SUMMARY OF FINDINGS

# Consumer Testing of Mortgage Broker Disclosures

*Submitted to:*

Board of Governors of the Federal Reserve System

*Submitted by:*

MACRO INTERNATIONAL INC.

July 10, 2008

# Consumer Testing of Mortgage Broker Disclosures

## Summary of Findings

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# Executive Summary

# Executive Summary

In January 2008 the Board of Governors of the Federal Reserve System (the Board) issued proposed amendments to Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA).[1] The purposes of the amendments were to restrict home mortgage lending and servicing practices that the Board found to be unfair or deceptive; to ensure that mortgage loan advertisements are accurate, balanced, and not misleading; and to require that certain disclosures be provided to consumers earlier in the mortgage loan process. One of the Board's proposed amendments would prohibit creditors from paying mortgage brokers unless the mortgage broker disclosed to potential customers three things: a) the total amount of compensation that the broker will receive for arranging a loan; b) that the consumer will pay that entire amount, even if some or all is paid by the lender; and c) that such a payment from a lender could influence the broker to offer the consumer loan terms or products that are not the most favorable the consumer could obtain. Under the proposed rule, these disclosures would have to be provided early in the mortgage transaction, before the consumer submits a loan application or pays any fee.

The Board's proposed amendments included model language that was intended to provide the above disclosures in a manner that would be clear and understandable to consumers. The Board contracted with Macro International to test this model language through a series of cognitive in-depth interviews with consumers. The goal of these interviews was to assess how clearly the model language communicated the intended content, and to help the Board make any necessary revisions to make the language more effective.

## Methodology

Macro conducted four rounds of consumer testing in March through May 2008: two in Washington, DC, and one each in Los Angeles, CA and Kansas City, KS. A total of 35 separate interviews were completed: 31 with individuals and 4 with couples who had jointly made mortgage decisions. Interviews lasted between 60 and 90 minutes. Participants for the interviews were recruited by telephone, and were selected because they had all obtained or refinanced a mortgage in the past two years. Potential participants were also screened to include a range of ethnicities, ages, and education levels. In an effort to ensure that interviews were conducted with subprime as well as prime borrowers, Macro and Board staff developed a series of three questions about participants' credit history and current mortgage interest rates which were used as a proxy for such borrowers.

For each round of testing, Macro and Board staff developed an agreement for a fictional broker that included the information about broker compensation as required in the Board's proposal. In the interviews, participants were asked to imagine that they had met with a broker who had given them this agreement to read and sign. As they read the agreement participants, were asked to communicate their reactions to it, including whether they found any information surprising and how they perceived the broker who had given it to them. After they finished reading, they were then asked a series of follow-up questions to test their understanding of what the agreement was trying to communicate.

[1] As of July 8, 2008, the Federal Register notice for this proposed amendment could be found at: http://edocket.access.gpo.gov/2008/pdf/E7-25058.pdf.

Following each round of interviews, Macro and Board staff discussed what had and had not worked well. Macro then revised the agreement for use in the next round that was intended to address any comprehension problems that had become apparent. This iterative process continued through all four rounds of testing.

### Findings

The agreements that were tested, particularly later versions that were revised based on results from early interviews, were successful at communicating certain pieces of information to participants. For example:

- The language used in all rounds successfully communicated the amount of the broker's commission to participants, as well as the fact that they would have to pay that commission. Some participants in early rounds incorrectly believed that they would have to pay this commission regardless of whether they closed on a loan through that broker; this misconception was addressed through revisions in the language.
- Participants in the first round of testing did not understand a key implication of the agreements—that the best way to ensure that they received a loan with favorable terms was to shop among different brokers and lenders. Because Board staff identified this as an important communication goal, an explicit statement about the importance of shopping was added to the agreements that were tested in later rounds. These later versions were more effective in communicating to participants the importance of shopping for a mortgage.

However, Macro's testing showed that several other comprehension issues remained, despite repeated attempts to address them through revisions of the agreement. These misunderstandings included:

- Most participants who read the agreements did not understand how lender payments to brokers created a financial incentive for brokers to provide loans with higher interest rates. While some initially understood that brokers receive more compensation for providing loans with a higher interest rate, this fact was extremely counter-intuitive to participants—many of whom had previously assumed that a broker would work in their best interest. As a result, a significant number had difficulties comprehending and rationalizing the conflict of interest described in the agreement.
- A key reason that participants had difficulty understanding this conflict of interest is that many did not understand how the interest rate on their loan is determined, and thus did not realize that brokers have influence over the rates they offer their customers. Some participants assumed that the interest rates that brokers provided were set by the lender based on creditworthiness alone, and did not know that the broker could have latitude in deciding which loans and what interest rates to offer.

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- In some cases, the broker agreement seemed to bias participants against working with a broker—particularly those who learned for the first time that brokers' compensation depends on the interest rates of the loans they offer. To address this bias, an explicit statement was added to the agreement that loan officers who work for lenders have the same conflict of interest as brokers, and that as a result borrowers would not necessarily save money by working directly with a lender. Despite this statement, however, some participants still believed that they would pay less commission when working directly with a lender.

- In some cases, the agreements being tested also led to an additional bias against brokers that was unrelated to any conflict of interest. Some participants were uncomfortable that a broker would discuss his or her commission in such detail before providing any services, and felt that this showed the broker was overly concerned with his or her own compensation.

- Several participants in different rounds commented that they found the broker agreement internally inconsistent in that it seemed to fix the commission at a certain amount but then stated that the broker received greater compensation for providing loans with higher interest rates. When asked how they would resolve this perceived contradiction, participants either ignored the text about increases in broker compensation and assumed that the amount was fixed, or assumed that the broker would receive a separate payment from lenders in addition to the amount shown. This latter belief—that the broker would receive two separate payments—often led to bias against the broker.

- Participants in the first three rounds did not understand that if a lender paid all or some of the broker commission, it would mean that the interest rate on their loan was higher than it otherwise could be. Most thought that language about lender payment of the commission was simply informing them that they could "roll" the fee into their loan. In the final round of testing in Kansas City this comprehension issue was addressed by explicitly stating in the broker agreement the different ways that a borrower could pay the commission. However, even when it was explained that their interest rate would be higher if the lender paid the broker's commission, participants did not connect this to the conflict of interest mentioned elsewhere in the agreement.

# Introduction

# Introduction

## Background

On January 9, 2008, the Board of Governors of the Federal Reserve System issued proposed amendments to Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA).[2] The purposes of the amendments were to restrict home mortgage lending and servicing practices that the Board found to be unfair or deceptive; to ensure that mortgage loan advertisements are accurate, balanced, and not misleading; and to require that certain disclosures be provided to consumers earlier in the mortgage loan process.

One of the Board's proposed amendments would prohibit creditors from paying mortgage brokers unless the mortgage broker disclosed to potential customers three things: a) the total amount of compensation that the broker will receive for arranging a loan; b) that the consumer will pay that entire amount, even if some or all is paid by the lender; and c) that such a payment from a lender could influence the broker to offer the consumer loan terms or products that are not the most favorable the consumer could obtain. Under the proposed rule, these disclosures would have to be made before the consumer submits a mortgage application or pays any fee in connection with the transaction. The rationale for this proposed rule was that consumers are not aware that brokers receive payments from lenders that are based on the interest rate of the loan or other loan features. Moreover, the Board stated in its proposal, many consumers incorrectly assume that brokers are working "in their best interest"—that is, that the loans brokers arrange have the best terms available to the consumer. As a result, consumers may not see any need to shop with other lenders or brokers to find the best loan.

The Board's proposed rule included model language that was intended to provide the disclosures described above to consumers in a clear and easily understandable manner. In order to test the effectiveness of this model language, the Board contracted with Macro International to conduct a series of cognitive in-depth interviews with consumers. The goal of these interviews was to assess how clearly the model language communicated the intended content, and to help the Board make any necessary revisions to the language to make it more effective.

As part of this project, Macro conducted a total of four rounds of testing. A total of 35 separate interviews were completed. In most cases these interviews were with individuals—however, in four cases, couples who had jointly made a mortgage decision were interviewed together (Table 1).




[2] As of July 8, 2008, the Federal Register notice for this proposed amendment could be found at: http://edocket.access.gpo.gov/2008/pdf/E7-25058.pdf.

*Table 1: Interviews of Participants*

| Location | Date of Interviews | Total Interviews | Dyad Interviews (Couples) |
|---|---|---|---|
| Washington, DC | March 4 & 6, 2008 | 7 | 0 |
| Los Angeles, CA | March 25-26, 2008 | 7 | 1 |
| Washington, DC | April 30 & May 1, 2008 | 10 | 0 |
| Kansas City, KS | May 13-14, 2008 | 11 | 3 |
| **Total** | | **35** | **4** |

### Recruitment of Participants

Interview participants were recruited by telephone using a structured screening instrument developed by Macro International and Board staff. Participation was limited to people who had obtained or refinanced a mortgage in the past two years and were the primary mortgage decision-maker in their households. Participants were screened out if they worked for a bank or other financial institution, or if they worked in the real estate or mortgage industry. Other questions ensured the recruitment of participants with a range of ethnicities, ages, education levels, and mortgage behavior. The recruiting screener used for the final round of interviews in Kansas City is provided as Appendix A; while the screener for other rounds varied slightly, the intent of the screening questions was essentially the same.

