UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Economics
Bureau of Consumer Protection
Office of Policy and Planning

October 30, 2007

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. OP-1292

Dear Ms. Johnson:

The Federal Trade Commission (FTC or Commission) staff appreciates the opportunity to comment to the Office of the Comptroller of the Currency, Treasury (OCC); the Board of Governors of the Federal Reserve System (Board); the Federal Deposit Insurance Corporation (FDIC); the Office of Thrift Supervision, Treasury (OTS); and the National Credit Union Administration (NCUA) (collectively, the Agencies) on the Agencies' notice of Proposed Illustrations of Consumer Information for Subprime Mortgage Lending (the Notice).[1] The Agencies seek comment on two documents that would, if adopted, provide examples of consumer information disclosures that would be consistent with the guidance provided in the Agencies' Statement on Subprime Mortgage Lending (Subprime Statement).[2] The Agencies

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[1] Proposed Illustrations of Consumer Information for Subprime Mortgage Lending, 72 Fed. Reg. 45495 (Aug. 14, 2007).

[2] The Subprime Statement provides federally regulated depository institutions and certain affiliates guidance about certain subprime products that can give rise to payment shock. Drawing on the banking agencies' safety and soundness concerns as well as their consumer protection objectives, the Subprime Statement sets forth standards for such loans' issuance, underwriting, loan workouts or modifications, consumer protection principles, and control and monitoring systems. Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569-75 (July 10, 2007). The Statement's "Consumer Protection Principles" include "Providing information that enables consumers to understand material terms, costs, and risk of loan products at a time
(continued...)

also request that commenters "provide information on any consumer testing that they have conducted in connection with comparable disclosures."[3]

The FTC staff supports the Agencies' effort to develop mortgage disclosures to help subprime borrowers make better informed decisions. For the reasons set forth below, the FTC staff recommends that the Agencies consider conducting consumer research to confirm that the proposed disclosures will benefit consumers. The Commission staff also recommends that the federal agencies consider undertaking a more comprehensive effort to improve federal mortgage disclosures. Our research suggests that consumers would benefit most from the development of a single mortgage disclosure document that consolidates information on the key costs and features of their mortgages.

I. FTC Experience

As the primary federal agency that enforces consumer credit laws with respect to non-depository institutions, the Commission has wide-ranging responsibility regarding consumer financial issues in the home mortgage market, including those involving mortgage lenders, brokers, servicers, and advertisers. The FTC enforces a number of federal laws governing mortgage lending, including the Truth in Lending Act (TILA)[4] and Home Ownership and Equity Protection Act (HOEPA).[5] The Commission also enforces Section 5 of the Federal Trade Commission Act (FTC Act), which prohibits unfair and deceptive acts and practices in the marketplace, generally.[6]

The Commission's law enforcement actions have targeted deception and other illegal practices used in the marketing, advertising, and servicing of mortgage loans, focusing in particular on the subprime mortgage market. In recent years, the agency has brought 21 actions

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2 (...continued)
that will help the consumer select a product." *Id.* at 37574.

3 72 Fed. Reg. 45495, 45497.

4 15 U.S.C. § 1601-1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions).

5 15 U.S.C. § 1639 (amending TILA to provide additional protections for consumers who enter into certain high-cost refinance mortgage loans).

6 15 U.S.C. § 45(a).

against companies and principals in the mortgage industry.[7] Several of these cases have resulted in large monetary judgments, collectively returning more than $320 million to consumers. The Commission also conducts research on home mortgage lending issues, including two recent studies of consumer mortgage disclosures,[8] develops consumer and business education materials,[9] responds to inquiries about these matters from consumers, industry and the media, and works with other federal and state law enforcement entities to protect consumers from unfair or deceptive mortgage lending and servicing practices.

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[7] *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006); *FTC v. Ranney*, No. 04-1065 (D. Colo. 2004); *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *United States v. Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002); *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2000); *United States v. Action Loan Co.*, No. 00-511 (W.D. Ky. 2000); *FTC v. NuWest, Inc.*, No. 00-1197 (W.D. Wash. 2000); *United States v. Delta Funding Corp.*, No. 00-1872 (E.D.N.Y. 2000); *FTC v. Barry Cooper Prop.*, No. 99-07782 (C.D. Cal. 1999); *FTC v. Capitol Mortgage Corp.*, No. 99-580 (D. Utah 1999); *FTC v. CLS Fin. Serv., Inc.*, No. 99-1215 (W.D. Wash. 1999); *FTC v. Granite Mortgage, LLC*, No. 99-289 (E.D. Ky. 1999); *FTC v. Interstate Res. Corp.*, No. 99-5988 (S.D.N.Y. 1999); *FTC v. LAP Fin. Serv., Inc.*, No. 99-496 (W.D. Ky. 1999); *FTC v. Wasatch Credit Corp.*, No. 99-579 (D. Utah 1999); *In re First Plus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000); *In re Fleet Fin., Inc.*, FTC Docket No. C-3899 (1999); *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998).

[8] FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007), *available at* http://www.ftc.gov/os/2007/06/ P025505mortgagedisclosurereport.pdf (Mortgage Disclosure Study); and FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO & JANIS K. PAPPALARDO, THE EFFECT OF MORTGAGE BROKER COMPENSATION DISCLOSURES ON CONSUMERS AND COMPETITION: A CONTROLLED EXPERIMENT (2004), *available at* http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf (Mortgage Broker Compensation Study).

