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A Chance to Make Mortgage Shopping Easier

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MORTGAGE rates are very low, but some people who could qualify for cheap refinancing are procrastinating. That may be because shopping for a mortgage can make root canal surgery seem fun.

Choosing a home and mortgage is probably the largest financial decision that most Americans ever make. Yet perhaps because the **loan** process is so onerous and opaque, many take the first quote they are offered. In fact, **research shows** that people typically spend more time shopping for a car or vacation than for a mortgage, and I suspect that many families spend as much or more time picking out a microwave oven.

Shirking on mortgage shopping is a costly type of sloth. Other research, done for the Department of Housing and Urban Development, **finds that most borrowers** could save several thousand dollars by getting just one more quote.

Now is a propitious time for raising these issues because the new **Consumer Financial Protection Bureau** is undertaking a Congressionally mandated revision of some disclosure forms that are required by law. (Disclosure: Along with **John G. Lynch Jr.**, a professor at the University of Colorado, I met with bureau staff members last month to discuss this proposal from a behavioral science perspective.)

The bureau's goals should be to make mortgage shopping easier and more efficient, and to make the industry more transparent and competitive, all while reducing the kinds of bad loans that helped create the financial crisis.

One form is of particular importance. It's the "loan estimate," a paper copy of which must go to borrowers within three days of application for a loan.

The bureau's research team did extensive testing to decide what data should be included on this new form. It proposed a three-page version containing more than 100 pieces of information, including the interest rate, charges for various services and whether features like prepayment penalties or balloon payments were part of the deal.

The designers had to make formatting choices — which numbers should go where on the form, in what size and font, and so forth. There are nearly endless possibilities — and the choices are important because design influences consumer behavior.

A good example involves the annual percentage rate, which has been required to be reported since 1968. Because tests showed that this number often confused consumers, the bureau chose to put it on the third page of the form. **Some critics say it should be displayed more prominently**, but most economists agree that the A.P.R. can be a misleading measure of a loan's cost.

The A.P.R. is an estimate of total loan costs, including fees, expressed as an interest rate. Two factors complicate its usefulness. First, it is calculated by assuming that the loan will be held for the entire term, typically 30 years, amortizing the fees over those years. But most mortgages are repaid much sooner, either because the homeowner sells the home or refinances the loan. This is especially true for adjustable-rate mortgages with initially low teaser rates.

If borrowers refinance after three years, for example, but the A.P.R. is calculated over a 30-year period, the total costs of the loan are greatly understated, and can wrongly steer borrowers toward loans with higher upfront fees.

The second problem is that the A.P.R. for an adjustable-rate mortgage is simply a guess, because it is calculated by assuming that interest rates will never change. Because rates are currently at historic lows, it is likely that anyone who actually holds a 30-year adjustable mortgage for its full life will pay a higher rate at some point in the future.

The bottom line is that there is no single correct way to design this form or to calculate the A.P.R. But one small change would make all of these issues less important, while sharply improving consumers' ability to shop around.

All the bureau needs to do is to give borrowers the right to receive the disclosure in a machine-readable version — meaning that the information would be stored in a way that allows easy processing by computers.

The move would be in keeping with the Obama administration's "**smart disclosure**" initiative "to expand consumers' access to data that helps them make better informed decisions." And it wouldn't impose significant additional costs on lenders because the regulation already wisely requires lenders to keep records of the loan estimate forms in an "electronic, machine-readable format" to demonstrate compliance.

If banks are already storing this information electronically, it would be straightforward for them to transmit it to borrowers in a secure, confidential way. In fact, that should be cheaper for the lender, especially if the alternative is an overnight delivery service. With a machine-readable version, a mortgage shopper could then upload the information to any number of Web sites or applications that would serve as intelligent “choice engines.” Some might be nonprofit organizations that could alert borrowers to usually high fees or potentially dangerous features. Others could be commercial sites, similar to the various travel Web sites that many of us use to book airline tickets and hotels. But unlike some of those sites, these would reveal all fees, not shroud them. (Think baggage fees and required valet parking.)

Choice engines would also vastly improve upon existing Web sites for mortgage shopping that don’t provide consumers with all the details they need to evaluate loans. (It’s a bit like trying to choose a flight online if the only information you receive about the destination is “somewhere in Florida.”) And the option of electronic transmission to consumers would solve the problems of a cumbersome, inefficient paper-only system, which would require them to either scan the forms they receive or manually enter myriad pieces of data.

MACHINE-READABLE disclosure also makes the form’s physical design less crucial. That’s because choice engines would analyze every number, no matter where on the form, and emphasize specific numbers for individual borrowers. For example, if you plan to refinance after three years, the A.P.R.’s of various loans could be calculated accordingly. If you tend to be absent-minded about making payments, late fees could be highlighted. These features would indeed make the disclosure process “smart.”

If the bureau can’t modify the rule in this way now, here’s a challenge to lenders who want to compete by offering transparency and low rates: Why not unilaterally give all prospective borrowers complete information about your loans in a machine-readable format as soon as you provide the initial quote?

If enough lenders do this — listen up, credit unions, community banks and online lenders — the cottage industry of online mortgage advisers could get a jump-start, and mortgage shopping could finally enter the 21st century.

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This article has been revised to reflect the following correction:

Correction: August 26, 2012

The Economic View column last Sunday, about a proposal to make mortgage shopping easier for borrowers, misstated part of the name of the new agency undertaking a revision of some loan disclosure forms. It is the Consumer Financial Protection Bureau, not the Consumer Finance Protection Bureau.