Table 2 provides a summary of information about the interview participants and their mortgage history. A more detailed table, which includes the breakdown for each round of testing, is provided in Appendix B.

One of Board staff's recruiting goals was to ensure that interviews were conducted with both prime and subprime borrowers. Because many consumers do not know their credit scores or are reluctant to share them, it was determined that credit score could not be used as a screening variable for the purposes of recruiting. Therefore, participants were defined as "subprime" if they had: a) suffered a "financial hardship" such as bankruptcy, foreclosure, repossession, or a tax lien in the past seven years; b) been denied credit or discouraged from applying for credit in the past two years; or c) received an interest rate higher than 8 percent on their most recent first mortgage (or 10 percent on their most recent second mortgage). These cutoff points on the interest rate screening questions for borrowers with subprime loans were set to be roughly consistent with the Home Mortgage Disclosure Act (HMDA) APR-based thresholds for reporting higher-priced loans over the 2006-2007 period. Twelve of the 35 interviews qualified as "subprime" using this proxy definition.

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*Table 2: Summary of Participant Background Information (N=35)*[3,4]

| Personal Information | |
|---|---|
| **Gender** | |
| Male | 13 (37%) |
| Female | 22 (63%) |
| **Age** | |
| 18-35 | 11 (31%) |
| 36+ | 24 (69%) |
| **Race** | |
| Caucasian | 16 (46%) |
| African-American | 15 (43%) |
| Hispanic | 4 (11%) |
| **Education Level** | |
| High school or less | 4 (11%) |
| Some college or more | 31 (89%) |
| **Current Number of Mortgages on Primary Residence** | |
| One | 31 (89%) |
| Two or more | 4 (11%) |
| **Adjustable Rate Mortgage in Past 5 Years?** | |
| Yes | 22 (63%) |
| No | 13 (37%) |
| **Financial Hardship (e.g., bankruptcy, foreclosure) in Past 7 Years?**[5] | |
| Yes | 1 (3%) |
| No | 34 (97%) |
| **Denied Credit or Discouraged From Applying in Past 2 years?**[5] | |
| Yes | 7 (20%) |
| No | 28 (80%) |
| **Information About Most Recent Mortgage Loan** | |
| **Reason for Loan** | |
| Refinance | 20 (57%) |
| Home purchase | 15 (43%) |
| **Method of Obtaining Loan** | |
| Through broker | 9 (26%) |
| Directly from lender | 24 (69%) |
| Don't know | 2 (6%) |
| **FHA or VA Loan?** | |
| Yes | 5 (14%) |
| No | 30 (85%) |
| **First-Time Home Buyer?**[6] | |
| Yes | 7 (47%) |
| No | 8 (53%) |
| **Current Interest Rate Above the Threshold?**[5,7] | |
| Yes | 4 (11%) |
| No | 31 (89%) |

3 Percentages may not add to 100 because of rounding.
4 In the case of dyad interviews, the information shown in Table 2 is from the member of the dyad who was recruited and screened by telephone.
5 Participants' responses to these three questions were used to identify them as likely prime or subprime borrowers.
6 Only respondents whose most recent mortgage was for a home purchase (as opposed to a refinance) answered this question.
7 Respondents were classified as "subprime" if they reported having an interest rate higher than 8 percent for a first mortgage and 10 percent for a second or third mortgage. These cutoff points were set to be roughly consistent with the Home Mortgage Disclosure Act (HMDA) APR-based thresholds for reporting higher-priced loans over the 2006-2007 period.

# Introduction

## Structure of Report

In the remainder of this report, each of the four rounds of testing is addressed in a separate chapter. Each chapter reviews the goals of that round, as well as the structure of the interview protocol and changes that were made to the documents that were tested. It then provides a summary of the findings from that set of interviews. At the conclusion of the report, we provide an overall summary of findings from all four rounds combined.

# Round One of Testing

## Washington, DC

March 4 & 6, 2008

# Round One of Testing
## Washington, DC / March 4 & 6, 2008

### Goals and Structure of Testing

The first round of testing consisted of seven in-depth interviews in Washington, DC. The goal of this round of testing was to evaluate how successfully the proposed language communicated to participants that:

a. The borrower will be responsible for paying the broker the fee shown on the agreement;

b. If the lender pays this fee the borrower will end up paying it back to the lender through a higher interest rate; and

c. If the broker receives this payment from a lender, the broker has an incentive to arrange a loan with a higher interest rate.

At the beginning of the interview each participant was asked to describe his or her experience shopping for and obtaining mortgages in the past two years. The purpose of this section of the interview was to learn more about how participants made decisions related to their mortgage, as well as their understanding of the loan application process.

Two different broker agreements were used in this round of testing. Version A was for a fictional broker named "Home Safe Loans" and was based on a model broker agreement that originally was developed by industry. Variations of this agreement have been used widely in a number of states. For comparison purposes, a second agreement (Version B, for a fictional broker named "EZ Loans") was used that contained elements of another agreement in use in the market. Both were titled "Mortgage Loan Origination Agreement," and began with two paragraphs describing the nature of the relationship between the applicant and the broker. The most important difference between the two agreements was the section titled "Our Compensation." In both cases, this section indicated that the brokers' fee would be $3,100 for arranging a loan and noted that if the lender paid a portion of this fee, the interest rate on the loan would be higher.[8] However, the wording of the agreements was significantly different; Version A included the Board's proposed model disclosure text in this section, while Version B used alternative language to describe the same content.



Participants were shown an agreement and asked to read it just as they would if they were given the document by an actual broker. The participant was asked to "think aloud" while reviewing the document—that is, to verbalize what they were thinking as they read, and comment if they saw anything that surprised or confused them. After the participant finished reading, the interviewer asked several follow-up questions designed to measure comprehension of key concepts.

On the first day of testing, each participant was then given the second version of the disclosure, and the same protocol was repeated. The order in which participants were shown the two agreements was rotated to minimize learning effects and order bias. However, Macro found that when comparing the two agreements, participants focused almost exclusively on the differences in how the agreements broke out the amount of the commission. Since this difference was not relevant to the testing and was distracting, on the second day each participant was only shown Version A. The interviewer's guide for this round of testing is provided as Appendix C. The two agreements that were tested are provided as Appendix E.

[8] The amount of the fee that was listed on the agreements used in testing was adjusted for different testing locations, and was determined according to the median loan amount in that region (derived from Home Mortgage Disclosure Act data). The estimated fee was based on anecdotal information that broker compensation is often 1 to 2 percent of the loan amount.

# Round One of Testing
## Washington, DC / March 4 & 6, 2008

### Findings

*Understanding of the Role of Brokers*

- Most participants had some level of understanding of the difference between "brokers" and "lenders." However, there were some participants who were less clear on the difference and used these terms interchangeably. Similarly, a few participants were unsure of whether they had used a broker or a lender when procuring their most recent mortgage. This pattern was consistent throughout all rounds.

*Understanding of Broker Compensation*

- All participants were able to identify the amount of the broker fee, regardless of which agreement they were reading.
- Version B separated the broker fee into three components (an application fee, a processing fee, and a broker fee equal to 1 percent of the loan amount), while Version A provided a single dollar amount without additional detail. Participants consistently preferred Version B's treatment of the broker fee, because they felt it provided more explanation as to how the amount was determined. When asked to compare the two agreements, this was the only difference that was important to participants; some indicated that this difference alone would make them more likely to work with the broker described in Version B.
- When reading the agreements, most participants focused their attention almost exclusively on the dollar amounts shown and often ignored the details of compensation described in the narrative agreement; participants were most interested in the amount of the fees.
- Several participants incorrectly assumed that they would have to pay the dollar amount shown on the agreement to the broker regardless of whether they closed on a loan arranged by that broker.

*Conflict Between Broker Compensation and Best Possible Loan Terms*

- After reading both agreements, about half of participants understood that brokers would not necessarily provide a loan with the lowest rate. In most instances, however, they did not understand why this was the case. Participants' concern seemed to arise from phrases in the disclosure referring to "loan products and terms…which may not be in your best interest or may be less favorable than you could otherwise obtain." However, it was not clear that participants understood exactly why the broker would provide terms that were less favorable.
- Most participants were surprised to read that the broker did not guarantee the lowest interest rate, because they had previously assumed that a broker's responsibility was to provide the best possible loans for his or her customers. One participant reflected this view by saying after reading the agreements, "It should be guaranteed that they will try to find the best loans…Why can't they guarantee it?"

