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KNOW BEFORE YOU OWE: MORTGAGES

New Forms Improve Consumer Understanding, Make Loan Comparisons More Straightforward, and Help Prevent Closing Table Surprises

The Consumer Financial Protection Bureau (CFPB) is issuing a rule today requiring easier-to-use mortgage disclosure forms that clearly lay out the terms of a mortgage for a homebuyer. The new "Know Before You Owe" forms will replace the existing federal disclosure forms and help consumers both understand a mortgage better and make loan comparisons. The rule also requires that consumers receive these forms in advance of making key decisions, so they have time to process the deal before signing on the dotted line.

The two new forms, one which consumers will receive shortly after applying for a loan and one which they will receive shortly before closing, use plain language and design to make it easier for consumers to locate key information such as the interest rate, monthly payments, and the costs to close the loan. And they make it easier to compare the initial estimate to the final costs. Starting Aug. 1, 2015, mortgage lenders must use the new forms and homebuyers will be able to more clearly understand what they are getting into – the terms of the loan, their obligations, and what could possibly change. Consumers will be more empowered to take a more informed and active role in the important process of choosing a loan that is right for them.

BACKGROUND

- **In the lead up to the financial crisis, many consumers took on loans they could not afford:** When shopping for a mortgage loan, most consumers are concerned about the interest rate and their monthly payment. Consumers may underestimate that interest rates and payments can increase later on, or they may not fully understand that this possibility exists. They also may not appreciate other costs that could arise later, such as prepayment penalties. This focus on short-term costs while underestimating long-term costs may result in consumers taking out mortgage loans that are more costly than they realize.
- **When consumers are confused, they are more likely to take on riskier loans:** Research points to a relationship between consumer confusion about loan terms and conditions and an increased likelihood of adopting higher-cost, higher-risk mortgage loans in the years leading up to the mortgage crisis. A study of data from the 2001 Survey of Consumer Finances found that some adjustable-rate mortgage loan borrowers, particularly those with below median income, underestimated or did not realize how much their interest rates could change. These findings are consistent with a 2006 Government Accountability Office study, which raised concerns that mortgage loan disclosure laws did not require specific disclosures for adjustable-rate loans. This evidence suggests that borrowers who are not presented with clear, understandable information about their mortgage loan offer may lack an accurate understanding of the loan costs and risks.

- **Difficult-to-understand mortgage disclosures continue to make it hard for consumers to know the true costs and risks of their mortgages:** For more than 30 years, federal law has generally required that within three business days after receiving an application, mortgage lenders must deliver two different, overlapping disclosures to consumers: an early Truth in Lending Statement and a Good Faith Estimate. At closing, federal law again requires two different disclosures: a final Truth in Lending Statement and HUD-1 settlement statement. These forms, which were managed by two different federal agencies, contain overlapping information and they can be confusing to consumers.
- **The current forms make it difficult to comparison shop:** When the terms of the loan can be difficult to discern, consumers have a hard time comparing loans and determining which works best for them and their families.
- **The result can be surprises at the closing table:** When consumers get to the closing table, there is a stack of paperwork to read. Often, this is paperwork that they are seeing for the first time. The consumer can feel trapped – it is not easy to object, ask questions, or walk away from the deal at closing.
- **The Dodd-Frank Wall Street Reform and Consumer Protection Act recognized the need to simplify and streamline this information for consumers:** Under the Dodd-Frank Act, rulemaking responsibility for the Real Estate Settlement Procedures Act (RESPA) and for most of the Truth in Lending Act (TILA), which are the laws that required the disclosure forms, transferred to the CFPB. In doing so, Congress also directed the CFPB to combine the TILA and RESPA forms.
- **The CFPB conducted extensive research and analysis:** The CFPB conducted more than two years of research, testing, and designing to create mortgage disclosures that do what they are supposed to do: disclose information in a way consumers can understand so they can make meaningful comparisons between loan products and select the product that best suits their needs. The Bureau received feedback from consumer testing, through the Bureau's website, from a small business review panel, through public comments on the proposed rule, and from other supplemental outreach.
- **Mortgages made safer:** The new forms announced today are just one part of the CFPB's efforts to make the mortgage market work better for consumers, the industry, and the economy as a whole. In January 2013, the CFPB released new rules on mortgage servicing, mortgage loan origination compensation, and the mortgage origination process.

NEW "KNOW BEFORE YOU OWE" MORTGAGE FORMS

Today's rule will provide substantial, long-term benefits to consumers and industry. Consumers will get a simple accounting of their likely payments and fees, and how much they may increase, to prevent costly surprises. They will be able to better comparison shop for the best mortgage. Industry will experience cost savings in the long-term because they will no longer have to provide two different sets of disclosures and administer compliance with two different sets of regulatory requirements.

