

**BEFORE THE
CONSUMER FINANCIAL PROTECTION BUREAU**

**In the Matter of
Request for Comment on Notice of Proposed Rulemaking:
Integrated Mortgage Disclosures under the Real Estate Settlement
Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z)**

Docket No. CFPB-2012-0028

**Comments of the Staff of the Federal Trade Commission
Bureau of Consumer Protection, Bureau of Economics, and Office of Policy Planning***

September 25, 2012

*** These comments represent the views of the staff of the Bureau of Consumer Protection, the Bureau of Economics, and the Office of Policy Planning. They are not necessarily the views of the Commission or any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments.**

I. Introduction

On July 9, 2012, the Consumer Financial Protection Bureau (CFPB) issued a notice of proposed rulemaking (NPRM),¹ seeking comment, data, and information from the public about its proposal to combine certain disclosures that consumers receive in connection with applying for and closing on a home mortgage loan under the Truth in Lending Act (TILA)² and Real Estate Settlement Procedures Act (RESPA).³ The NPRM, among other things, sets forth two proposed disclosure forms (and accompanying instructions) designed to aid consumers in understanding the features, costs, and risks of mortgage loans.

Federal Trade Commission (FTC or Commission) staff commends the CFPB's efforts to develop improved mortgage disclosures that are designed to help consumers make better-informed decisions about mortgages. Based on its own research and law enforcement experience, the FTC staff believes that the disclosures that current federal regulations require often fail to effectively convey the key information consumers need to make decisions about mortgages.

FTC staff also believes that the disclosures developed and being considered by the CFPB will likely improve the information that consumers receive under current federal regulations; they are generally simpler and less technical, and should be easier to understand. Given the significance of a consumer's decision to purchase a home or seek other home financing, and the importance of mortgage disclosures in enabling consumers to evaluate the costs of this important transaction, it is vitally important to ensure that disclosures effectively enable consumers to evaluate the real costs of taking out a mortgage. Therefore, FTC staff encourages the CFPB to conduct controlled quantitative testing of the proposed disclosures prior to finalizing a rule to help ensure that the proposed disclosures effectively convey key mortgage terms to consumers, are not misinterpreted or misunderstood, and offer significant benefits over the currently mandated disclosures. Previous studies of mortgage disclosures by FTC staff have demonstrated the value of such testing in the mortgage area. In this comment, FTC staff provides a general description of the FTC's experience in the mortgage market (including the FTC staff's own research on mortgage disclosures), and discusses its view of the value of controlled quantitative testing of disclosures in the area of mortgage financing.

II. FTC Authority and Experience

The FTC has a long history as the nation's consumer protection agency. The Commission has used law enforcement, rulemaking, research, conferences and workshops, and educational efforts to protect consumers of mortgage loans from deceptive, unfair, and other unlawful conduct. Most significantly for purposes of the current rulemaking proceeding, FTC

¹ The NPRM was initially issued on the CFPB's website, <http://www.consumerfinance.gov>, and is now available at 77 Fed. Reg. 51116 (Aug. 23, 2012).

² 15 U.S.C. § 1601 *et seq.*; TILA is implemented by Regulation Z, 12 C.F.R. Part 1026.

³ 12 U.S.C. § 2601 *et seq.*; RESPA is implemented by Regulation X, 12 C.F.R. Part 1024.

staff has engaged in rigorous empirical research on mortgage disclosures and has long been an advocate for comprehensive reforms to improve consumer understanding of these disclosures.

A. Legal Authority

The FTC enforces Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices, against a variety of financial service companies that offer mortgage products, including many non-bank lenders, servicers, brokers, and advertisers.⁴ The Commission also has law enforcement authority under a number of consumer protection statutes and regulations that relate to mortgage lending, mortgage advertising, and other aspects of the mortgage process. These laws include the Truth in Lending Act (TILA) and its implementing Regulation Z,⁵ the Home Ownership and Equity Protection Act (HOEPA),⁶ the Equal Credit Opportunity Act (ECOA),⁷ and the Omnibus Appropriations Act of 2009 (as clarified by the Credit CARD Act).⁸ Further, the FTC is authorized to enforce, with respect to entities within the FTC's jurisdiction, rules promulgated by the CFPB to protect consumers of financial services, including mortgage disclosure rules that the CFPB issues to implement Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).⁹

In addition to its law enforcement authority, the Commission can promulgate rules under the FTC Act¹⁰ and under certain other statutes¹¹ to protect consumers of financial services. The

⁴ See 15 U.S.C. § 45(a). The FTC Act, however, exempts banks, savings and loan institutions, and Federal credit unions from the Commission's jurisdiction.

⁵ See *supra* note 2.

⁶ 15 U.S.C. §§ 1667-1667f (requires disclosures, limits balloon payments, and regulates advertising in connection with consumer lease transactions).

⁷ 15 U.S.C. §§ 1691-1691f (prohibits creditor practices that discriminate on the basis of race, religion, national origin, sex, marital status, age, receipt of public assistance, and the exercise of certain legal rights).

⁸ Omnibus Appropriations Act of 2009, Pub. L. 111-8, 123 Stat. 524; Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. 111-24, 123 Stat. 1734; 12 C.F.R. Part 1014 (prohibits deceptive mortgage advertising practices); 12 C.F.R. Part 1015 (prohibits deceptive and unfair practices in connection with mortgage assistance relief services).