[9] Education materials on mortgage issues are available at the Commission's web page. FTC, CREDIT AND LOANS (2007), *available at* http://www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm. The materials include brochures such as *Mortgage Payments Sending You Reeling? Here's What to Do, High-Rate, High-Fee Loans (HOEPA/Section 32 Mortgages)*, and *Reverse Mortgages: Get the Facts Before Cashing In On Your Home's Equity*.

In fulfilling its dual mission to protect consumers and promote competition, the Commission has studied the role of consumer information, and information regulations, in a broad range of markets. Two lessons are clear. First, markets work better if consumers understand what they are buying and how much they are paying. Second, although disclosures can help consumers understand the products offered for sale and their price, they need to be carefully crafted to work as intended. Disclosures often need to be tested, using standard marketing research techniques, to ensure they will effectively communicate the intended messages to the target audience.[10]

II. Proposed Illustrations

The Agencies' Subprime Statement, among other things, outlined consumer protection principles relevant to the underwriting and marketing of certain mortgage loans, and one of these principles focused on information to be provided to borrowers.[11] The Agencies stated that clear and balanced information should be provided to borrowers. This information should enable borrowers to understand the material terms, benefits, costs, and risks of loan products at a time that will help them select a loan product.[12] The statement specifies that consumers should be informed of:[13]

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[10] *See generally* the FTC Staff's Mortgage Disclosure Study and the Mortgage Broker Compensation Study, *supra* note 8. *See also* FTC, RULEMAKING ON THE EFFECTIVENESS OF ENERGY LABELING (2007), *at* http://www.ftc.gov/appliances/ (particularly the Background Information for Consumer Research section). These materials discuss recent consumer research conducted by Commission staff to evaluate alternative designs for new Energy Guide labels prior to issuing the final amendments. *See also* Press Release, Concluding Two-Year Rulemaking, FTC Announces New EnergyGuide Label (Aug. 7, 2007), *at* http://www.ftc.gov/opa/2007/08/energy.shtm (explaining two-year review of the rule, consumer testing, and final amendments to 16 C.F.R. Part 305).

[11] The guidance on consumer protection principles also stated that loan approvals should be based on the borrower's ability to repay the loan according to its terms, that the period in which a prepayment penalty is assessed should not exceed the initial reset period, and that, in general, borrowers should be given a reasonable period of time before the reset date to refinance without penalty. 72 Fed. Reg. 37569, 37571-72.

[12] The guidance provided in the Subprime Statement applies only to certain loans made to subprime borrowers considering adjustable rate mortgages (ARMs). However, the Subprime Statement also notes that "institutions generally should look to the principles of this Statement when such ARM products are offered to non-subprime borrowers." *Id.* at 37571.

[13] The following list is taken verbatim from the statement. *Id.* at 37574 (citations (continued...)

- *Payment Shock.* Potential payment increases, including how the new payment will be calculated when the introductory fixed rate expires.

- *Prepayment Penalties.* The existence of any prepayment penalty, how it will be calculated, and when it may be imposed.

- *Balloon Payments.* The existence of any balloon payment.

- *Cost of Reduced Documentation Loans.* Whether there is a pricing premium attached to a reduced documentation or stated income loan program.

- *Responsibility for Taxes and Insurance.* The requirement to make payments for real estate taxes and insurance in addition to their loan payments, if not escrowed, and the fact that taxes and insurance costs can be substantial.

The proposed illustrations, which consist of two documents, would provide a safe-harbor to institutions seeking to meet the consumer information guidance described in the Subprime Statement.[14] The documents would be provided in addition to the other disclosure documents currently required under federal, state, and local laws.

The first illustration is described as a "narrative explanation of some of the key features of certain ARM loans that are identified in the Subprime Statement . . . [that] seeks to provide both the general and loan-specific information contemplated in the Subprime Statement."[15] The second illustration, which compares the payment streams for two hypothetical mortgages, is described as a "chart with numerical examples that is designed to show the potential consequences of payment shock in a concrete, readily understandable manner for a loan structured with a discounted interest rate for the first two years."[16]

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13 (...continued)
omitted).

14 Copies of the documents are provided in Appendix A of this letter. *See also* Subprime Statement, *supra* note 2.

15 72 Fed. Reg. 45497.

16 *Id.*

The information in the illustrations is largely general and often hypothetical. As noted, the second illustration is purely a hypothetical example. The first illustration provides some information about the loan attributes highlighted in the Subprime Statement, but includes few loan-specific details.[17]

Consumers would receive the disclosures while they are still shopping for mortgages, but the precise timing within the shopping process is not clear. According to the Subprime Statement: "This information should be provided in a timely manner to assist consumers in the product selection process, not just upon submission of an application or at consummation of the loan."[18] This early timing may account for some of the lack of specificity in the disclosures.

III. Analysis

A. Role of Disclosures in the Mortgage Market

The Commission staff shares the Agencies' concerns about recent mortgage market turmoil and its effects on individuals, families, neighborhoods, and the overall economy. Some of the current problems in mortgage markets may be attributable to consumers not receiving information they need to make well-informed decisions. The FTC staff is very concerned about the extent to which consumers misunderstand critical aspects of their mortgages, and supports public and private efforts to provide mortgage customers with the information they need.