- Several participants felt more negatively towards brokers upon learning that brokers would not necessarily provide the best possible loan. One such participant commented about the fact that a broker might not provide the loan with the lowest interest rate "makes me suspicious."

*Payment of Compensation by Lender*

- Neither agreement effectively communicated the relationship between interest rate and broker compensation. Even after reading both agreements, few participants understood that if the lender paid any part of the broker's commission it would mean an increase in the interest rate for the borrower. Nearly all participants—even those that understood that brokers' compensation depended on the interest rate of the loan—were confused by phrases like "the lender will increase your interest rate if the lender pays any part of this amount" on Version A, or by the reference to "points" in Version B.

## Conclusions

The agreements that were tested in the first round successfully communicated to participants the amount of the commission the broker would receive. However, a number of other important concepts were not clearly communicated to participants, including:

- The situation in which the participant would have to pay a broker commission (i.e., only if they closed on a loan the broker arranged);
- The reasons why a broker might not provide the best possible loan; and
- The relationship between interest rate and broker compensation.

Based on these findings, a number of revisions were made to the language about broker compensation that was being tested. In addition, changes were made to the testing protocol to focus participants' attention more directly on the language being tested. These changes are described in the following section of this report.

# Round Two of Testing

## Los Angeles, CA

March 25 – 26, 2008

# Round Two of Testing
## Los Angeles, CA / March 25–26, 2008

### Goals and Structure of Testing

The second round of testing consisted of seven in-depth interviews in Los Angeles, CA. As in the first round, the goals of the interviews were to determine the extent to which the disclosure communicated to participants that:

a. The borrower will be responsible for paying the broker fee shown on the agreement;

b. If the lender pays this fee the borrower will end up paying it back to the lender through a higher interest rate; and

c. If the broker receives this payment from a lender, the broker has an incentive to arrange a loan with a higher interest rate.

Based on findings from the first round, Macro was also asked to determine the extent to which participants who saw the broker agreements understood that:

d. Loan officers who work for lenders also receive commissions that are based on the interest rate of the loan; and

e. The best way for consumers to ensure that they get the best possible loan is to shop for mortgages with multiple brokers and/or lenders.

While the segment of the interview protocol in which participants described their mortgage shopping experiences remained the same for the second round, the testing of broker agreements was restructured significantly. The first round had shown that comprehension of the disclosure language was weak, and that substantial revision was needed. To make sure that participants focused their attention on the relevant text, the decision was made to test this language on its own rather than in the context of a longer document. The broker agreements that were tested were written as a series of short bullets, and participants were shown one bullet at a time. They were asked to comment on each bullet separately, and to indicate whether anything that they read surprised or confused them. After each bullet they were asked to explain what they read in their own words to determine the extent to which they understood it. As in the first round, after the participant read the entire disclosure, the interviewer asked several targeted questions to measure comprehension of key concepts.

The interviewer's guide that was used for this round is provided as Appendix D. Since the structure of the guide did not change appreciably in the third or fourth round, this guide can serve as a model for what was used for those sets of interviews as well.

# Round Two of Testing
## Los Angeles, CA / March 25–26, 2008

### Changes to Broker Agreements for Round Two

In addition to minor changes in wording, four significant changes were made to the disclosure agreements that were tested in this round:

- As noted above, the disclosures were designed as a series of short, bulleted statements. This change was made because the first round of testing showed that participants were less likely to read longer pieces of narrative text.Because the disclosures that were shown to participants in the first round of testing produced some misconceptions among participants, the language that was tested in the second round was expanded and provided more detail.
- Because of concerns that the disclosures used in the first round may have biased participants against using brokers, the agreements used in Los Angeles included a statement that loan officers who work for lenders also generally receive commissions that vary based on the interest rate of the loan.
- Because one of the Board's goals is to encourage consumers to shop for mortgages, this piece of advice was explicitly stated in the agreements used in this round.

Different agreements were used for each of the two days of testing in Los Angeles. After the first day, Macro and Board staff made changes to the written agreement based on interview findings. The revisions that were made, as well as the reasons behind them, are discussed below; both versions that were used are provided in Appendix F.

### Findings

*Understanding of Broker Compensation*

- All participants understood that as a result of this agreement, they would be responsible for paying the entire amount shown.
- Participants varied in whether they thought they could negotiate the amount of the broker's commission; some thought the commission could be lowered through negotiation, while others thought it was fixed. As one woman who thought the fee was fixed explained, "I would assume that that's their rate. You go to [a fast food restaurant] and it's $6 for a burger...It's not like…I'm going to barter for my hamburger."
- Several participants indicated that they wanted more detail about how the commission was determined—for example, whether it was the same for all loans, or whether it was based on a percentage of the loan amount.

- A few participants incorrectly thought that the figure provided on the agreement might include other loan closing costs.
- Some participants mistakenly believed that in addition to receiving the commission shown on the agreement from the consumer, the broker might receive additional compensation from the lender.
- When asked how committed they would feel to working with this broker if they signed the agreement, most participants indicated that they would not feel committed and would feel that they could also shop with other brokers or lenders. A few, however, thought that by signing the agreement they were committing to pay the broker a fee regardless of whether or not a loan was closed. As one put it, "If you sign this, you are committed no matter what."

*Conflict Between Broker Compensation and Best Possible Loan Terms*

- Upon their first reading of the agreements tested in Los Angeles, participants understood that the broker would receive higher compensation for providing a loan with a higher interest rate. In at least two cases, however, these participants assumed that the higher rate would be charged because of the size of the loan (e.g., a "jumbo" loan) or because the consumer had a lower credit score. These participants did not understand that a broker might have latitude in determining what interest rate to offer.
- Nearly all participants were surprised to read about the brokers' conflict. Some questioned why brokers' compensation would be structured like this, because they had assumed that brokers would be working in the borrowers' best interests. "I thought their [the broker's] job was to get you the best interest rate you can get or afford based on your credit. This contradicts what you are saying here." A few were not surprised that the conflict existed, but were confused by the fact that the broker was disclosing the conflict to them.
- Shortly after reading the disclosure, about half of the participants made statements that directly contradicted what they had read in the agreement about broker incentives. Several, for example, stated late in their interviews that they would expect the broker to show them the loans with the best terms available. However, the disclosure they had just read specifically pointed out that brokers would in fact have incentives not to do so.



*Payment of Compensation by Lender*

- Most participants from this round of testing did not understand the various ways that the broker's fee could be paid. The agreements tested on both days included the sentence, "If you prefer not to pay this fee in cash or out of your loan proceeds, we can collect some or all of it by raising the interest rate on your loan." Most participants assumed that this meant that they had the option of either paying the fee themselves or "rolling it into" the loan amount; they did not realize that there was a third option that involved a higher interest rate. Also, most participants did not seem to understand the phrase "your loan proceeds."

# Round Two of Testing
## Los Angeles, CA / March 25–26, 2008

- Because of the way that this text was phrased, participants assumed that it described a choice that they could make at a future time as to how to pay the broker's commission. The majority of participants indicated if they had the money available they would pay the broker fee themselves at closing, rather than having the lender pay it or rolling it into the loan.

- There were a few participants who understood that if the lender paid the broker commission it would mean that the interest rate would increase. However, at least one participant seemed to believe that this was designed as a punishment for the consumer not being able to pay the fee out of pocket: "You have to pay it up front or they will jack up the interest rate."

*Comparison of Compensation Paid to Brokers and Loan Officers*

- Participants on the first day did not understand the bullet stating that lenders' employees "make commissions just as brokers do." Some thought that this meant that by using a broker, they would be paying a commission to both the broker and a loan officer.

- Because of this misconception, this bullet was revised for the second day of testing. Unlike the first version, the second agreement explicitly stated that loan officers also receive higher compensation for providing higher-rate loans. This revision seemed to be effective; more participants on the second day understood that compensation for brokers and loan officers was structured in the same way.

*Importance of Shopping for a Mortgage*

- Several participants on the first day misunderstood the statement on the agreement about the importance of shopping for a mortgage: "The best way to make sure you are satisfied with your mortgage is to compare loan offers from several different sources." These participants believed this statement indicated that the broker would compare offers between lenders, not that the participant should be shopping on his or her own. For this reason, the wording of this portion of the written agreement was revised for the second day. This second version was much more successful; most participants who saw the revised agreement indicated that they would be more likely to shop with multiple lenders or brokers.

# Round Two of Testing
## Los Angeles, CA / March 25–26, 2008

### Conclusions

The agreements tested in this round, particularly the version used on the second day, communicated to participants that:

- They would be responsible for paying the entire amount of the commission shown; and
- In order to get the best possible loan, it is important to shop between different brokers and lenders.