⁹ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010). See § 1061(b)(5)(C)(ii), 12 U.S.C. § 5581(b)(5)(C)(ii) (2010).

¹⁰ See, e.g., Credit Practices Rule, 16 C.F.R. Part 444 (restricting the use of certain remedies in consumer credit contracts); Holder in Due Course Rule, 16 C.F.R. Part 433 (preserving the ability of consumers to raise claims and defenses against purchasers of consumer credit contracts).

¹¹ For example, as detailed below, the Commission used the authority granted to it by Congress under the Omnibus Appropriations Act of 2009 (as amended by the Credit CARD Act) to issue the MAP and MARS Rules. See *supra* note 8; *infra* notes 17 & 19. In another important example, the FTC promulgated the Telemarketing Sales Rule (TSR), pursuant to rulemaking authority conferred by Congress in the Telemarketing and Consumer Fraud and Abuse Prevention Act. See 15 U.S.C. § 6102; 16 C.F.R. Part 310. The Commission also amended the TSR to include specific provisions curbing deception and abuse in the telemarketing of credit card debt relief services, like debt settlement. See 75 Fed. Reg. 48458 (Aug. 10, 2010).

Commission also has conducted research and studies, hosted public workshops and conferences, developed consumer and business education materials, and worked with other federal and state law enforcement and regulatory entities to protect consumers from unlawful practices in connection with mortgage lending.

B. Efforts to Protect Consumers of Mortgage Loans

1. Law Enforcement

The FTC has aggressively pursued law enforcement actions against companies in the mortgage lending industry that have engaged in unfair, deceptive, or otherwise illegal practices. In the last two decades, the Commission has filed 35 law enforcement actions against those who advertise, originate, or service mortgage loans,¹² obtaining relief of more than a half-billion dollars for consumers. These actions have challenged the illegal conduct of different types of entities (*e.g.*, non-bank lenders, brokers, and servicers) during all stages of the mortgage lending process. In many of these lawsuits, the Commission charged companies with deceiving consumers regarding key terms and costs of mortgage products, including the annual percentage rate (APR), finance charges, and whether a loan has a fixed or adjustable rate.¹³ In other cases, the FTC has challenged unlawful practices in servicing mortgages. For example, the Commission in 2011 took action against the allegedly unlawful actions of large mortgage

¹² See *FTC v. Countrywide Home Loans, Inc.*, No. CV10-4193 (C.D. Cal. 2010); *FTC v. Golden Empire Mortg., Inc.*, No. CV09-03227 (C.D. Cal. 2009); *In re Michael Gendrolis*, F.T.C. Dkt. No. C-4248 (2009); *In re Shiva Venture Group, Inc.*, F.T.C. Dkt. No. C-4250 (2009); *In re Am. Nationwide Mortg. Co.*, F.T.C. Dkt. No. C-4249 (2009); *FTC v. Ryan*, No. 1:09-cv-00535-HHK (D.D.C. 2009); *FTC v. EMC Mortgage Corp.*, No. 4:08-cv-338 (E.D. Tex. 2008); *FTC v. Safe Harbour Found. of Fla., Inc.*, No. 08-C-1185 (N.D. Ill. 2008); *FTC v. Mortgages Para Hispanos.com Corp.*, No. 4:06-cv-19 (E.D. Tex. 2006); *FTC v. Chase Fin. Funding, Inc.*, No. SACV04-549 GLT (ANx) (C.D. Cal. 2004); *FTC v. Ranney*, No. 04-F-1065 (MJW) (D. Colo. 2004); *U.S. v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. 30 Minute Mortg., Inc.*, No. 03-60021 (S.D. Fla. 2003); *FTC v. OSI Fin. Servs., Inc.*, No. 02-C-5078 (N.D. Ill. 2002); *United States v. Mercantile Mortg. Co.*, No. 02-C-5079 (N.D. Ill. 2002); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *FTC v. Assocs. First Capital Corp.*, No. 1:01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortg. Co.*, No. SACV 00-964 DOC (EEx) (C.D. Cal. 2000); *In re FirstPlus Fin. Group, Inc.*, F.T.C. Dkt. No. C-3984 (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 Fleet Fin., Inc.*, FTC Docket No. C-3899 (1999); *United States v. Unicor Funding, Inc.*, No. 9901228 (C.D. Cal. 1999); *FTC v. Capital City Mortg. Corp.*, No. 1:98CV237 (D.D.C. 1998); *In re Felson Builders, Inc.*, 119 F.T.C. 652 (1995); *In re Lomas Mortg. U.S.A., Inc.*, 116 F.T.C. 1062 (1993).