The Commission staff commends the Agencies' efforts to develop disclosures that might improve consumer information in the mortgage market. Information policies that make mortgage characteristics and costs more transparent to consumers can help to prevent deception and make markets more efficient. However, experience and research at the FTC indicate that consumers likely benefit more from a comprehensive review and reform of federal mortgage disclosures, including giving serious consideration to creating a single disclosure document that summarizes all of the key features and costs of a mortgage.

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[17] For example, the illustration notes that the loan has a reduced initial interest rate, but does not specify the maximum note rate or monthly payment; it notes that a prepayment penalty exists, but does not specify the amount of the prepayment penalty or the conditions that would trigger the penalty; it alerts consumers to the fact that the monthly payment will not include an amount to cover required taxes and insurance, but does not provide an estimate of the additional amount that would be necessary to cover these expenses, or the total amount for principal, interest, taxes and insurance (PITI); and it notes that the loan contains a balloon payment, but not size of the balloon or the date on which it is due.

[18] 72 Fed. Reg. 37574.

As noted above, it is often critical to test disclosures to determine whether they will benefit consumers and make markets work better. The likely impact of disclosures for complex products, such as a mortgage, is difficult to predict without conducting consumer research. Marketing research is routinely conducted to ensure that consumers understand advertising campaigns as intended, and similar research is also often needed to ensure that public sector communications will be understood as intended by the target audience of consumers. Research at the FTC has illustrated the importance of applying standard marketing research methods to the analysis of disclosures. The FTC has previously advocated this type of research for the evaluation of information disclosures in a variety of markets.[19]

B. Recommendations for Testing the Effectiveness of Proposed Disclosures

In addition to our general recommendation to test the proposed disclosures, we also recommend that the research include procedures to evaluate how well the illustrations address the problems described in the Subprime Statement. One concern is that the illustrations provide general rather than transaction-specific information about mortgage offers. Even if consumer research were to demonstrate that consumers understand the information in the illustrations, it is unclear whether this information would substantially help consumers understand the terms of their loans and thereby avoid the payment shock and other problems discussed in the Subprime Statement. Consumer testing should be designed to evaluate whether the illustrations materially improve understanding of the overall mortgage transaction, not merely whether consumers understand the disclosure language. For example, a form may clearly and conspicuously disclose to borrowers that their mortgage payments do not include escrow amounts for taxes and insurance. Even if borrowers understand this disclosure, however, they may not understand that this means they are obligated to pay a sizeable amount of money separately at the end of the year for their local property tax bill. Thus, testing should try to discern whether consumers understand the implications of the disclosures for their particular future financial obligations.

Another recommendation is to design research that will examine the role of the proposed disclosures within the overall mortgage disclosure environment. These disclosures would be added to the many disclosures that consumers already receive. One concern, discussed below, is

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19 *See, e.g.*, FTC, STAFF COMMENT TO THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT ON PROPOSED AMENDMENTS TO THE REGULATIONS IMPLEMENTING THE REAL ESTATE PROCEDURES SETTLEMENT ACT CLAIMS (Oct. 28, 2002), *available at* http://www.ftc.gov/be/v030001.pdf; FTC, STAFF COMMENT TO FOOD AND DRUG ADMINISTRATION ON TRANS FATTY ACIDS IN NUTRITION LABELING: CONSUMER RESEARCH TO CONSIDER NUTRIENT CONTENT AND HEALTH CLAIMS AND POSSIBLE FOOTNOTE ON DISCLOSURE STATEMENTS (Oct. 9, 2003), *available at* http://www.ftc.gov/os/2003/10/fdafattyacidscomment.pdf; and FTC, STAFF COMMENT TO FOOD AND DRUG ADMINISTRATION ON ASSESSING CONSUMER PERCEPTIONS OF HEALTH CLAIMS (Jan. 17, 2006) *available at* http://www.ftc.gov/be/V060005.pdf.

that current disclosures are often ineffective, and sometimes seriously misunderstood. Consumer research designed to evaluate the likely effect of the proposed disclosures should include procedures to evaluate the likely role of the new disclosures within the current, overall mortgage information environment.

C. FTC Experience Testing the Effectiveness of Mortgage Disclosures

In recent years, Commission staff have completed two research projects that evaluate the effectiveness of mortgage disclosures. The studies were conducted, in part, because the Commission's experience has demonstrated that current mortgage disclosures are often ineffective in preventing deception. This conclusion is drawn from numerous law enforcement investigations through which it became clear that consumers were deceived even though they properly received all federally required mortgage disclosures.[20] The Commission's interest in conducting consumer research on mortgage disclosures is also derived from its experience using consumer research to evaluate consumer comprehension of advertising claims and information disclosures in other markets.