However, as in the first round, participants did not fully understand that the way in which brokers are compensated gives them a financial incentive to provide loans with a higher interest rate. They also did not understand that if a lender paid the broker commission, it would mean that their interest rate had been increased. Participants also had several other misconceptions, including that brokers would receive additional compensation from lenders in addition to the amount shown in the agreement and that the amount shown on the agreement included other loan closing costs.

For these reasons the agreements were again revised before the next round of testing, as described in the following section.

# Round Three of Testing

## Washington, DC

April 30 – May 1, 2008

# Round Three of Testing
## Washington, DC / April 30–May 1, 2008

### Goals and Structure of Testing

The third round of testing consisted of ten in-depth interviews in Washington, DC. As in the second round, the purpose of the interviews was to determine the extent to which the disclosure communicated to participants that:

a. The borrower will be responsible for paying the broker fee shown on the agreement;

b. If the lender pays this fee the borrower will end up paying it back to the lender through a higher interest rate;

c. If the broker receives this payment from a lender, the broker has an incentive to arrange a loan with a higher interest rate;

d. Loan officers who work for lenders also receive commissions based on the interest rate of the loan; and

e. The best way for consumers to get the best possible loan is to shop for mortgages with multiple brokers and/or lenders.

The framework of the interview protocol was identical to that used in the second round.

### Changes to Broker Agreements for Round Three

In addition to minor changes in wording, two significant changes were made to the agreements that were tested in this round:

- ▲ Because several participants in Los Angeles were unsure as to whether the amount shown on the agreement also covered other closing costs generally associated with the loan, the agreements tested in the third round included a statement that "This amount is for our services only and does not include other closing costs."
- ▲ To further emphasize the importance of comparing mortgage offers from different sources, this piece of the disclosure was separated into its own bullet.

As in Los Angeles, the disclosure agreement was revised slightly after the first day of testing, so two different versions were shown to participants. These revisions and the reasons behind them are discussed below, and both versions are provided in Appendix G.

### Findings

*Understanding of Broker Compensation*

- ▲ Participants on both days understood that they would be responsible for paying the fee shown on the agreement and that this amount did not include other closing costs.
- ▲ About half of the participants commented that they would want to know more about how the broker's fee was determined. Some said that simply being provided an amount with no explanation would make them less likely to work with the broker.

- Almost all participants believed that the commission shown on the agreement could probably be negotiated with the broker. All participants thought that the size of the commission would probably vary among brokers.

- Most participants assumed that brokers based their commission on factors like the size of the loan, not on factors related to the interest rate or other features of the loan. Even those participants who understood that the commission depended on the interest rate of the loan assumed that the interest rate would be determined only by the borrower's creditworthiness. They did not understand that the broker might offer a higher interest rate solely to increase the size of the commission.

- As in Los Angeles, several participants on the first day of testing in D.C. incorrectly believed that the broker would receive a payment from the lender in addition to the payment described in the agreement. This seemed to be because the fact that a commission would be charged was disclosed at the beginning of the disclosure, while the amount of the commission was not listed until later in the agreement. Therefore, when they read the document, some participants thought these two pieces of text referred to different commissions. Because of this misconception, the version used on the second day disclosed the amount of the commission at the beginning of the agreement. This change seemed to reduce the confusion; participants who saw the version used on the second day of testing did not think there would be more than one commission paid to the broker.

- Several participants commented that the document seemed contradictory in that it listed a fixed commission but at the same time indicated that brokers' commissions depended on loan interest rates. When probed about this contradiction, most assumed that the commission would be fixed at the amount shown on the agreement and ignored the portion of the agreement that discussed variation of the fee based on interest rates. One participant, however, concluded that this meant he could be charged a higher commission than the one shown if the interest rate on his loan turned out to be "higher than expected."

- Over half of the participants on the first day incorrectly believed that they would be committed to pay the broker the entire commission if they signed the agreement, regardless of whether they closed on a loan through that broker. To prevent this confusion on the second day, the amount of the commission was placed in close proximity to the phrase "If you close a loan that we arrange…"

*Conflict Between Broker Compensation and Best Possible Loan Terms*

- As in Los Angeles, most participants were initially struck by the fact that brokers were paid more for providing loans with higher interest rates. In fact, several laughed or expressed disbelief about how broker compensation worked because they found it so unexpected. Some participants commented that even if what they read were true, brokers would never give them that information.

- However, many of the participants did not seem to retain or focus on this information. While answering questions after they had finished reading, most reverted to what they had assumed prior to the interview and stated that the broker would provide the best loans available—even though the agreement specifically stated that this was not true. This seemed to be an example of "cognitive dissonance"—the fact that people tend to ignore information that directly conflicts with their prior beliefs.

*Payment of Compensation by Lender*

- Nearly all participants misunderstood the portion of the agreement that described what would happen if the lender paid the broker's commission. As in the previous round, most thought that this bullet would allow the commission to be "rolled into" the loan amount and did not realize that the interest rate would increase. The wording of this portion of the agreement was revised slightly on the second day to try to address this problem, but this change did not noticeably improve comprehension.
- Participants who understood that the interest rate would increase if the lender paid the broker commission did not seem clear as to how or why—for example, at least one participant was confused about whether the interest rate would be higher on the entire loan amount or just on the amount of the commission.

*Comparison of Compensation Paid to Brokers and Loan Officers*

- Most participants did not see the compensation structures for brokers and loan officers as equivalent or similar in nature. A few participants commented that if they used a broker the loan officer would also earn a commission, and as a result they would save money by working directly with the loan officer and not using a broker. Others believed that loan officers' commissions were paid by the lender, not the borrower.
- Because these misconceptions arose during the first day of testing, the version used on the second day reverted to text used on the second day in Los Angeles, which more effectively communicated to participants that loan officers receive commission, just like brokers. As one participant said, "The playing field [between lenders and brokers] is more or less even. It might be worth going to a broker. Lenders don't have an incentive to do anything for you." However, some participants did not seem to feel that the conflict of interest was as strong with loan officers. In some cases, this was because participants seemed to believe that loan officers' commissions were set by the lender, while brokers had more latitude in determining their own fees.

# Round Three of Testing
## Washington, DC / April 30–May 1, 2008

*Importance of Shopping for a Mortgage*

- The agreement used on the first day was not effective at communicating the importance of shopping between brokers and/or lenders to find the best mortgage. Several participants commented that since the broker was shopping for them, additional shopping might not be necessary. For this reason, two changes were made to the agreement for the second day. First, a reference to shopping was added to the second bullet, which was changed to, "We make larger commissions if we charge customers higher interest rates than they may be able to get if they shop around." Second, the bullet specifically describing the importance of shopping was moved to the end of the agreement and strengthened to make it more prominent. These revisions improved the comprehension of the broker agreement on the second day and communicated more effectively the importance of shopping.

### Conclusions

The version of the agreement that was tested on the second day was successful in communicating to participants that:

- They would be responsible for paying the entire amount of the commission shown on the agreement;
- They would only be responsible for paying the broker's commission if they closed a loan through that broker;
- The broker would not receive any additional compensation from the lender above the amount shown on the agreement;
- The amount shown did not include other loan closing costs; and
- In order to get the best possible loan, it is important to shop among different brokers and lenders.

However, participants still did not understand (or, in some cases, refused to accept) a key point of the agreement—that brokers receive a higher commission for arranging a loan with a higher interest rate, and that this fact creates a financial incentive for brokers not to offer the best possible loan for their customers. In fact, several participants did not even understand that brokers have some latitude in what loan terms they offer to their customers. As in previous rounds, participants also continued to misunderstand the impact a lender paying a broker's commission would have on the borrower's interest rate, with most participants assuming that they could add the broker's commission to their loan amount if they wished.

Because of these continuing misconceptions, another set of revisions was made to the language being tested before the final round of interviews. These changes are described in the following section.

# Round Four of Testing

## Kansas City, KS

May 13 – 14, 2008

# Round Four of Testing
## Kansas City, KS / May 13–14, 2008

### Goals and Structure of Testing

The fourth round of testing consisted of eleven in-depth interviews in Kansas City, KS. The goals and structure of this round of testing were essentially unchanged from the previous round.

### Changes to Broker Agreements for Round Four

Aside from minor changes in wording, two significant changes were made to the agreements used in this round:

- The versions used in Kansas City described in greater detail three different ways that the broker's commission could be paid. The goal of this change was to make clearer to consumers the difference between "rolling the commission into your loan" (i.e., adding it to the loan balance but paying the same interest rate) and paying the lender back through a higher interest rate.
- The agreements used in Kansas City were also more explicit about the fact that the broker could increase the interest rate on a loan in order to receive greater compensation. This change was to address the fact that even though most participants realized that there was a conflict for brokers, they did not seem clear as to exactly how this conflict worked, or how it would impact them.

Three different versions of the disclosure were used in Kansas City: one on the first day of testing and two on the second day. As in previous rounds, variations between these models were based on findings from the interviews. All three versions are provided in Appendix H.