¹³ See, *e.g.*, *FTC v. Safe Harbour Found. of Fla., Inc.*, No. 08-C-1185 (N.D. Ill. 2008); *FTC v. Chase Fin. Funding, Inc.*, No. SACV04-549 GLT (ANx) (C.D. Cal. 2004); *FTC v. First Alliance Mortg. Co.*, No. SACV 00-964 DOC (EEx) (C.D. Cal. 2000). Additionally, in 2007, the Commission sent warning letters to more than 200 mortgage advertisers and associated media outlets, informing them that their ads may be deceptive in violation of Section 5 of the FTC Act or in violation of TILA. See *FTC Warns Mortgage Advertisers and Media That Ads May Be Deceptive* (June 1, 2007), available at <http://www.ftc.gov/opa/2007/09/mortsurf.shtm>.

servicer Countrywide Home Loans, Inc., obtaining \$144 million in consumer redress to settle the action.¹⁴

The Commission also has waged an active campaign to protect consumers who are having difficulty making their monthly mortgage payments. Many of these consumers fall prey to mortgage relief scams that falsely promise to obtain loan modifications or help them avoid foreclosure. In the last five years, the FTC has filed 38 actions and obtained more than \$174 million in judgments against mortgage assistance relief companies for violating Section 5 of the FTC Act or the Mortgage Assistance Relief Services (MARS) Rule.¹⁵

¹⁴ See Bank of America Subsidiary Reversing or Refunding \$36 Million in Fees to Resolve FTC Allegations That it Overcharged Struggling Homeowners (Feb. 9, 2012), available at <http://www.ftc.gov/opa/2012/02/bachomeloans.shtm>; FTC Returns Nearly \$108 Million to 450,000 Homeowners Overcharged by Countrywide for Loan Servicing Fees (June 20, 2011), available at <http://www.ftc.gov/opa/2011/07/countrywide.shtm>.

¹⁵ See *FTC v. Freedom Companies Marketing, Inc.*, No. 12-cv-5743 (N.D. Ill. July 23, 2012); *FTC v. Consumer Advocates Group Experts, LLC*, No. CV12-04736 (C.D. Cal. filed May 30, 2012); *FTC v. Sameer Lakhany*, No. SACV12-00337 CJC (C.D. Cal. filed Mar. 5, 2012); *FTC v. Mallett*, No. 1:11-cv-01664-CKK (D. D.C. filed Sep. 14, 2011); *FTC v. Phillip A. Flora*, No. SACV11-00299-AG-(JEMx) (C.D. Cal. filed Feb. 22, 2011); *FTC v. U.S. Mortgage Funding, Inc.*, No. 11-CV-80155-COHN (S.D. Fla. filed Feb. 7, 2011); *FTC v. Residential Relief Foundation, Inc.*, JFM 10 CV3214 (D. Md. Filed Nov. 15, 2010); *FTC v. U.S. Homeowners Relief, Inc.*, No. SA-CV-10-1452 JST (PJWx) (C.D. Cal. filed Sept. 27, 2010); *FTC v. National Hometeam Solutions, LLC*, No. 4:08-cv-067 (E.D. Tex. filed Aug. 30, 2010) (contempt action); *FTC v. Dominant Leads, LLC*, No. 1:10-cv-00997 (D.D.C. filed June 15, 2010); *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009); *FTC v. The Debt Advocacy Center, LLC*, No. 1:09-cv-2712 (N.D. Ohio filed Nov. 19, 2009); *FTC v. First Universal Lending, LLC*, No. 09-82322-CIV-ZLOCH (S.D. Fla. filed Nov. 18, 2009); *FTC v. Kirkland Young, LLC*, No. 09-23507 (S.D. Fla. filed Nov. 18, 2009); *FTC v. 1st Guaranty Mortgage Corp.*, No. 09-CV-61846 (S.D. Fla. filed Nov. 17, 2009); *FTC v. Washington Data Resources, Inc.*, No. 8:09-cv-2309-T-23 TMB (M.D. Fla. filed Nov. 12, 2009); *FTC v. Federal Housing Modification Dept.*, No. 1:09-cv-01753-RJL (D.D.C. filed Sept. 16, 2009); *FTC v. United Credit Adjusters*, No. 09-cv-00798 (D.N.J. amended complaint filed Aug. 4, 2009); *FTC v. Infinity Group Services*, No. 8:09-cv-00977-DOC-MLG (C.D. Cal. filed Aug. 4, 2009); *FTC v. Lucas Law Center*, No. SA-CV-09-770 DOC (ANx) (C.D. Cal. filed July 17, 2009); *FTC v. Apply2Save, Inc.*, No. 09-00345-EJL (D. Idaho filed July 15, 2009); *FTC v. Loss Mitigation Services, Inc.*, SA-CV-09-800 DOC (ANx) (C.D. Cal. filed July 13, 2009); *FTC v. US Foreclosure Relief Corp.*, SA-CV-09-768 JVS (MLGx) (C.D. Cal. filed July 7, 2009); *FTC v. Freedom Foreclosure Prevention Services, LLC*, No. 09-1167 (D. Az. filed June 1, 2009); *FTC v. Data Medical Capital, Inc.*, No. SA-CV-99-1266 AHS (EEx) (C.D. Cal. filed May 27, 2009) (contempt action); *FTC v. Dinamica Financiera LLC*, No. 09-CV-03554 (C.D. Cal. filed May 19, 2009); *FTC v. Sean Cantkier*, No. 1:09-cv-00894 (CKK) (D.D.C. filed May 14, 2009); *FTC v. Federal Loan Modification Law Center, LLP*, No. SA-CV-09-401-CJC (MLGx) (C.D. Cal. filed April 3, 2009); *FTC v. Home Assure LLC*, No. 8:09-cv-547-T-23TBM (M.D. Fla. filed March 24, 2009); *FTC v. Thomas Ryan*, No. 1:09-cv-00535-HHK (D.D.C. filed March 20, 2009); *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. filed March 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. filed March 17, 2009); *FTC v. National Foreclosure Relief, Inc.*, No. 8:09-cv-00117-DOC-MLG (C.D. Cal. filed Feb. 2, 2009); *FTC v. United Home Savers*, No. 8:08-cv-01735-VMC-TBM (M.D. Fla. Filed Sept. 3, 2008); *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075-SO (N.D. Ohio filed Apr. 28, 2008); *FTC v. Safe Harbour Foundation of Florida, Inc.*, No. 1:08-cv-01185 (N.D. Ill. filed Feb. 27, 2008); *FTC v. National Hometeam Solutions, LLC*, No. 4:08-cv-00067-RAS (E.D. Tex. filed Feb. 26, 2008); *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv-00388-SDM-EAJ (M.D. Fla. filed Feb. 26, 2008).