The recently completed Mortgage Disclosure Study, discussed below, revealed that two principal disclosure documents are frequently misinterpreted by consumers.[21] These disclosures may not only fail to convey the desired information to consumers and help to prevent deception, but also may contribute to information problems in the mortgage market. This research project also included the development of a new summary disclosure document that combines information about all key mortgage attributes and costs. Tests of the new prototype disclosure demonstrated the potential benefits of designing a single, comprehensive mortgage disclosure document. An earlier study, the Mortgage Broker Compensation study, illustrated that more information is not always better than less. The tested broker compensation disclosures led to incorrect understandings of loan costs and biased loan choices.[22] Both projects demonstrate the potential benefit of testing mortgage disclosures prior to implementation.

The Mortgage Disclosure Study, which employed standard marketing research techniques, consisted of two phases. The first phase included extended interviews with several dozen recent borrowers who discussed their own mortgage shopping experiences, reviewed their

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[20] *See* FTC, COMMENT FROM THE COMMISSION TO FEDERAL RESERVE BOARD ON HOME EQUITY LENDING MARKET (Sept. 14, 2006), *available at* http://www.ftc.gov/os/2006/09/docketop-1253commentfedreservehomeeqlendimagev.pdf. This comment also discusses the benefits of testing mortgage disclosures to ensure that they are understood as intended.

[21] FTC Staff, Mortgage Disclosure Study, *supra* note 8.

[22] FTC Staff, Mortgage Broker Compensation Study, *supra* note 8.

own mortgage documents, and reviewed a new prototype mortgage disclosure developed by FTC staff. The second phase included quantitative testing with over 800 recent mortgage customers; roughly half examined examples of current mortgage disclosures, while the other half reviewed the new prototype disclosure. The new prototype disclosure consists of a comprehensive one-page summary of key loan information, and two pages with additional details.[23] The prototype design is based on lessons gleaned from deceptive lending cases, first principles of consumer finance, and first principles of consumer communications design.

Findings from the study are striking. The failure to convey key mortgage costs and features was evident across a wide range of loan characteristics and among substantial proportions of study participants, both prime and subprime. Many of the problems highlighted in the Subprime Statement were apparent during the consumer interviews. Recent borrowers could not determine if their own mortgages had prepayment penalties, even when examining their own Truth-in-Lending documents. Consumers with adjustable rate mortgages were not always aware that their monthly payments could increase, or the extent of such increases. Confusion about the inclusion of taxes and insurance in monthly payment amounts was also revealed.

The extended interviews also suggested that some standard terms in current required disclosures promote misunderstanding. For example, the "Amount Financed" on the TILA statement was typically interpreted as the loan amount, rather than the loan amount minus prepaid finance charges. This misunderstanding sets the stage for possible confusion regarding the total mortgage fees and the extent to which mortgage fees are financed. The "Discount Fee" on the Good Faith Estimate (GFE) was often misinterpreted as a discount to the borrower, rather than a payment from the borrower to the lender in exchange for the given contract interest rate.[24]

Systematic testing with over 400 recent mortgage customers confirmed that current disclosures are confusing and often misunderstood. Respondents were given information about hypothetical mortgages using examples of current TILA and GFE disclosures, given time to examine the disclosures in a quiet setting, and asked objective questions about the mortgages. The forms used for the test provide more information than currently required under federal law.[25] Even with these enhanced disclosures, mortgage customers could not identify critical mortgage features:

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23 *See* Appendix B for an example of the FTC staff prototype disclosure document.

24 The GFE provides an itemized disclosure of several dozen individual settlement costs. The disclosures must be provided within three days of receiving a consumer's written application. *See generally* DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD), RESPA – REAL ESTATE SETTLEMENT PROCEDURES ACT (2007), *at* http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm.

25 *See* Appendix C for an example of the tested TILA and GFE disclosures.

- About a fifth of the respondents viewing the current disclosure forms could not correctly identify the APR of the loan, the amount of cash due at closing, or the monthly payment (including whether it included escrow for taxes and insurance).

- Nearly a quarter could not identify the amount of settlement charges.

- About a third could not identify the interest rate or which of two loans was less expensive, and a third did not recognize that the loan included a large balloon payment or that the loan amount included money borrowed to pay for settlement charges.

- Half could not correctly identify the loan amount.

- Two-thirds did not recognize that they would be charged a prepayment penalty if in two years they refinanced with another lender (and a third did not even recognize that they "may" be charged such a penalty).

- Three-quarters did not recognize that substantial charges for optional credit insurance were included in the loan.

- Almost four-fifths did not know why the interest rate and APR of a loan sometimes differ.

The Mortgage Disclosure Study also showed that consumers would benefit substantially from a single mortgage disclosure like that tested in the study. The prototype mortgage disclosure document received enthusiastic reviews during the extended interviews from consumers.[26] Quantitative testing verified that the prototype disclosure substantially improves consumer recognition of key loan features. The roughly 400 respondents who examined loans using current forms answered an average of 61 percent of the test questions correctly. In contrast, the roughly 400 respondents who examined the same loans using the prototype form answered 80 percent of the questions correctly – a 19 percentage point improvement.

The prototype disclosures provided improvements across a wide range of loan terms and for substantial proportions of respondents. The improvements provided by the prototype form included:

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[26] The prototype combines information about the loan features, such as the interest rate and monthly payments with information about the costs of acquiring the loan. Under current regulations, information about the loan appears on the TILA statement and information about the costs obtaining the mortgage appears in the GFE. Combining key elements of both documents should make it easier to shop for the best deal and to verify verbal claims by a mortgage originator.