### Findings

*Understanding of Broker Compensation*

- Several participants commented that they would ask the broker to justify how the amount of the commission was determined.
- Some participants believed that the commission shown on the agreement could be negotiated with the broker. Others, however, assumed that the fee was not negotiable and was either standard for all customers or was based on the size of the loan. All participants assumed that the size of commissions would vary between brokers.
- Most participants who saw the first two versions of the agreement believed that the broker would receive two separate commissions—one from the borrower and one from the lender. One explanation for this response is that these agreements provided the amount of the commission in the first bullet, and then in a later bullet included the phrase "we generally receive a payment from lenders." Because these two statements about compensation were presented independently, most participants assumed that they were describing two unrelated payments. In some cases, this misconception that the broker would receive two commissions led to a bias against brokers, because participants were concerned that they were being overpaid for their services.

# Round Four of Testing
## Kansas City, KS / May 13–14, 2008

- Because of concerns about this misconception, the third version of the agreement explicitly stated that the payment that the broker would receive from a lender was included in the amount shown. However, this led to confusion among participants, who did not understand why a payment from a lender was being included in an amount for which the consumer would be responsible.

- The language used in this round seemed to be slightly more effective at communicating to participants that the broker would have latitude in determining the interest rates that he or she offered to customers. However, this knowledge sometimes confused participants who found it difficult to accept the fact that a broker would deliberately provide his or her customers a loan with a higher interest rate.

- Most participants understood that by signing the agreement they were agreeing to pay a commission to the broker only if they closed a loan arranged by him or her. As in previous rounds, however, a few participants incorrectly believed that they would be agreeing to pay a commission regardless of whether or not they closed a loan.

*Conflict Between Broker Compensation and Best Possible Loan Terms*

- As in Los Angeles, most participants understood upon their first reading of the agreement that the broker would have a financial incentive to provide them with higher-interest rate loans. Again, however, participants' preconceived belief that brokers were working in the best interest of borrowers made this conflict difficult to accept. As a result, many became confused or reverted to their prior assumptions. As one participant commented, "I don't want [the broker] to increase [the interest rate]. It doesn't make sense. It's not logical." Another said, "Why are they charging me a commission and a higher interest rate? [If they find me a loan with a high rate] then why would I pay them an additional fee?"

- After they read the written agreement they were given, some participants were shown the following alternative text:

  *"You may qualify for a range of loan products and interest rates, and we will choose which ones we will offer to you. However, lenders are willing to pay us more for selling loans that are more profitable for them, such as loans with a higher interest rate. This means that we have a conflict between getting you the best possible loan terms and earning the highest possible compensation."*

  Unanimously, participants felt that this text was the clearest alternative for describing the conflict that brokers have in regards to their compensation. However, like other versions used in this round, this text led to the misconception that the lender payment that brokers would receive was in addition to the commission shown at the top of the agreement (see above).

# Round Four of Testing
## Kansas City, KS / May 13–14, 2008

*Payment of Compensation by Lender*

- The increased amount of detail about the different ways in which the broker commission could be paid did increase participants' understanding of these options. Unlike in earlier rounds, most participants understood the difference between the second option (adding the commission to the amount of the loan) and the third option (paying the commission through an increased interest rate).
- Almost all participants commented that the first option (paying the entire commission at closing) would be the least costly. As in earlier rounds, paying the commission through an increased interest rate was consistently seen as the least desirable option, because people instinctively wanted to keep their rate as low as possible. A few participants even expressed some resentment towards the second and third choices, because of the assumption that borrowers who chose these options would end up paying more than the stated amount.
- In some cases, the added specificity in terms of how the commission could be paid engendered negative feelings toward the broker. A few participants commented that the agreement made it seem that "all the broker cares about is how he is getting paid." They seemed to resent the fact that so much attention was being focused on the commission before the broker performed any services for them.
- Participants were not able to relate the reference to the "lender payment" that brokers received for higher interest rate loans (e.g., the second bullet in the version used on May 13) to the part of the agreement that described how the lender could pay the broker commission (the fifth bullet on the same agreement). While these bullets were intended to describe the same process in two different ways, participants did not perceive them as connected. They saw the first piece of text as a description of an additional payment that the brokers would receive for their services, while the second piece of text referred to a method through which they could pay the commission for which they were responsible.

*Comparison of Compensation Paid to Brokers and Loan Officers*

- Most participants understood that loan officers who work for lenders would receive a commission for making a loan. However, most did not understand that loan officers' commissions would also be based on the interest rate of the loan they provided, just as brokers' would. Most seemed to think that the commissions they would pay if they worked directly with a lender would be smaller, or that loan officers received a flat rate per loan while brokers did not. There also continued to be a few who were less concerned about loan officers' commissions because they assumed that they would be paid by the lender, not the borrower.

# Round Four of Testing
## Kansas City, KS / May 13–14, 2008

*Importance of Shopping for a Mortgage*

- ▲ Regardless of which version of the agreement they saw, most participants in this round of testing indicated that they would talk to several brokers and/or lenders before committing to a mortgage. However, it was difficult to determine the extent to which the agreements were effective in this regard because most of the participants in Kansas City were already aware of the importance of shopping prior to reading the agreement, as evidenced by their descriptions of their past behavior.

- ▲ As in previous rounds, there remained a few participants who did not believe that shopping was necessary. As one participant commented, "Why would I shop and compare other offers, if that's the point of hiring a broker? Aren't they supposed to do the shopping and comparing for me?"

### Conclusions

The agreements that were used in this round were more successful at communicating several concepts to consumers. In each case, however, these improvements were at the expense of consumer understanding of other aspects of broker compensation. For example:

- ▲ Participants in this round were more likely to understand that a broker could select from a range of products and interest rates when choosing what loan to offer them, and that the way brokers' compensation is structured provides an incentive to choose loans that are not in their customers' best interest. Because this information was so unexpected to consumers, however, some seemed to disregard or refuse to accept it. In addition, the language that was used led to the misconception that brokers would be receiving a separate payment from the lender, in addition to the amount shown on the agreement, which in turn led to an increased bias against brokers.

- ▲ The increased specificity with which the agreements addressed the different ways that the commission could be paid did lead to greater understanding that if a lender pays the commission, the interest rate on the loan will be increased. However, participants did not connect this to the conflict of interest discussed elsewhere in the agreement. In addition, the increased specificity of the agreement led to some bias against brokers for participants who felt too much attention was being focused on the broker's compensation.

- ▲ Participants in this round were more likely to understand that loan officers who work for banks also receive commissions, and that these commissions also depend on the interest rate of the loan. However, participants generally still believed that they would save money by working directly with a lender, even though the agreement explicitly stated otherwise.

# Summary
## of Overall Findings

# Summary of Overall Findings

The following is a summary of findings from all four rounds of testing:

- Some of the disclosures—particularly those used in Los Angeles and Kansas City—were initially effective in communicating to participants that brokers receive more compensation for providing loans with higher interest rates. However, this was extremely counter-intuitive to participants, most of whom had previously assumed that if they paid a commission to a broker he or she would work in their best interest. As a result, a significant number either did not believe or ignored the conflict of interest described in the agreement.

- Much of the reason that participants had difficulty understanding the conflict of interest that brokers face was that they did not understand how or why brokers might opt to show them loans with higher interest rates. Many assumed that the interest rates that brokers provided were set by the lender based on their creditworthiness alone, and did not realize that the broker would have latitude in deciding which loans to present them and what interest rates to offer. The disclosures used in the Kansas City interviews showed some promise in explaining this to participants, but these versions of the agreements led to other misconceptions.

- Even after reading agreements that explicitly stated that loan officers who work for lenders have the same conflict of interest as brokers, almost all participants still assumed that the compensation worked differently for loan officers and brokers. In most cases participants believed that they would pay less commission when working directly with a lender, either because a) loan officers received smaller commissions; b) the lender, not the borrower, paid these commissions; or c) loan officers received set commissions for each loan, while brokers had more latitude to set their own fees.

- While participants in early rounds had difficulty understanding the consequences if a lender paid the broker commission, most participants in Kansas City understood that they would pay the lender back through an increased interest rate. This was because the agreements used in Kansas City explicitly described the different ways that the commission could be paid. However, participants did not relate this information to any conflict of interest on the part of the broker; they assumed that the agreement was simply informing them that this was an option they had if they could not afford to pay the commission up front.

- Some participants, particularly those who saw longer, more detailed broker agreements, resented that a broker would focus so much attention on his or her compensation before providing any services. One such participant commented that the agreement made it seem that "all the broker cares about is how he is getting paid."

# Summary of Overall Findings

- A number of participants were confused by what they saw as a contradiction between the fixed commission shown on the agreement and the statement that the broker receives greater compensation for providing loans with higher interest rates. Participants dealt with this contradiction in different ways, usually by either disregarding the text about increases in broker compensation, or by assuming that the broker was going to receive a separate payment from lenders in addition to the amount shown. This latter belief—that the broker would receive two separate payments—often led to negative perceptions of the broker.