2. Rulemaking

The FTC has used its prior rulemaking authority to create new protections for consumers of mortgage loans. Most recently, the FTC promulgated two rules designed to protect consumers in connection with mortgage lending, both pursuant to the Omnibus Appropriations Act of 2009 (as clarified by the Credit CARD Act).¹⁶

First, in July 2011, the FTC issued the Mortgage Acts and Practices (MAP) Advertising Rule.¹⁷ The MAP Advertising Rule prohibits advertisers of mortgage credit products from making material misrepresentations regarding the key characteristics of loans, including the interest charged; the annual percentage rate; the existence, nature, or amounts of fees or costs to the consumer; and the variability of interest, payments, or other terms of a mortgage.¹⁸

Second, in December 2010, the Commission used its rulemaking authority under the Omnibus Appropriations Act of 2009 to issue the Mortgage Assistance Relief Services (MARS) Rule, which prohibits unfair and deceptive conduct by third-party providers of loan modification or other mortgage relief services.¹⁹ The MARS Rule specifically prohibits these companies from charging advance fees to consumers; requires that they disclose key information regarding their services; and prohibits them from making material misrepresentations.²⁰

Under the Dodd-Frank Act, the FTC's authority to issue rules to implement the Omnibus Appropriations Act of 2009 transferred to the CFPB.²¹ In December 2011, the CFPB reissued the MAP Advertising Rule without substantive modification as "Regulation N."²² At the same time, the CFPB reissued the MARS Rule without substantive modification as "Regulation O."²³

The MAP and MARS Rules (now reissued as Regulations N and O, respectively) confer significant protections on consumers of mortgage loans. Under the Dodd-Frank Act, the

¹⁶ See *supra* note 8.

¹⁷ 76 Fed. Reg. 43826 (July 22, 2011).

¹⁸ 12 C.F.R. § 1014.3.

¹⁹ 75 Fed. Reg. 75092 (Dec. 1, 2010).

²⁰ 12 C.F.R. §§ 1015.3 - 1015.5.

²¹ Although the FTC retains law enforcement authority for the MAP and MARS Rules, its rulemaking authority was transferred to the CFPB, effective July 21, 2011, under the Dodd-Frank Act. See §§ 1061, 1097, 12 U.S.C. §§ 5581, 5538.

²² 76 Fed. Reg. 78130 (Dec. 16, 2011), *see also* 12 C.F.R. Part 1014.

²³ 76 Fed. Reg. 78130 (Dec. 16, 2011); *see also* 12 C.F.R. Part 1015.

Commission retains the authority to enforce these regulatory requirements, and the agency is actively enforcing these rules.²⁴

3. Consumer Education

In mortgage lending, as in other financial areas, consumer education can help prevent a great deal of harm. The FTC has published a wide variety of consumer education pieces and alerts on mortgage lending to assist consumers of mortgage products to make well-informed decisions, and avoid deceptive and unfair practices.²⁵ The Commission's online library of consumer education addresses many important steps of the mortgage borrowing process, including mortgage advertising, tips on shopping for a mortgage loan, working with a mortgage servicer, home equity loans, and dealing with monthly mortgage payments. The Commission also has published and widely distributed numerous alerts to help consumers avoid deceptive practices and scams, like certain mortgage loan modification and foreclosure rescue services.

4. Research and Policy Development

The FTC staff conducted studies in 2004 and 2007 testing the impact of mortgage disclosures and has advocated for comprehensive reform of the current disclosure regime under RESPA and TILA. This research has shown that then-current mortgage disclosures did not effectively help consumers make better-informed decisions.

In 2007, the Commission's Bureau of Economics released a research report, "Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms."²⁶ FTC staff used both qualitative and quantitative research to compile this report. The FTC staff's quantitative testing was the first comprehensive, quantitative assessment of then-existing mortgage disclosures. The study examined how consumers search for mortgages, how well they understand cost disclosures and the terms of their own loans, and whether better disclosures could help them shop for mortgage loans and avoid deceptive lending practices. The

²⁴ In fact, the Commission has already filed four lawsuits against companies for alleged violations of the MARS Rule. See *FTC v. Freedom Companies Marketing, Inc.*, No. 12cv5743 (N.D. Ill. filed July 23, 2012); *FTC v. Consumer Advocates Group Experts, LLC*, No. CV12-04736 (C.D. Cal. filed May 30, 2012); *FTC v. Sameer Lakhany*, Case No. SACV12-00337 CJC (C.D. Cal. filed Mar. 5, 2012); *FTC v. Mallett*, No. 1:11-cv-01664-CKK (D. D.C. filed Sep. 14, 2011).