- 66 percentage point increase in the proportion of respondents correctly identifying the total amount of up-front charges in the loan.

- 43 percentage point increase in the proportion of respondents recognizing that the loan contained charges for optional credit insurance.

- 37 percentage point increase in the proportion correctly identifying the amount borrowed.

- 24 percentage point increase in the proportion recognizing that a prepayment penalty would be assessed if the loan was refinanced in two years.

- 21 percentage point increase in the proportion correctly identifying why the APR and interest rate may differ in a loan.

- 16 percentage point increase in the proportion correctly identifying the APR amount.

- 15 percentage point increase in the proportion correctly identifying the amount of settlement charges.

- 13 percentage point increase in the proportion correctly identifying which of two loans was less expensive.

- 12 percentage point increase in the proportion correctly identifying the interest rate amount.

- 9 percentage point increase in the proportion recognizing that settlement charges were financed and included in the loan amount.

- The prototype form also conveyed the correct prepayment penalty amount to 59 percent of the respondents, and the correct amounts of property taxes and homeowner's insurance charges for a loan in which the charges were not included in the monthly payment to 79 percent of the respondents. This information is not included in the current forms.

The new prototype disclosure developed and tested at the FTC addresses several of the serious problems highlighted in the Subprime Statement, which advises: "Information provided to consumers should clearly explain the risk of payment shock and the ramifications of prepayment penalties, balloon payments, and the lack of escrow for taxes and insurance as necessary."[27] For example, the prototype addresses prepayment penalty misunderstanding with a demonstrably clearer and more comprehensive prepayment penalty disclosure. The prototype addresses concern about escrow misunderstanding by explicitly indicating whether escrow payments for taxes and insurance are included in the monthly payment estimates.[28] More can be done to make the prototype more responsive to the concerns raised in the Subprime Statement. The prototype did not include an adjustable interest rate disclosure, although one could readily be included to disclose key aspects of adjustable rate mortgages. The testing also revealed room for improving the balloon payment disclosure. Further testing and development can uncover remaining deficiencies and solutions, yielding even better results.

IV. Conclusion

The FTC staff supports the Agencies' effort to develop mortgage disclosures to help subprime borrowers make better-informed decisions. As shown by the Commission's research and enforcement experience, however, required mortgage disclosures, even those for simple, fixed-rate, fully amortizing loans, often confuse consumers in both the subprime and prime markets. FTC staff therefore recommend that the Agencies consider conducting tests of the effectiveness of the proposed new disclosures. Such research would be particularly useful to policymakers if the testing simulated the overall information environment and employed measures to evaluate how well the proposed disclosures meet the objectives set forth in the Subprime Statement.

In addition to considering testing these disclosures, FTC staff also recommend that federal agencies consider undertaking a more comprehensive effort to improve federal mortgage disclosures. The proposed disclosures might not substantially improve a borrower's overall understanding of his actual loan choices. The disclosures include only a partial list of potentially costly loan attributes, and little loan-specific detail about these attributes. In addition, the proposed disclosures would be added to the often-confusing disclosures that consumers already receive. Based on Commission staff's research, consumers likely would benefit from one clear disclosure document that alerts them to the major costs and features of a mortgage; will significantly reduce the cost of obtaining information about the true value of different mortgage options; is noticeable, easy to read, and easy to understand; summarizes key loan features up-front to facilitate informed comparison shopping; and makes clear what a consumer is getting into before signing on the dotted line. FTC staff research also indicates that such a document

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27 72 Fed. Reg. at 37574.

28 Many key loan features, identified as a source of concern, are not required in any of the federally required disclosures. Lenders are not currently required to specify the nature of prepayment penalty obligations, the absence of escrow payments for taxes and insurance in monthly payment estimates, the maximum monthly mortgage payment amount for loans with adjustable rate features, or total up-front costs of obtaining a mortgage.

could be developed using principles from consumer finance, communications design, and consumer research. The Commission staff stands ready to participate with other federal agencies in a more comprehensive effort to improve federal mortgage disclosures.

The Commission appreciates your consideration of its views. If any other information would be useful regarding these matters, please contact Janis K. Pappalardo, staff economist, at (202) 326-3380.

Sincerely,

Mike Baye

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APPENDIX A

Disclosure Illustrations Proposed by the Agencies

Illustration 1

Important Facts About Your Adjustable Rate Mortgage

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an adjustable rate mortgage (ARM) is right for you. ARMs can be complicated. If you do not understand how they work, you should not sign any loan contracts, and you might want to consider other loans.

With an ARM, the interest rate on your loan is not fixed. Instead, it changes over time according to a formula – typically, a base interest rate (index) plus a certain percent (margin) (for example, the Prime Rate plus 3 percent). So, if the base interest rate increases, your interest rate and monthly payment will also increase.

Some specific terms of your ARM loan are explained below.

► Your loan will have a reduced initial interest rate.
Some ARMs have a reduced interest rate (start rate) for a short period of time – for example, the first two years of the loan. This rate is less than the index plus margin rate. This means that your interest rate and monthly payments will be lower than normal for the first two years. However, your interest rate and monthly payment may increase significantly when that period is over – even if market rates stay the same. And, your interest rate and monthly payment will increase even more if market rates rise.

