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TESTING "KNOW BEFORE YOU OWE" MORTGAGE FORMS

Qualitative and Quantitative Tests Show New Forms Improve Consumer Understanding, Aid Comparison Shopping, and Help Prevent Surprises

The Consumer Financial Protection Bureau (CFPB) is issuing a rule today requiring mortgage disclosure forms that clearly lay out the terms of the loan for a borrower. The new "Know Before You Owe" mortgage forms will replace the existing federal disclosure forms and help consumers understand their mortgage options, choose the deal that's best for them, and avoid costly surprises at the closing table.

FORMS IN THE FIELD

To create the best forms possible, throughout the process the CFPB had ongoing dialogue with consumer advocates, industry groups, financial institutions, designers, and government policymakers. But most importantly, the CFPB put the new mortgage disclosure forms – the Loan Estimate, which will be received when a consumer first applies for a loan, and the Closing Disclosure, which will be received three days before closing – through more than two years of qualitative and quantitative testing.

From prototype to today's final forms and rule, rigorous testing guided the development of the mortgage disclosures every step of the way:

- **Ten rounds in nine cities of qualitative testing on the prototypes before the proposal:** The CFPB contracted with an experienced design and consumer research firm, Kleimann Communication Group, Inc., to help design and test prototype Loan Estimate and Closing Disclosure forms. In total, the CFPB interviewed 92 consumer participants and 22 industry representatives for the qualitative testing of the prototypes before issuing the proposed rule. With each lesson learned in the rounds of testing, the forms were improved. A report is available here.

- **More than 27,000 individual comments on the prototypes:** The CFPB also invited the public to provide supplemental feedback on the prototypes via the CFPB's "Know Before You Owe" website. The CFPB received more than 150,000 unique visitors and more than 27,000 individual comments and emails from consumers and industry.

- **Nearly 3,000 public comments on the proposed forms and rule:** Based on all the public feedback, the CFPB redesigned the forms and issued a proposed rule on July 9, 2012. The CFPB received almost 3,000 public comments and other feedback on the proposal during the comment period.

- **Additional qualitative testing to tweak the proposed forms:** After reviewing public comments suggesting changes to the forms, the CFPB also conducted seven additional rounds of qualitative testing after issuing the proposal. This testing included testing versions of the Loan Estimate and

Closing Disclosure that were translated into Spanish and versions of the forms that would be used for refinance loans. The CFPB conducted this testing across the country.

- **More than 850 consumers in 20 locations across the country test proposed forms:** After issuing the proposed rule and forms the CFPB also conducted a large-scale quantitative validation test of the proposed forms to compare them with the disclosures in use today. From May 2013 to June 2013, 858 consumers in 20 locations, including urban, suburban, and rural areas participated in this quantitative study. The CFPB used this additional testing to validate the effectiveness of its forms. All test results were statistically significant with a margin of error of plus or minus 4.7 percentage points and the overwhelming outcome was that CFPB's new forms work better for consumers.

- **Final forms:** Using the valuable feedback from the pre-proposal testing, as well as the additional feedback received from the post-proposal qualitative testing, and after validation by the quantitative testing, the CFPB finalized the two forms with the rule being issued today.

<u>IMPROVED CONSUMER UNDERSTANDING</u>
The CFPB's goal with the new integrated forms is for consumers to know upfront what they are getting into – the terms of the loan, their obligations, and what could possibly change. The extensive quantitative testing showed that participants who used the CFPB's redesigned forms provided more correct answers on a written test about a sample mortgage than participants who reviewed the current forms – an overall improvement of 29 percent. More specifically, consumers of all different experience levels, with different loan types – whether focused on buying a home or refinancing – were able to understand CFPB's new forms better than the current forms:

- **Risk factors:** Because the CFPB forms use plain language to disclose important information about risks, participants who used the CFPB's new forms were better able to identify certain troublesome factors. On test questions relating to risk factors, the CFPB's new forms outperformed the current forms by as much as:
  - 12 percent: Improvement in understanding exactly how the interest rate could increase after closing.
  - 32 percent: Improvement in identifying negative amortization features, which are when the consumer pays a minimum payment that doesn't cover the interest, the unpaid interest gets added to the amount borrowed, and the total amount owed increases.

- **Short-term and long-term costs:** By getting rid of the confusing industry jargon and fine print in the current Truth in Lending, Good Faith Estimate, and HUD-1 forms and putting the important information in plain language, both the Loan Estimate and Closing Disclosure more easily explain the overall costs of the loan. This includes an important breakdown of where the money is going. The CFPB's new forms outperformed the current forms by as much as:
  - 62 percent: Overall improvement in understanding the final loan offer.
  - 75 percent: Improvement in identifying the loan amount.
  - 75 percent: Improvement in identifying the total cash required to close the loan.

- **Monthly payments:** The CFPB forms state in bold font what a consumer's monthly principal and interest payments will be. Participants who used the CFPB's redesigned disclosures were better able to correctly answer questions regarding their monthly payment, including questions asking them to

identify their total monthly payment, highest possible monthly payment, and changes to their monthly payment. The CFPB's new forms outperformed the current forms by as much as:
  - 197 percent: Improvement in identifying the highest possible total monthly payment in the final loan offer.
  - 54 percent: Improvement in identifying monthly payments. This included identifying adjustable-rate loans and their projected minimum and maximum payments over the different stages in the life of the loan.
  - 47 percent: Improvement in understanding whether monthly principal and interest payments would change.