²⁵ These educational publications are available at <http://www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm>.

²⁶ See James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, FTC Bureau of Economics Staff Report (2007), available at <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>. FTC staff also released an earlier report on mortgage disclosures that presented the results of controlled, quantitative testing of mortgage broker compensation disclosures proposed by the U.S. Department of Housing and Urban Development (HUD), finding that the proposed disclosures confused consumers and led many to choose more expensive loans. See Lacko and Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: a Controlled Experiment*, FTC Bureau of Economics Staff Report (2004), available at <http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf>.

study was based on in-depth qualitative interviews with 36 consumers who had recently obtained a mortgage, and controlled quantitative testing of existing and prototype disclosures with over 800 mortgage customers. Among other issues, the qualitative interviews examined consumers' understanding of the disclosure documents they had received in their recent loans, which they were asked to bring to the interviews. During the quantitative testing, consumers were given disclosure forms for hypothetical mortgage loans and asked a series of objective questions to assess whether the forms effectively conveyed information on key loan terms. Half of the participants were given disclosures using the existing forms required by TILA and RESPA and half were given prototype disclosures developed by FTC staff for the study.²⁷

The study found that the then-existing mortgage disclosures failed to convey key mortgage terms and costs to many consumers and often resulted in confusion. The qualitative interviews revealed, for example, that many consumers mistakenly believed that the "amount financed" disclosed on the TILA statement of their recently obtained loan represented their total loan amount and that the "discount points" disclosed on the Good Faith Estimate was a discount they received (as opposed to a fee they paid). The quantitative testing demonstrated that many consumers viewing the existing disclosures could not correctly identify key loan provisions. More specifically, the testing showed that:

- About a fifth of the consumers could not correctly identify the APR of the loan, the amount of cash due at closing, or the monthly payment;
- Nearly a quarter could not identify the amount of settlement charges;
- About a third could not identify the interest rate;
- About a third did not recognize that the loan included a large balloon payment;
- A third did not recognize 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 they refinanced with another lender;
- Three-quarters did not recognize that substantial charges for optional credit insurance were included in the loan; and
- Nearly nine-tenths could not identify the total amount of up-front charges.

²⁷ HUD revised the Good Faith Estimate disclosures after the study was conducted. Thus, the study examined the then existing disclosures rather than those now required. *See* HUD, 24 C.F.R. Parts 203 and 3500, Real Estate Settlement Procedures Act (RESPA): Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs; Final Rule, 73 Fed. Reg. 68204-288 (Nov. 17, 2008).

The study also showed that consumers' understanding of mortgage terms and costs significantly improved when they were presented with clearer, prototype disclosures developed by FTC staff, demonstrating that better disclosures are possible. The study further concluded that, in efforts to improve mortgage disclosures, controlled quantitative consumer testing is important to help ensure that the new disclosures effectively convey key information to consumers.

In light of the FTC staff's research, Commission staff has advocated for improved mortgage disclosures and rigorous disclosure testing in public comments to other federal agencies. For example, in the period 2006-2008, FTC staff filed public comments to federal banking regulators working on improved disclosures to recommend the comprehensive reform of mortgage disclosure documents.²⁸ More recently, in other public comments filed with federal regulators regarding mortgage lending, FTC staff has advocated for stronger consumer protections under the TILA; broader data reporting under the Home Mortgage Disclosure Act; and guidance on deceptive practices in connection with reverse mortgages.²⁹

The Commission also has hosted two public conferences that focused on mortgage disclosure research and other important mortgage lending issues.³⁰

III. Recommendations Regarding Consumer Research and Mortgage Disclosures

FTC staff commends the CFPB for its efforts to consolidate and improve the disclosures consumers receive when shopping for and closing on a mortgage. The proposed new disclosures

²⁸ See FTC Staff Files Comments with HUD on Proposed Amendments to RESPA Regulations (June 16, 2008), available at <http://www.ftc.gov/opa/2008/06/respafyi.shtm>; FTC Staff Files Mortgage Disclosure Comments With Banking Agencies (Nov. 1, 2007), available at <http://www.ftc.gov/opa/2007/11/mortgage.shtm>; Commission Provides Federal Reserve Board with Comments on the Home Equity Lending Market (Sept. 19, 2006), available at <http://www.ftc.gov/opa/2006/09/fyi0661.shtm>.

²⁹ See FTC Staff Submits Comments to Federal Reserve on Making Fair Lending Law Stronger (Dec. 17, 2010), available at http://www.ftc.gov/opa/2010/12/hmda_fcra.shtm; FTC Submits Comments on Proposed Guidance to Help Consumers Avoid Reverse Mortgage Deception (Mar. 19, 2010), available at <http://www.ftc.gov/opa/2010/03/revmortgage.shtm>; FTC Approves Filing of Staff Comment to the Board of Governors of the Federal Reserve System Regarding Proposed Rule to Restrict Certain Mortgage Practices Under TILA (Apr. 16, 2008), available at <http://www.ftc.gov/opa/2008/04/frb.shtm>.