- Disclosures that were used in later rounds of testing advised consumers that the only way to ensure they get the best possible loan is to compare offers from different brokers and/or lenders. Versions which included this advice prominently did seem to effectively communicate the importance of shopping. However, it was difficult to determine this for certain because most of the participants in the last two rounds of testing understood the value of shopping for mortgages even before reading the agreement, as evidenced by their descriptions of their past behavior.

# Appendix A

## Sample Recruiting Sceener

# Appendix A

## Sample Recruiting Screener

(From Testing in Kansas City, KS on May 13 and 14)

## Recruiting Script

Hello, I am calling on behalf of the United States Federal Reserve Board. As you may know, recently many Americans have had problems with their mortgages. In response to the recent mortgage issues, the Federal Reserve Board is sponsoring a series of consumer interviews in your area so that we can learn more about how people make decisions regarding their mortgages. We will use what we learn from these interviews to help improve the information consumers receive when they get a mortgage loan.

Have you obtained a new mortgage or re-financed a mortgage in the past two years?

- ❑ Yes → Continue
- ❑ No → *Thank respondent politely and end call.*

Great. We will be holding interviews in Kansas City on Tuesday, May 13th and Wednesday, May 14th. Participants will receive $75 in exchange for their time and input on this important topic. I was wondering if you would be interested in attending.

- ❑ Yes → Continue to screening questions
- ❑ No → *Record reason (not interested, not available on that date, etc); thank them politely and end call.*

That's great. I just need to ask you a few more questions to see if you qualify for one of our interviews.

Q1: Were you the person in your household who was responsible for making decisions related to this mortgage?

- ❑ Yes → Continue
- ❑ Yes, in cooperation with my [spouse, partner, etc.] → Continue
- ❑ No → *Thank respondent politely and end call.*

Q2: Was this mortgage related to a property for your own use, or a property you purchased solely as an investment?

- ❑ Own use → Continue
- ❑ Investment → *Thank respondent politely and end call.*

Q3: Do you work or have you worked for a bank or other financial institution, or in the real estate or mortgage industry?

- ❑ Yes → *Thank respondent politely and end call.*
- ❑ No → Continue

Q4: ARTICULATION QUESTION: In a few sentences, could you describe the process through which you found your current mortgage lender?

- ❑ If respondent indicates that he/she got their mortgage through a family member or close friend who was a broker or worked at a bank → *Thank respondent politely and end call.*
- ❑ In all other cases…
- ❑ If respondent gives a thoughtful, articulate answer → Continue
- ❑ If respondent does not give a thoughtful, articulate answer → *Thank respondent politely and end call.*

At this point, I am going to ask you a few questions that pertain to financial information that you might find personal or private. However, I want to assure you that none of this information will be shared outside the group conducting this research, and all information will be kept anonymous—your name will never be used in any reports.

Q5: Have you experienced any of the following financial hardships in the past 7 years: bankruptcy, foreclosure, repossession, or a tax lien?

- ❑ Yes → Respondent qualifies as Subprime (SP)
- ❑ No

Q6: In the past two years, have you been turned down for credit or have you been discouraged from applying for credit?

- ❑ Yes → Respondent qualifies as SP
- ❑ No

Q7: How many mortgages do you currently have on your primary residence?

- ❑ One *(skip to Q9a)*
- ❑ Two or more

Q8: Was the mortgage that you obtained in the past two years the larger or smaller of these mortgages?

a) Larger (1st mortgage)

b) Smaller (2nd or 3rd mortgage) [*NOTE: No more than 2 among interviews*]

c) Both [*Direct respondent to answer remaining questions based on larger (1st) mortgage*]

| *If answer is "a" or "c"* | *If answer is "b"* |
|---|---|
| Q9a: What is the current interest rate on this mortgage?<br>❑ 8% or below<br>❑ Above 8% → **Qualifies as SP**<br>❑ Don't know | Q9b: What is the current interest rate on this mortgage?<br>❑ 10% or below<br>❑ Above 10% → **Qualifies as SP**<br>❑ Don't know |

# Appendix A

| Screening Criteria | Quotas |
|---|---|
| *Does participant qualify as "SP"?* | • At least 4 recruits must be SP<br>• At least 4 recruits must NOT be SP |
| Q10: How did you get your recent mortgage?<br>a) Through a mortgage broker (i.e., someone who does not directly lend you money, but works with different lenders to get you a loan)<br>b) Directly from a lender (e.g., credit union or bank)<br>c) Don't know | • At least 4 recruits should respond "a" (of whom at least 2 are SP and at least 2 are not SP)<br>• At least 4 recruits should respond "b" (of whom at least 2 are SP and at least 2 are not SP) |
| Q11: Was the mortgage that you obtained used to re-finance an existing mortgage?<br>a) Yes *(skip to Q13)*<br>b) No | • No more than 4 recruits should answer "a" |
| Q12: Is this the first home you have ever purchased?<br>a) Yes<br>b) No | • At least 4 recruits should respond "a" |
| Q13: Some mortgages have an interest rate which is "adjustable"—that is, the rate doesn't stay the same but can change over time. Does your new mortgage have a rate that is adjustable or will become adjustable in the future?<br>a) Yes, adjustable<br>b) No, not adjustable → Have you had an adjustable rate mortgage in the past five years? *If Yes, then count as "a"* | • No more than 3 recruits should respond "b" |
| Q14: Was your mortgage an "FHA loan" or a "VA loan" (that is, did you get it through a program of the Federal Housing Administration or Department of Veterans Affairs)? [*If respondent doesn't know, mark "No".*]<br>a) Yes<br>b) No | • No more than 2 recruits should respond "a" |
| Q15: What is your age?<br>a) 18 to 25<br>b) 26 to 35<br>c) 36 to 50<br>d) 50 or above | • At least 3 recruits should respond "a" or "b"<br>• At least 3 recruits should respond "c" or "d" |

| Screening Criteria | Quotas |
|---|---|
| Q16: Which of the following categories best reflects your race or ethnicity? You can choose more than one category. [*Respondents who wish to choose more than one category should be counted as minorities, even if one race mentioned is White.*]<br>a) White<br>b) Black or African-American<br>c) Hispanic or Latino<br>d) Asian<br>e) Native American or Pacific Islander | • At least 4 recruits should respond "b", "c", "d", or "e"<br>• At least 4 recruits should respond "a" |
| Q17: What is the highest level that you reached in school?<br>a) Some high school<br>b) High school graduate<br>c) At least some college work<br>d) College graduate<br>e) At least some graduate school | • At least 3 recruits should respond "a" or "b" |
| Q18*: Gender* | • At least 3 recruits of each gender |

*If participant qualifies for an interview:*

Based on your responses, we would like to invite you to participate in an interview, which will be held at our facility in Kansas City. The interview will last about 90 minutes. We will be showing you some sample mortgage documents for you to refer to, so if you use reading glasses please be sure that you bring them. We will provide you with a $75 stipend for participating in the interview.

We would like to ask you to bring copies of some of the forms you received when you got your mortgage. **We would only like to look at these documents to record a few key pieces of information. Neither your name nor any other personally identifiable information will be recorded, and no copies will be made.** The forms that we are most interested in are the Truth in Lending Disclosure and a form called the Settlement Statement (sometimes called a "HUD-1" form). Both of these forms give information about the amount you borrowed, your closing costs, and the payments you will make on the loan. If you are not sure what forms these are, please bring whatever you have available.

*NOTE: If participants refuse to bring forms but would like to participate, do not place them in an interview slot, but place them on a wait list.*

[*If respondent answered "Yes, in cooperation with partner" for Q1*] At the beginning of this interview, you had mentioned that you made decisions related to this mortgage in cooperation with a spouse or partner. If this other person is available at the same time, we would like him or her to come in with you. If that is possible, you would receive double the stipend, for a total of $150.

- ❑ Yes
- ❑ No

*Note To Recruiters:*

If at any point during the screening process a respondent expresses that they are currently having difficulty paying their mortgage, please give them the following information. This does not impact the other screening questions that should be asked, or the quotas for the groups.