- **The Loan Estimate:** This will be provided to consumers within three business days after they submit a loan application. It replaces the early Truth in Lending disclosure and the Good Faith Estimate, and

provides a summary of the key loan terms and estimated loan and settlement costs. Consumers can use this new form to compare the costs and features of different loans.

- **The Closing Disclosure:** This will be provided to consumers three business days before consumers close on a loan. It replaces the final Truth in Lending Statement and the HUD-1 uniform settlement statement. In addition to summarizing the final loan terms and costs, the Closing Disclosure provides consumers with a detailed accounting of their transaction. By providing consumers with the Closing Disclosure three business days before closing, consumers will have time to review their final loan terms and costs in an unpressured environment rather than at the closing table.
- **Spanish-language versions:** The CFPB is also including Spanish-language versions of the forms in the final rule, which it tested with Spanish-speaking consumers. These Spanish-language versions will provide important benefits to industry in communicating with Spanish-speaking consumers.

Improved consumer understanding

Consumers of all different experience levels, with different loan types – whether they are buying a home or refinancing – are better able to understand the CFPB’s new forms. They are better able to decide whether they can afford the loan, including the cost of the loan over time. An extensive study confirmed the benefits of the new forms. Participants who used the CFPB’s new forms were better able to answer questions about a sample loan – a statistically significant improvement of 29 percent. Specifically, the forms help identify:

- **Risk factors:** Because information on the new CFPB forms will be disclosed in an easy-to-read format, consumers can more easily identify risky loan features. In addition, lenders will have to tell homebuyers about any:
 - Prepayment penalties if a consumer pays off the loan early;
 - Balloon payments, which are when the mortgage requires the borrower to make a larger-than-usual periodic payment; and
 - An increase in the loan balance in a negative amortization loan, which is when the consumer pays a minimum payment that doesn’t cover the interest, and that unpaid interest gets added to the amount borrowed, resulting in an increase in the overall amount owed.
- **Short-term and long-term costs:** By putting the important information in a clearer format than the current forms and in plain language, both the Loan Estimate and Closing Disclosure more easily explain the total costs of the loan. This includes an important breakdown of the loan amount, the principal and interest payment and how it could change, and closing costs.
- **Monthly payments:** The CFPB forms state in bold font what a consumer’s monthly principal and interest payments will be. If it is an adjustable-rate loan, the forms say the projected minimum and maximum payments over the life of the loan.

Better comparison shopping

When consumers understand their loan offers, they can better compare competing offers. In testing, CFPB’s new forms performed better than the current forms when it comes to comparing competing offers by as much as 42 percent. This leads to better consumer choice. The forms enable better:

- **Comparisons of competing loan offers:** The new forms use formatting that clearly breaks down the costs of the loan, such as the interest rate, mortgage insurance costs, and closing costs. As a result, would-be-homebuyers and those refinancing their existing mortgage are better able to distinguish between two different loan offers.
- **Shopping for closing costs:** Closing costs are the costs of completing a mortgage transaction, including origination fees, appraisal fees, title insurance, taxes, settlement services, inspections, and homeowner's insurance. Consumers can save money if they shop around for their own service providers for some of these costs. The CFPB forms plainly outline what closing services a consumer will need and which ones they can shop around for.

Avoiding costly surprises at the closing table

With the current forms, consumers can have a hard time comparing their original loan terms with their final loan offer. Consumers need to be reasonably sure that the mortgage they signed up for is the one they thought they were getting. The CFPB's rules curtail "bait and switch" tactics, where the terms change at closing, by implementing several new consumer protections:

- **Easier comparisons of the estimated and final terms of the loan:** By making the Loan Estimate and Closing Disclosure very similar in format, consumers are better able to compare their estimate with the final terms of the loan. In testing , the CFPB's new forms performed better than the current forms when it comes to comparing estimated and final numbers by as much as 28 percent.
- **More time to consider choices:** By providing the Closing Disclosure three days before closing, consumers can review their final loan terms and costs in an unpressured environment rather than at the closing table. This allows consumers time to confirm whether they are getting what they expected. It also gives consumers time to ask questions and negotiate over changes that have occurred. This is especially true for consumers who are refinancing and can more easily delay the closing of the loan.
- **Limits on closing cost increases:** Today's rule restricts circumstances in which consumers can be required to pay more for settlement services than the amount stated on their Loan Estimate. Lenders cannot hit consumers with new or higher fees on the final loan unless there is a legitimate reason.