³⁰ In May 2008, the FTC's Bureau of Economics held a conference entitled "Consumer Information and the Mortgage Market," at which participating scholars shared their research on how disclosures and other forms of consumer information affect consumer choices, mortgage outcomes, and consumer welfare. At the conference, FTC economists and conference panelists discussed the FTC staff's mortgage disclosures study (detailed above). See "Consumer Information and the Mortgage Market" (May 2008), presentations and transcript available at <http://www.ftc.gov/be/workshops/mortgage/index.shtml>. Further, in May 2006, the Commission hosted a public workshop, "Protecting Consumers in the New Mortgage Marketplace," to explore the characteristics and potential risks of alternative mortgage products, such as interest-only loans and payment option ARMs. At this workshop, FTC staff and other panelists again emphasized the importance of clear disclosures for ensuring that consumers are in a position to make well-informed decisions about mortgage loans. See "Protecting Consumers in the New Mortgage Marketplace" (May 2006), transcript available at <http://www.ftc.gov/bcp/workshops/mortgage/index.shtml>.

hold great promise for improving the information consumers receive and their subsequent choices of mortgages. The new disclosures are likely to benefit consumers in several ways. First, combining the currently separate TILA and RESPA disclosures into a single document will make it much simpler for consumers to review key loan terms. Second, combining the forms also eliminates the possibility of inconsistent disclosures between forms, which can lead to consumer confusion. Third, the language and formatting in the new forms appears to be more effective than current forms in conveying key loan terms to consumers, in ways they can understand and use. Fourth, the new disclosures change or clarify some current disclosures that may be confusing.

FTC staff also commends the CFPB for its use of careful qualitative consumer research to develop, assess, and refine the proposed disclosures. This research involved ten rounds of qualitative testing conducted over a 10-month period.³¹ The CFPB also used innovative methods to solicit consumers' opinions on several rounds of disclosure forms posted on the agency's website, and received input from 27,000 consumers in this process.³² Obtaining input from consumers on the importance of various loan terms in their mortgage shopping decisions and on the usability of alternative designs for the language and format of the new forms is important to the development of effective disclosures. This type of research can improve the disclosures and help avoid forms that are confusing.

While qualitative consumer research suggests that the new disclosures are understandable and an improvement over current disclosures, quantitative consumer testing is an effective way of confirming that this is the case and can help ensure that consumers are not confused by the disclosures in the new form. For many consumers, purchasing a home or obtaining another home mortgage involves one of the largest and most important financial transactions of their lives. Given the importance of mortgage disclosures for consumers, FTC staff encourages the CFPB to conduct controlled quantitative testing prior to the final approval of the proposed disclosures to help ensure that the forms result in the greatest practicable level of consumer understanding.

A. The Value of Quantitative Testing for Developing Effective Disclosures

In the NPRM, the CFPB states that it “may conduct large-scale quantitative testing of the [proposed new disclosure] forms to confirm that the forms aid consumers’ understanding of mortgage transactions,”³³ and previously announced its intention to seek approval for quantitative testing from the Office of Management and Budget (OMB).³⁴ FTC staff encourages

³¹ See 77 Fed. Reg. at 51127-51128. Kleimann Communication Group, Inc. conducted the testing on the combined forms for the CFPB. Kleimann specializes in testing consumer financial disclosures and was used by the FTC and the Federal banking agencies to design and conduct consumer testing for revised model privacy disclosures. *Id.* at 51126.

³² See 77 Fed. Reg. at 51129.

³³ See 77 Fed. Reg. at 51129.

³⁴ CFPB, *Proposed Collection; Comment Request*, 77 Fed. Reg. 18793, 18794 (March 28, 2012).

the CFPB to test the proposed forms prior to finalizing the rule, including with use of control groups that allow for valid comparisons to existing forms. Controlled quantitative testing can help to ensure that the proposed disclosures effectively convey key mortgage terms to consumers, are not misinterpreted or misunderstood, and offer significant benefits over currently mandated disclosures.

Effective disclosures can greatly benefit consumers by reducing search costs, facilitating comparison shopping, preventing deception, improving purchase decisions, and promoting efficient markets. Ineffective disclosures may fail to provide such benefits – and may even do more harm than good. For example, as discussed above, FTC staff’s consumer testing of mortgage disclosures has shown that then- mandated disclosures failed to convey key information to many consumers and, in some cases, confused and misled them.³⁵

An established mechanism for testing the effectiveness of proposed disclosures is through controlled quantitative testing, in an experimental setting, with random assignment, using objective performance measures, with representative samples of relevant consumers, in large enough numbers to reach valid statistical conclusions. Quantitative testing can be conducted in either a “laboratory” environment using hypothetical mortgage loans or as part of a “real-world” field test using real loans in real transactions actually undertaken by consumers. Quantitative testing in either context would use similar methodology, including the use of controls, random assignment, objective performance measures, and representative samples of consumers. Several members of the mortgage industry have suggested that some form of “real-world” field testing be conducted.³⁶