BETTER COMPARISON SHOPPING

Because important information can be buried in the fine print of the current mortgage disclosure forms, consumers can have difficulty understanding the true terms of their deal. The CFPB forms are designed for better consumer comprehension, which means better consumer shopping and choice. Testing showed that the CFPB's new forms outperformed the current disclosures consistently when it comes to looking at competing offers.

- **Comparisons of competing loan offers:** The forms use formatting that clearly breaks down the costs of the loan such as the interest rate, mortgage insurance costs, and origination application fees. As a result, would-be-homebuyers and those refinancing their existing mortgage were better able to provide accurate answers to questions asking them to compare two different loan offers. The CFPB's new forms outperformed the current forms by as much as:
  - 42 percent: Overall improvement in consumers comparing two competing loan offers.
  - 74 percent: Improvement in comparing changes in the total monthly payment.
  - 98 percent: Improvement in comparing the highest possible total monthly payments between two loans.

- **Shopping for closing costs:** By using clear titles and headers, the CFPB forms plainly outline what closings costs a consumer will need to get the loan. Consumers can save money if they shop around for their own service providers for these costs. The CFPB's new forms outperformed the current forms by as much as:
  - 48 percent: Improvement in comprehending closing costs consumers 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 are getting. The CFPB's rules curtail "bait and switch" tactics, where the terms change at closing, by implementing several new consumer protections. Testing showed the new forms give consumers:

- **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. The CFPB's new forms outperformed the current forms by as much as:
  - 28 percent: Overall improvement for comparing initial and closing disclosures.
  - 63 percent: Improvement in comparing estimated and final loan amounts.
  - 21 percent: Improvement in comparing estimated and final closing costs.

- **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 they are getting what they expected. It also gives consumers time to ask questions and negotiate over changes that have occurred, especially for consumers who are refinancing and can more easily delay the closing of the loan. The CFPB's new forms outperformed the current forms by as much as:
    - 71 percent: Overall improvement in understanding the final disclosure form and loan offer.

- **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 higher or new fees on the final loan unless there is a legitimate reason for them.

More information about the quantitative testing results is available here.

RESPONDING TO PUBLIC FEEDBACK

The CFPB has considered all the ideas and suggestions it has received, and responded by making changes all along its iterative process. Among the items that the CFPB has changed based on public comments and feedback on the forms and rule are the following:

- **Spanish-language forms**: The CFPB received public comments describing the potential benefits to consumers and industry of Spanish-language versions of the new forms. The CFPB translated the Loan Estimate and Closing Disclosure into Spanish and conducted four rounds of additional qualitative testing. Because of the feedback, the CFPB is including Spanish-language versions of its forms in the final rule.

- **Refinance transactions:** Public comments suggested the new forms should more clearly state when a consumer is receiving cash from refinancing a mortgage loan. Responding to this demand, the CFPB conducted three additional rounds of qualitative testing after issuing the proposal to evaluate revisions to its proposed forms specifically for refinance transactions. Based on the testing, the CFPB modified the forms to include checkboxes to tell consumers whether they are receiving or paying cash at closing. The CFPB also modified the forms to include a streamlined calculation of that amount.

- **Definition of the APR:** The CFPB had proposed to include more items in the annual percentage rate (APR) such as the title insurance costs and appraisal fees. But after reviewing public comments, the CFPB is not finalizing this provision but will continue to study the issue. According to public feedback, such a change might have affected the types of loans available to consumers. In the CFPB's study of the issue, which will be conducted in connection with its five-year review of this final rule, the CFPB will look at consumer understanding of the APR and finance charge disclosures, and make improvements to those disclosures if necessary.

- **Machine-readable data:** The CFPB had proposed requiring lenders to retain records in an electronic, machine-readable format but public comments said that industry would benefit from a more specific data standard in the rule. This is an ongoing issue also being studied by other federal government partners. Fannie Mae and Freddie Mac, at the direction of the Federal Housing Finance

Agency, are working together to create a data standard based on the CFPB's final Closing Disclosure form. The CFPB will work to ensure that if it adopts any such requirement in a future rulemaking, the data standards are useful and efficient, and align with the direction of the industry.

- **Additional disclosure before closing:** The CFPB had proposed requiring lenders to re-disclose the Closing Disclosure and provide another three-day waiting period if anything changed on the loan, with a few exceptions. However, commenters said this requirement could result in frequent closing delays, which could harm consumers, sellers, industry, and the market. To protect consumers, the CFPB is reducing the number of situations that could trigger an additional three-day waiting period. The situations will now be limited to substantial changes in the APR, changes in the loan product, and the addition of a prepayment penalty. This solution still gives homebuyers time to evaluate and understand significant changes to their final loan terms and costs.

- **"Business days" and Saturday:** The CFPB had proposed to include Saturdays in the three days lenders would have to provide the Loan Estimate to consumers after receiving a consumer's mortgage application. However, commenters, especially small entities, like community banks and credit unions, said they generally are not open on Saturdays and that this requirement would force them to be. The CFPB believes the compliance cost to smaller entities from having to open on Saturdays outweighs the benefit to consumers. Additionally, this could have resulted in a reduction in access to mortgage credit for consumers. In today's final rule, the CFPB will include only days on which the lender is open in the three days the lender has to provide the Loan Estimate after receiving a homebuyer's application.