► Your monthly payment will not include an amount to cover taxes and insurance.
In some mortgages, your monthly payment includes both principal and interest and an amount to cover real estate taxes and home insurance – and your lender pays your taxes and insurance out of these funds. In other mortgages, your monthly payment covers only principal and interest, and you are responsible for paying real estate taxes and insurance premiums when the bills arrive. When you are comparing mortgages, or deciding whether you can afford a mortgage, you need to consider whether or not the monthly payment includes an amount to cover estimated taxes and insurance.

► You will be required to pay a prepayment penalty if you pay off your loan more than 60 days before the initial interest rate is adjusted. The amount of the penalty will be a percentage of the outstanding balance of the loan.
Some ARMs require you to pay a large prepayment penalty if you sell your home or refinance during the first few years of the loan. A prepayment penalty can make it difficult, or very expensive, to sell your home or refinance – which you may need to do if your interest rate, and therefore your payment, is about to increase significantly.

► Your loan will have a balloon payment.
Most mortgages are set up so that you pay off the loan gradually by the monthly payments that you make over the loan term (for example, 30 years). Some ARMs, however, are set up with "balloon payments" – you make the same monthly payments that you would for a 30-year loan, but after a shorter period of time (for example, 10 years), the entire remaining balance of the loan is due. When the balloon payment is due you will usually need to refinance your loan to pay it, or sell your home if you cannot refinance the loan.

► Your loan will have a higher price because of reduced documentation.
"Reduced documentation" or "stated income" loans usually have higher interest rates or other costs compared to "full documentation" loans available if you document your income, assets, and liabilities. These higher costs can be substantial.

Illustration 2

SAMPLE MORTGAGE COMPARISON

(Not actual loans available)

Sample Loan Amount $200,000 – 30-Year Term – Interest Rates For Example Purposes Only

	Fixed Rate Mortgage 7.5%	Reduced Initial Rate "2/28" ARM 7% for two years, then adjusting to variable rate; 10% maximum rate in Year 3; 11.5% maximum rate in Year 4; 13% maximum rate in Years 5-30
	REQUIRED MONTHLY PAYMENTS (includes $200 per month for real estate tax and insurance escrow)	
Years 1-2	**$1,598**	**$1,531**
Year 3 – if rates don't change	**$1,598**	**$1,939**
Year 4 – if rates don't change	**$1,598**	**$2,152**
Year 5 – if rates rise 2%	**$1,598**	**$2,370**

APPENDIX B

Example of Comprehensive Disclosure Prototype Developed and Tested by FTC Staff

(Fixed-Rate Loan)

Mortgage Loan Offer

JL Mortgage Company
123 Main Street
Mortgagetown, Virginia 22189
(703) 555-2767

LOAN "K"

Borrower:	James and Clara Borrower	Offer Date:	October 14, 2005
Property Location:	123 Your Street, Hometown, VA 22189		

This page provides a summary of your loan, our charges for the loan, and your loan payments. See pages 2 and 3 for important details on each of these items.

YOUR LOAN

Loan Type Summary	30 year fixed-rate
Loan Amount	$ 175,425.00
Loan Term	30 years (360 monthly payments)

OUR LOAN CHARGES

Interest Rate	6.20%	Fixed rate
Up-Front Charges	$ 5,303.39	Total settlement charges
	$ 0.00	Charges for optional products and services
	$ 5,303.39	Total up-front charges
Monthly-Billed Charges	None	
Annual Percentage Rate (APR)	6.38%	The cost of credit, including both interest payments and other finance charges, expressed as an annual rate.

YOUR LOAN PAYMENTS

Cash Due at Closing	$ 5,303.39	
Monthly Payments	$ 1,074.42	Payments number 1–360 (Does NOT include required payments for property taxes and hazard insurance.)
Balloon Payment	None	

PENALTIES AND LATE FEES

Prepayment Penalty	A penalty of four percent (4%) of the prepaid loan balance will be charged if the loan is paid off during the first five years. An immediate refinancing of the loan would result in a penalty of $7,017.00.
Late Fee	A 5% late fee will be charged on payments more than 7 days late.

This page and the next provide explanations and important details about your loan amount, our charges for the loan, and your loan payments. See page 1 for a summary of these items.

LOAN AMOUNT DETAILS

Loan Amount	$ 150,000.00	Refinance current mortgage loan
	$ 20,000.00	Cash paid to borrower
	$ 5,425.00	Consolidation of borrower's other debts
	$ 0.00	Financed settlement charges
	$ 0.00	Financed charges for optional products and services
	$ 175,425.00	Total Loan Amount

OPTIONAL CHARGES DETAILS

Optional Products and Services Charges	None

CASH DUE AT CLOSING DETAILS

Cash Due at Closing	$ 5,303.39	Settlement charges
	$ 5,303.39	Total cash due at closing

MONTHLY PAYMENT DETAILS

Monthly Payment

Itemization of initial monthly payment

$ 1,074.42	Principal and interest
$ 0.00	Property tax escrow
$ 0.00	Hazard (homeowners) insurance
$ 0.00	Private mortgage insurance (PMI)
$ 0.00	Monthly-billed optional products or services
$ 1,074.42	Total initial monthly payment

Taxes and Insurance

Property taxes and hazard insurance are NOT included in your monthly loan payment. You will be responsible for paying these additional required costs yourself. Your additional monthly costs will be:

$ 145.83	Property taxes
$ 60.00	Hazard insurance
$ 205.83	Total additional monthly costs

SETTLEMENT CHARGES DETAILS

This page lists the settlement services included in the settlement charges shown on page 1. ALL of the settlement services you need to close the loan are included.