³⁵ See Lacko and Pappalardo (2007), *supra* note 26 and accompanying text. See also Lacko and Pappalardo, *Improving Mortgage Disclosures: Consumer Testing of Current and Improved Disclosure Forms*, Presentation at the FTC Bureau of Economics Conference on Consumer Information and the Mortgage Market, May 29, 2008, available at http://www.ftc.gov/be/workshops/mortgage/presentations/Lacko_Pappalardo.pdf. Other research also has shown that ineffective attempts to improve disclosures can actually have the opposite effect and lead some consumers to make worse decisions. See Lacko and Pappalardo (2004), *supra* note 26 (2004 study examining HUD’s proposed mortgage broker compensation disclosures). In that study, which used controlled, quantitative testing of over 500 recent mortgage consumers, subjects were shown cost information on two hypothetical mortgage loans and asked which loan was less expensive and which they would choose if they were shopping for a mortgage. The proposed broker compensation disclosures were included in the cost information shown to some of the consumers, but were not included for others. The study found that the proposed disclosures confused consumers, significantly reduced the proportion that correctly identified the less expensive loan, and significantly increased the proportion choosing the more expensive loan as the one they would select if shopping for a mortgage.

³⁶ See, e.g., Mortgage Disclosures: How Do We Cut Red Tape for Consumers and Small Businesses?: Hearing Before the H. Comm. On Financial Servs. 112th Cong. 8 (2012) (statement of Bill Cosgrove, Mortgage Bankers Association: “Also, while the forms should continue to be tested on consumers, they must be carefully tested in conjunction with lenders and settlement service providers on real loans.”); *id.* at 3 (statement of Housing Policy Council: “After the Bureau issues proposed rules and forms but before they are finalized, we continue to urge the Bureau to establish a trial program with a few lenders using the new forms in real world transactions.”); *id.* at 9–10 (statement of Mr. Chris Abbinante, American Land Title Ass’n: “[Q]ualitative testing of disclosures should take place in the context of the greater transaction. During the last round of RESPA Reform in 2002-2009, consumer testing took place in a vacuum where the testing of the GFE and HUD-1 were conducted individually instead of as part of an actual loan and real estate transaction. While the new forms passed that testing, many ALTA members today find that consumers are having a more difficult time, rather than a less difficult time, understanding their

Although qualitative research, such as focus groups and in-depth interviews, allows for detailed, open-ended exploration of issues, and can provide valuable preliminary insight when developing and assessing consumer disclosures, it also has limitations. Qualitative testing is typically limited to the examination of small, non-representative samples of consumers. Thus, the results cannot be projected to the larger population of interest, and statistical findings and comparisons are not possible. Additionally, qualitative studies usually employ less structured and standardized lines of questioning, which make it difficult to compare responses across subjects. The interactive nature of the questioning also raises the possibility that subjects' responses will be influenced by the statements or questions of the interviewer (or, in group settings, interactions with other subjects).³⁷

Quantitative testing, on the other hand, typically involves larger, representative samples of consumers, in a controlled, experimental setting. This approach yields statistically valid results that can be projected to the larger population of interest. Quantitative testing also uses structured survey instruments that ask the same questions to all subjects, allowing for precise aggregation of the responses and comparisons between treatment and control groups.

The importance of quantitative testing is widely recognized, including in publications by the Federal Reserve Board³⁸ and the OMB³⁹ – as well as in the report submitted to the CFPB by

costs.”); *id.* at 3 (statement of Anne C. Canfield, Consumer Mortgage Coalition: “[O]nce the new draft disclosures are designed, they need to be tested on actual closed loans across all available loan products to ensure that they actually work.”); *id.* at 8 (statement of Independent Community Bankers of America: “ICBA recommends that the CFPB conduct a BETA test of the finalized forms and proposed TILA/RESPA rules on real loan transactions done by community banks, large banks, and small and large mortgage bankers.”).

³⁷ The qualitative testing conducted by the CFPB, for example, used a sample of 92 consumers spread across 10 different testing sessions, with most sessions evaluating two alternative disclosure designs (with subjects viewing both alternatives in some sessions and primarily a single alternative in others), using multiple loan products. In addition, the CFPB also released information about and posted prototype forms on their Web site, obtaining feedback and comments from the public. The CFPB received over 150,000 visits to this Web site and over 27,000 public comments and emails about the prototype disclosures. This latter approach creatively solicited information about the disclosures from consumers (or other parties, such as industry representatives), who chose to respond and provide feedback or their views. However, it did not involve quantitative testing or utilize a random or representative sample of respondents, and did not test specific consumer understanding of the disclosures.

³⁸ See Jeanne M. Hogarth and Ellen A. Merry, *Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing*, Federal Reserve Bulletin, Vol. 97(3), August 2011, at 8-9, available at <http://www.federalreserve.gov/pubs/bulletin/2011/pdf/designingdisclosures2011.pdf> (“Including a quantitative validation phase in the study design can help determine whether the changes based on findings from the small samples used in qualitative testing actually result in improvements when tested with a larger and statistically representative sample of the population. . . . Unlike focus groups or individual interviews, consumer surveys can be used to assess whether alternative disclosure designs can improve consumer comprehension by a statistically significant amount.”).

