because the law requires actual charges, it’s likely using an average charge would be a violation.

If you decide to use average charge pricing or already use it, it’s a good idea to contact an attorney to confirm that you are staying compliant with the laws in your state.