Settlement Services Package	$5,065.00	This package includes the following services: __Origination and lender services__: Loan origination; Appraisal; Credit report; Lender's property survey; Lender's property inspection; Pest inspection __Title services__: Settlement agent; Title search and examination; Title document preparation; Lender's title insurance; Attorney services; Notary fee __Government taxes and fees__: County recording fee; State and local tax stamps
Interest Charge for Partial Month	$ 238.39	This charge is for the daily interest charges from the day of your settlement until the end of the month. For this loan this amount is $ 29.7982 per day for 8 days (if your closing date is 10/24/05).
Prepaid Items	$ 0.00 $ 0.00	Property taxes (__ months at $_____ per month) Hazard insurance (__ months at $____ per month)
Reserves Deposited with the Lender	$ 0.00 $ 0.00	Property taxes (__ months at $____ per month) Hazard insurance (__ months at $____ per month)
Total Settlement Charges	**$5,303.39**	**Total Settlement Charges**

HOW TO PROTECT YOURSELF

COMPARISON SHOP TO FIND THE BEST DEAL — The lender or broker providing this loan is not necessarily shopping on your behalf or providing you with the lowest cost loan.

DO NOT RELY ON ORAL PROMISES TO CHANGE THESE TERMS — Obtain all changes in writing.

SAVE THIS OFFER SHEET AND COMPARE TO DOCUMENTS AT CLOSING — Before you sign any papers at your loan closing (loan settlement), make sure that the costs have not been increased.

Federal law requires that this offer sheet be provided to the borrower within three (3) business days after the borrower has applied for a loan. If the loan terms change prior to acceptance by the borrower, a new offer sheet must be provided. Notify the Federal Trade Commission (FTC) if the lender does not abide by the terms set forth in this offer or does not provide this offer sheet within three days of application: Federal Trade Commission (FTC), 600 Pennsylvania Avenue, N.W., Washington D.C., 20580, telephone (877) FTC-HELP (382-4357), web site www.ftc.gov.

APPENDIX C

Example of Current Disclosure Forms Tested by FTC Staff[1]

(Fixed-Rate Loan)

[1] The current disclosure forms tested in the study the FTC study consisted of the Truth-in-Lending Act (TILA) statement that is required for closed-end, fixed-rate residential mortgages under the Truth in Lending Act, and the Good Faith Estimate of Settlement Costs (GFE) required under the Real Estate Settlement Procedures Act (RESPA). The GFE used in the tests was an enhanced version that included information not required by the current regulations, including the amount of money borrowed, the interest rate, the total monthly payment amount, an itemization of the monthly payment, the cash due at closing, and the total settlement charges. Many lenders use some variation of an enhanced GFE that goes beyond the regulatory requirements. The form used in the tests followed this practice so that it would more closely reflect the information that many consumers actually receive. The use of an enhanced GFE implies, however, that the test results will understate any problems that consumers may have with a GFE that merely complies with the regulations.

Proprietary form used in the consumer testing

FEDERAL TRUTH-IN LENDING DISCLOSURE STATEMENT

For use with Fixed-Rate, GPM, Balloon Mortgage, Adjustable or Variable Rate Loans

LOAN "K"

Date: 10/14/05
Loan No.: 21782
Borrowers: James and Clara Borrower

Property Location: 123 Your Street
Hometown, VA 22189

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate	FINANCE CHARGE The dollar amount the credit will cost you	Amount Financed The amount of credit provided to you or on your behalf	Total of Payments The amount you will have paid after you have made all payments as scheduled
6.38 %	$ 214,725.92	$ 172,066.61	$ 386,792.53

You have the right to receive at this time an itemization of the Amount Financed.
☐ I want an itemization ☒ I do not want an itemization

Your payment schedule will be:

Number of Payments	Amount of Payments	When Payments Are Due
360	$ 1,074.42	Monthly beginning 12/01/05
	$	
	$	
	$	
	$	
	$	
	$	

Variable Rate: ☐ This loan has a Variable Rate Feature. Variable Rate Disclosures have been provided to you earlier.

☐ This obligation has a demand Feature.

Insurance: Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost. No such insurance will be in force until you have completed an application, the insurance company has issued the policy, the effective date of that policy has arrived and the required premium has been paid.

Type	Premium	Term	Signature
Credit Life	$		I want to apply for credit life insurance. ______ SIGNATURE
Credit Disability	$		I want to apply for credit disability insurance. ______ SIGNATURE
Credit Life and Credit Disability	$		I want to apply for credit life and disability insurance. ______ SIGNATURE

You may obtain property insurance from anyone you want that is acceptable to this institution. If you get the insurance from ______________ you will pay $ ________ for a term of ______________

Security: You are giving a security interest in:
☐ the property being purchased
☒ the property located at 123 Your St., Hometown, VA 22189

Late Charge: If payment is late, you will be charged $ ____________ / 5.00 % of the payment.