³⁹ See Executive Office of the President, OMB, Office of Information and Regulatory Affairs, Cass R. Sunstein, Administrator, *Disclosure and Simplification as Regulatory Tools*, Memorandum for the Heads of Executive Departments and Agencies, June 18, 2010, at 5, available at http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure_principles.pdf (“To the extent feasible, agencies should test, in advance, the likely effects of summary disclosure, and should also monitor the effects of such disclosure over time. . . . Scientifically valid experiments are generally preferable to focus group testing, and

the communications firm that assisted in the development of the proposed disclosures and conducted the qualitative testing.⁴⁰ Although careful and innovative qualitative research was clearly instrumental in the CFPB’s development of the proposed disclosures, and it suggests that these disclosures are an improvement over current disclosures, quantitative research can test and confirm this hypothesis.

B. Two Key Elements of Quantitative Testing

FTC staff notes that two elements of quantitative testing are particularly important. First, quantitative testing should focus on the actual performance of the disclosures in conveying the desired information to consumers, rather than consumers’ opinions about the disclosures, their preferences for alternative designs, or whether they believe they understand the information. Research conducted by FTC staff has demonstrated that consumers sometimes incorrectly believe that they understand a disclosure, when in fact they do not.⁴¹

Second, FTC staff recommends including an appropriate control group in the study design. This allows the study to isolate and measure the impact of the proposed disclosure. If

randomized experiments can be especially valuable.”); Executive Office of the President, OMB, Office of Information and Regulatory Affairs, John D. Graham, Administrator, *Guidance on Agency Survey and Statistical Information Collections*, Memorandum for the President’s Management Council, January 20, 2006, at 16-17, available at http://www.whitehouse.gov/sites/default/files/omb/assets/omb/inforeg/pmc_survey_guidance_2006.pdf (“In a qualitative study . . . the sample is usually not representative—in a statistical sense—of any larger population. However, the obtained information may be very useful in generating hypotheses that can be tested more systematically with other methods such as quantitative surveys. Sometimes qualitative studies are done in conjunction with or as a component of a larger quantitative study to obtain further insights or context for the results; however, these qualitative interpretations can be prone to misinterpretation and over-generalization. . . . Agencies need to acknowledge the limitations of data gathered using these methods and not generalize the data beyond those persons or entities that were interviewed. These studies should usually be considered preliminary, and will often need to be followed with a larger-scale, representative study.”)

⁴⁰ See Kleimann Communication Group, Inc., *Know Before You Owe: Evolution of the Integrated TILA-RESPA Disclosures*, Presented to the Consumer Financial Protection Bureau (July 9, 2012) at 40, available at http://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf (“Qualitative testing is not statistically based. In fact, the sample for qualitative testing is relatively small. The results are not generalizable to a larger population, but they are not meant to be. . . . A user-centered design project often includes a validation study as its fourth phase. These studies are quantitative in nature, use large samples, and aim for statistically significant results. Because our project took place before the notice and comment period for the disclosures, no quantitative validation study was conducted. The CFPB may undertake such a study after the notice and comment period.”); *id.* at 26 (“A quantitative test provides statistical data and evidence about the performance of the disclosure.”); *id.* at 32 (“The goal of qualitative usability testing is not to develop statistical results; that is the scope of the quantitative validation in user-centered design. In qualitative usability testing, we remain focused on design and how consumers interact with the design, and a small sample size is typical.”).

⁴¹ See Lacko and Pappalardo (2007), *supra* note 26 and accompanying text. As noted above, the qualitative interviews conducted for the staff’s 2007 mortgage disclosure study found that many consumers mistakenly believed that the “amount financed” disclosed on the TILA statement of their recently obtained loan was their total loan amount, and others believed that the “discount points” disclosed on their Good Faith Estimate was a discount they received, as opposed to a fee they paid. Presumably, if these consumers had been asked if they understood these terms, and nothing more, they would have incorrectly reported that they did.

the proposed disclosure is intended to replace an existing one, as is the case here, the appropriate control group should consist of subjects using the currently required disclosures.⁴² Subjects in both the current and revised disclosure groups would view disclosures based on the same loans and be asked the same questions. The impact of the revised disclosures could be measured by comparing the results of the two groups. Although there may be some information elements in the new forms proposed by the CFPB that do not appear in the current forms, thus making controls for those elements unavailable, there are numerous other elements that appear in both forms and which could be directly compared through the use of a control.

The comparison provided by the control group makes the test results clearer. The tests may show, for example, that the revised disclosure is not understood by a significant proportion of consumers, but a control group might confirm that the new disclosure still represents a substantial improvement over the current disclosure. Conversely, the tests may show that nearly all consumers understand the revised disclosure, but a control group might show that the same is true for the current disclosure, indicating that the revision provides little additional benefit.

IV. Conclusion

FTC staff supports the CFPB's efforts to develop improved mortgage disclosures designed to help consumers make better-informed decisions about mortgages, and believes that the CFPB disclosures are likely to improve the information that consumers currently receive under federal law. Based on the FTC staff's research and the Commission's law enforcement experience in this area, FTC staff encourages the CFPB to conduct controlled quantitative testing of the proposed disclosures prior to finalizing a rule. FTC staff hopes that its recommendations prove useful to the CFPB's efforts and appreciates your consideration of them. If you have any questions about this comment or would like additional information, please contact James Lacko, Deputy Assistant Director for the Bureau of Economics, at (202) 326-3387, or Carole Reynolds, Senior Attorney, Division of Financial Practices, at (202) 326-3230.

⁴² One also could include additional groups to test alternative designs for the revised disclosure.

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