*You may want to contact the Homeownership Preservation Foundation – an independent nonprofit that helps connect borrowers with HUD-approved housing counselors. You can reach them at 1-888-995-HOPE or go to www.995hope.org. We would encourage you to contact them soon if you are concerned about making your mortgage payments, because there are many efforts underway right now to help borrowers and they may be able to tailor a plan to help you.*

# Appendix B

## Summary of Participant Background Information

| | Round 1: Washington, DC | Round 2: Los Angeles, CA | Round 3: Washington, DC | Round 4: Kansas City, KS | Total[9, 10] |
|---|---|---|---|---|---|
| **Personal Information** | | | | | |
| Gender | | | | | |
| Male | 2 | 4 | 3 | 4 | 13 (37%) |
| Female | 5 | 3 | 7 | 7 | 22 (63%) |
| Age | | | | | |
| 18-35 | 3 | 3 | 1 | 4 | 11 (31%) |
| 36+ | 4 | 4 | 9 | 7 | 24 (69%) |
| Race | | | | | |
| Caucasian | 1 | 3 | 3 | 9 | 16 (46%) |
| African-American | 6 | 1 | 6 | 2 | 15 (43%) |
| Hispanic | 0 | 3 | 1 | 0 | 4 (11%) |
| Education Level | | | | | |
| High school or less | 1 | 0 | 1 | 2 | 4 (11%) |
| Some college or more | 6 | 7 | 9 | 9 | 31 (89%) |
| Current Number of Mortgages on Primary Residence | | | | | |
| One | 7 | 6 | 8 | 10 | 31 (89%) |
| Two or more | 0 | 1 | 2 | 1 | 4 (11%) |
| Adjustable Rate Mortgage in Past 5 Years? | | | | | |
| Yes | 6 | 5 | 4 | 7 | 22 (63%) |
| No | 1 | 2 | 6 | 4 | 13 (37%) |

[9] Percentages may not add to 100 because of rounding.
[10] In the case of dyad interview the information shown is from the member of the dyad who was recruited and screened by telephone.

| | Round 1: Washington, DC | Round 2: Los Angeles, CA | Round 3: Washington, DC | Round 4: Kansas City, KS | Total[9, 10] |
|---|---|---|---|---|---|
| Financial Hardship (e.g., bankruptcy, foreclosure) in Past 7 Years?[11] | | | | | |
| Yes | 0 | 0 | 0 | 1 | 1 (3%) |
| No | 7 | 7 | 10 | 10 | 34 (97%) |
| Denied Credit or Discouraged From Applying in Past 2 Years?[11] | | | | | |
| Yes | 2 | 1 | 2 | 2 | 7 (20%) |
| No | 5 | 6 | 8 | 9 | 28 (80%) |
| **Information About Most Recent Mortgage Loan** | | | | | |
| Reason for Loan | | | | | |
| Refinance | 1 | 3 | 9 | 7 | 20 (57%) |
| Home purchase | 6 | 4 | 1 | 4 | 15 (43%) |
| Method of Obtaining Loan | | | | | |
| Through broker | 2 | 3 | 1 | 3 | 9 (26%) |
| Directly from lender | 3 | 4 | 9 | 8 | 24 (69%) |
| Don't know | 2 | 0 | 0 | 0 | 2 (6%) |
| FHA or VA Loan? | | | | | |
| Yes | 1 | 0 | 2 | 2 | 5 (14%) |
| No | 6 | 7 | 8 | 9 | 30 (85%) |

[11] Participants' responses to these three questions were used to identify them as likely prime or subprime borrowers.

| | Round 1: Washington, DC | Round 2: Los Angeles, CA | Round 3: Washington, DC | Round 4: Kansas City, KS | Total[9, 10] |
|---|---|---|---|---|---|
| First-Time Home Buyer?[12] | | | | | |
| Yes | 4 | 2 | 0 | 2 | 7 (47%) |
| No | 3 | 2 | 1 | 2 | 8 (53%) |
| Current Interest Rate Above Threshold?[11, 13] | | | | | |
| Yes | 0 | 1 | 1 | 2 | 4 (11%) |
| No | 7 | 6 | 9 | 9 | 31 (89%) |

[12] Only respondents whose most recent mortgage was for a home purchase (as opposed to a refinance) answered this question.

[13] Respondents were classified as "subprime" if they reported having an interest rate higher than 8 percent for a first mortgage and 10 percent for a second or third mortgage. These cutoff points were set to be roughly consistent with the Home Mortgage Disclosure Act (HMDA) APR-based thresholds for reporting higher-priced loans over the 2006-2007 period.

# Appendix C

## Sample Interviewer Guide (Round One)

# Appendix C

## Sample Interviewer Guide

(From Testing in Washington, DC on March 4th and 6th)

## Introduction

At the beginning of the interview, the interviewer will give a short introduction to the background and purpose of the interviews. The participants will be assured that purpose of the project is to evaluate the disclosure materials, not their own intelligence or understanding, and that they should perform in whatever manner is typical and comfortable for them. The interviewer will also address issues of confidentiality.

The interviewer will introduce and demonstrate the concept of "thinking aloud," and explain that he would like the participant to "think aloud" throughout the interview.

## Topic 1 – Background

The primary reason that the Federal Reserve is conducting these interviews is because they want to know more about how people go about getting a mortgage and choosing a lender, so that they can make sure that consumers get the information they need.

1) Could I ask you to describe the process through which you obtained your loan? Take me through, step by step, exactly what you did.

   *Possible probes:*

   - Was your loan for a home purchase, or was it a refinance of an existing loan? If for a re-finance, for what purpose were you refinancing (e.g., take money out, lower payment, etc.)
   - Did you work with a broker, or directly with a lender? [*May need to be prepared to explain the difference: A lender makes loans, while a broker does not lend but works with you to obtain a loan from a lender.*]
     - o Why did you choose to work with a broker/lender, as opposed to the alternative?
     - o Please explain your reasons for choosing that particular broker/lender.
   - How many lenders or brokers did you talk to before making a decision?
   - How did you locate the lenders or brokers you talked to?
   - Were you asked to provide documentation about your income, such as a bank statement or W-2 form?

2) Did you have multiple loan products to choose from? When you were choosing a loan, what were the factors that were most important to you?

   *Probe for:*

   - Interest rate
   - Size of monthly payment
   - Closing costs or other fees
   - Type of product offered (ARM vs. fixed)

3) Does the mortgage we have been discussing have a fixed or adjustable rate?
   - (*If adjustable*) Has the rate changed yet? If so, by how much? If not, when is it scheduled to change?
   - (*If not adjustable*) Have you had adjustable rate mortgages in the past? If so, when?
4) Was there anything that surprised you at the closing of your loan—something that you were not expecting?

   *Possible probes:*
   - What was it? How did you react?
5) Was there anything about the process of finding a mortgage you found frustrating or difficult? What was it?
   - What would have made it less frustrating?
6) What concerns, obstacles, or problems did you encounter when shopping for a loan?
7) At any point, was there a situation in which you were unsure if something you were told was true?
   - What did you do? Who did you consult for advice?
8) Is there anything you wish someone had told you before you began the process of finding a mortgage?
9) In retrospect, is there anything that you would have done differently? Please explain.
10) How satisfied are you with the outcome of this process—that is, do you feel that you got the best possible terms for your loan?

## Topic 2 – Testing of Broker Disclosures

11) I want to you to imagine that you are looking for a new mortgage, and you are talking to a broker that you are considering working with. He or she hands you this form (*give participant either Version A or Version B).* Please look this over exactly as you would in real life, and "think aloud" as you are doing so. As you do, please let me know if you read anything that you find confusing, or that you think is particularly important.
12) What is the purpose of this form?
13) Is there anything here that you found surprising?
14) Is there anything that you found confusing or had difficulty understanding?
15) Does this form indicate whether or not you will be paying this broker a fee? If it does, does it tell you the amount of that fee?
16) Does this form indicate <u>when</u> you will have to pay this fee to the broker?

17) According to the form, is there anything that you can do to decrease this fee, so that you pay less?

- [*Point out text that may seem to imply that the fee can be decreased, such as "we may be paid all of our compensation by either you or the lender*] Does this mean that you might pay a smaller fee in some situations?

18) If your broker asked you to sign this form, would it make you feel more negatively or positively towards him or her? Would it make you less likely to work with him or her? Why? [*Probe to determine whether consumer perceives a conflict between their interests and those of the broker.*]

19) (*Take away form)* Now I am going to show you another form that a broker might give you. Again, I want to you to imagine a broker that you are speaking with hands you this form (*give participant the version of the form that they have not already seen*). Again, please look this over exactly as you would in real life, and "think aloud" as you are doing so. As you do, please let me know if you read anything that you find confusing, or that you think is particularly important.

20) Is there anything about the form that you found confusing or had difficulty understanding?

21) Does this form indicate whether or not you will be paying this broker a fee? If it does, does it tell you the amount of that fee?

22) Does this form indicate <u>when</u> you will have to pay this fee to the broker?

23) According to the form, is there anything that you can do to decrease this fee, so that you pay less?

- (*Point out text that may seem to imply that the fee can be decreased, such as "you may request that the lender pay all or a portion of our broker fees…"*) Does this mean that you might pay a smaller fee in some situations? (*Probe further to see the extent to which the consumer understands this information.*)

24) When you read the first form, you had said that (*refer to answer from Q17*). Is your reaction after reading this second form any different, or is your reaction the same? (*Probe to see whether participant sees the "conflict of interest" as being any different here than with Form A.*)

25) (*Hand back other form, so participant can see both of them)* Now I would like you to compare the two forms. After reading these, which of these two brokers would you prefer to work with?