Prepayment: If you pay off early, you
☒ may ☐ will not have to pay a penalty.
☐ may ☒ will not be entitled to a refund of part of the finance charge.

Assumption: Someone buying your home
☒ cannot assume the remainder of the mortgage on the original terms.
☐ may, subject to conditions, be allowed to assume the remainder of the mortgage on the original terms.

A deposit balance ☐ is ☒ is not required. The Annual Percentage Rate does not take into account your required deposit.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate

I/We hereby acknowledge receipt of this disclosure.

______________________ / ____________ DATE

______________________ / ____________ DATE

Prepared by: ______________________ ____________ TITLE

Proprietary form used in the consumer testing

GOOD FAITH ESTIMATE

Lender: JL Mortgage Company
Address: 123 Main Street
Mortgagetown, VA 22189
Applicant(s): James and Clara Borrower
Property Address: 123 Your Street
Hometown, VA 22189

LOAN "K"

Sales Price:	
Base Loan Amount:	$175,425.00
Total Loan Amount:	$175,425.00
Type of Loan:	Fixed Rate
Date Prepared:	10/14/05
Rate: 6.20% Term:	30 Year

The information provided below reflects estimates of the charges which you are likely to incur at the settlement of your loan. The fees listed are estimates - the actual charges may be more or less. Your transaction may not involve a fee for every item listed.
The numbers listed beside the estimates generally correspond to the numbered lines contained in the HUD-1 or HUD-1A settlement statement that you will be receiving at settlement. The HUD-1 or HUD-1A settlement statement will show you the actual cost for items paid at settlement.

800 ITEMS PAYABLE IN CONNECTION WITH LOAN:		
801 Loan Origination Fee (%)	$	2,400.00
802 Loan Discount Fee (%)	$	
803 Appraisal Fee	$	200.00
804 Credit Report	$	
805 Lender's Inspection Fee	$	
806 Mortgage Insurance Application Fee	$	
807 Assumption Fee	$	
808 Mortgage Broker Fee	$	
809 CLO Access Fee	$	
810 Tax Related Service Fee	$	50.00
Administrative Fee	$	450.00
Doc Prep Fee	$	100.00
Courier	$	50.00
	$	
	$	

900 ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE:		
901 Interest for 8 day @$ 29.7982 per day	$	238.39
902 Mortgage Insurance Premium	$	
903 Hazard Insurance Premium	$	
	$	
	$	
	$	

1000 RESERVES DEPOSITED WITH LENDER:		
1001 Haz Ins Prem @$	$	
1004 Tax & Assmt Res @$	$	
	$	
	$	
	$	

"L" designates those costs to be paid by Lender.

1100 TITLE CHARGES:		
1101 Closing or Escrow Fee	$	200.00
1102 Abstract or Title Search	$	125.00
1103 Title Examination	$	
1104 Title Insurance Binder	$	
1105 Document Preparation Fee	$	75.00
1106 Notary Fee	$	10.00
1107 Attorney Fees	$	
1108 Title Insurance	$	540.00
Title Binder	$	50.00
	$	
	$	
	$	

1200 GOVERNMENT RECORDING & TRANSFER CHARGES:		
1201 Recording Fees:	$	50.00
1202 City/County Tax/Stamps:	$	100.00
1203 State Tax/Stamps:	$	250.00
County Tax	$	275.00
	$	
	$	
	$	

1300 ADDITIONAL SETTLEMENT CHARGES:		
1301 Survey	$	120.00
1302 Pest Inspection	$	
Flood Certification	$	20.00
	$	
	$	
	$	
TOTAL ESTIMATED SETTLEMENT CHARGES	$	5,303.39

TOTAL ESTIMATED FUNDS NEEDED TO CLOSE:		
Downpayment	$	
Est. Closing Costs	$	5,065.00
Est. Prepaid Items/Reserves	$	238.39
OTHER:	$	
TOTAL EST. FUNDS NEEDED TO CLOSE	$	5,303.39

TOTAL ESTIMATED MONTHLY PAYMENT:		
Principal & Interest	$	1,074.42
Real Estate Taxes	$	
Flood & Hazard Insurance	$	
Mortgage Insurance	$	
	$	
TOTAL MONTHLY PAYMENT	$	1,074.42

THIS SECTION TO BE COMPLETED BY LENDER ONLY IF A PARTICULAR PROVIDER OF SERVICE IS REQUIRED. Use of the particular provider is required and the estimate is based on charges of the provider.

ITEM NO.	NAME & ADDRESS OF PROVIDER	TELEPHONE NO.	NATURE OF RELATIONSHIP

These estimates are provided pursuant to the Real Estate Settlement Procedures Act of 1974, as amended (RESPA). Additional information can be found in the HUD Special Information Booklet, which is to be provided to you by your mortgage broker or lender, if your application is to purchase residential real property and the Lender will take a first lien on the property. The undersigned acknowledges receipt of the booklet "Settlement Costs," and the Consumer Handbook on ARM Mortgages, if applicable.

Applicant	Date	Applicant	Date
Applicant	Date	Applicant	Date

☐ This Good Faith Estimate is being provided by , a mortgage broker, and no lender has yet been obtained

"S" designates those costs to be paid by Seller.