26) I would like you to focus on Section 2—the part of the form labeled "Our Compensation." Which form did you find clearer?

- Why? What did you find clearer about that form?
- Is there any ways in which the other form is better?

27) The reason that we are asking you these questions is that the Federal Reserve is trying to design a form that provides this information in this clearest way possible. With that in mind, do you have any other suggestions?

- Is there any way to combine the best features of both forms?

## False Close

The interviewer will excuse himself briefly. At this point, the observers can suggest additional questions that they would like asked, or responses upon which they would like more elaboration from the participant.

# Appendix D

## Sample Interviewer Guide (Round Two)

# Appendix D

## Sample Interviewer Guide

(from testing in Los Angeles, CA on March 25 and 26)

## Introduction

At the beginning of the interview, the interviewer will give a short introduction to the background and purpose of the interviews. The participants will be assured that purpose of the project is to evaluate the disclosure materials, not their own intelligence or understanding, and that they should perform in whatever manner is typical and comfortable for them. The interviewer will also address issues of confidentiality.

The interviewer will introduce and demonstrate the concept of "thinking aloud," and explain that he would like the participant to "think aloud" throughout the interview.

## Topic 1 – Background

The primary reason that the Federal Reserve is conducting these interviews is because they want to know more about how people go about getting a mortgage and choosing a lender, so that they can make sure that consumers get the information they need.

1) Could I ask you to describe the process through which you obtained your loan? Take me through, step by step, exactly what you did.

   *Possible probes:*

   - Prior to shopping, did you take any proactive steps to learn more about the process? For example, did you search the Internet, buy a book, talk to a friend or family member, etc.?
   - How did you begin shopping, and what information sources did you use?
     - Which types and sources of information did you use and would you prefer to use in the future? (*Probe for: Print, TV, Web-based, etc.*)
   - While shopping, did you rely more on verbal explanations or written material provided by the loan officer or broker?
   - Were you shopping primarily for loan approval, for the best terms, or both?
   - When you were shopping for your loan, what sort of timing were you thinking about? For example, did you expect you would move or refinance within a few years after the original purchase? Or were you thinking this loan would be the one you would probably stick with for a long time?

2) Did you work with a broker, or directly with a lender? [*May need to be prepared to explain the difference: A lender makes loans, while a broker does not lend but works with you to obtain a loan from a lender.*]

   - How helpful was your broker or lender in explaining things to you?
   - How many lenders or brokers did you talk to before making a decision?
   - How did you locate the lenders or brokers you talked to?

3) Did you know the type of product you wanted before speaking with the creditor?

4) Did the creditor offer you a choice of multiple loan products? If so, which were they?

   - Was your loan for a home purchase, or was it a refinance of an existing loan? If for a re-finance, for what purposes were you refinancing (e.g., take money out, lower payment, etc.) (*People who took out a second lien may not fit into either category*).

- Does your current mortgage have a fixed or adjustable rate?
    - (*If adjustable*) Has the rate changed yet? If so, by how much? If not, when is it scheduled to change?
    - (*If not adjustable*) Have you had adjustable rate mortgages in the past? If so, when?

5) When you were shopping for a home, how did you know what you could afford?
    - Were you asked to provide documentation about your income, such as a bank statement, W-2 form, or tax return?
    - Did a broker or lender provide you with information on what they thought you could afford?
        - If so, did this surprise you (either by being higher or lower than you thought)?

6) When you were choosing a loan, what were the factors that were most important to you?

    *Probe for:*
    - Interest rate (*Probe about the meaning of this.*)
    - Size of monthly payment
    - Closing costs or other fees
    - Type of product offered (ARM vs. fixed)

7) Was there anything that surprised you at the closing of your loan—something that you were not expecting?
    - If so, what was it? How did you react?

8) Was there anything about the process of finding a mortgage you found frustrating or difficult? What was it?
    - What would have made it less frustrating?

9) Is there anything you wish someone had told you before you began the process of finding a mortgage?
    - In retrospect, is there anything that you would have done differently? Please explain.

10) What do you think you were aiming for at the time you took out your loan? The best possible loan? A fair loan? Any loan at all?
    - How satisfied are you with the outcome?
    - How do you know? How confident are you that you know how your terms measure up to the best possible terms available at the time?

11) Was there any information that you wish had been provided earlier/later in the shopping process? (*Probe for: APR, payments, closing costs, or more general disclosure terms.*)

## Topic 2 – Testing of Broker Disclosure

I would like you to imagine that you are meeting with a broker to see if he or she can help you find a mortgage. At the end of the meeting, he or she gives you an agreement to sign. I am going to show you some of the text that is on that agreement, and would like your reaction to it. I'm going to show you one piece of the text at a time and ask you to react to each piece individually. (*Interviewer presents the participant with "Important Facts About Our Fee for Brokerage Services" with all but the first bullet covered up by another page).*

12) Could you describe in your own words what this phrase means?

- What are your initial reactions, if any, to this text?
- Do you find this information surprising?
- Is there anything about this text that you find confusing or difficult to understand?

(*Repeat this exercise by revealing the next bullet explaining broker compensation, and asking these same probe questions. Probe for any additional explanation, when necessary. After all text has been uncovered, move to the next question.*)

13) If a broker asked you to sign a form that contained this text, would it make you less likely to work with him or her? Why? [*Probe to determine whether consumer perceives a conflict between their interests and those of the broker.*]

- How committed would you feel to working with this broker and paying this fee if you signed a form with this information in it?
- Would you feel you could negotiate with this broker?
    - If so, what terms might you try to negotiate on (total payment, form of payment, or both)?
- After reading this, do you think that a broker has any more of a conflict of interest in working for you than a lender does? Please explain.
- The reason we are asking you these questions is that the Federal Reserve is trying to design a form that provides this information in the clearest way possible. With that in mind, do you have any other suggestions?

## False Close (5 minutes)

The interviewer will excuse himself briefly. At this point, the observers can suggest additional questions that they would like asked, or responses upon which they would like more elaboration from the participant.

# Appendix E

## Broker Agreements Tested in Round One

# Appendix E

## Version A
## Mortgage Loan Origination Agreement

You, the applicant(s), inquired into mortgage financing with Home Safe Loans on February 28, 2008. As an independent contractor Home Safe Loans contracts with multiple lenders to find a residential mortgage loan with such terms and conditions as you may request or a lender may require. By signing below, you agree to enter into this Mortgage Loan Origination Agreement with us. Home Safe Loans is licensed as a "Mortgage Broker" under the Illinois Mortgage Brokers Act.

### SECTION 1. NATURE OF RELATIONSHIP

Home Safe Loans, an independent contractor, is not acting as your agent. We will enter into a separate agreement with several lenders in order to gather information about various mortgage products. However, we do not guarantee the lowest price or the best terms available in the market, and do not distribute the products of all lenders or investors. Ultimately, we will seek to help you meet your financial needs.

### SECTION 2. OUR COMPENSATION

The lenders whose loan products we distribute generally provide their loan products to us at a wholesale rate. The retail price we offer you – your interest rate, total points, and fees – will include our compensation. In some cases, we may be paid all of our compensation by either you or the lender. Alternatively, we may be paid a portion of our compensation by both you and the lender. For example, in some cases, if you would rather pay a lower interest rate, you may pay higher up-front points and fees. Also, in some cases, if you would rather pay less up front, you may be able to pay some or all of our compensation indirectly through a higher interest rate, in which case we will be paid directly by the lender.

The total fee we will receive for your loan is $ 3,100.00. You will pay this entire amount. The lender will increase your interest rate if the lender pays any part of this amount. A lender payment to a mortgage broker can influence which loan products and terms the broker offers you, which may not be in your best interest or may be less favorable than you otherwise could obtain.

We also may be paid by the lender based on (i) the value of the Mortgage Loan or related servicing rights in the market place or (ii) other services, goods or facilities performed or provided by us to the lender.

By signing below, applicant(s) acknowledge receipt of a copy of this signed Agreement.

| MORTGAGE LOAN ORIGINATOR | APPLICANT(S) |
|---|---|
| By: ______________________ | By: ______________________ |
| Name: Aimee Appleton, Loan Officer | Name: Kelly Eway, Borrower |
| Date: ______________________ | Date: ______________________ |
| Address: 5 Executive Street, Suite 222 | Address: 223 Sinclair Street |
| Springfield, Illinois 10101 | Bridgeport, Illinois 10505 |

## Version B
## Mortgage Loan Origination Agreement

You, the applicant(s), agree to enter into this Mortgage Loan Origination Agreement with EZ Loans as an independent contractor to apply for a residential mortgage loan from a participating lender with which we from time to time contract upon such terms and conditions as you may request or a lender may require. You inquired into mortgage financing with EZ Loans on February 28, 2008. We are licensed as a "Mortgage Broker" under the Illinois Mortgage Brokers Act.

**SECTION 1. NATURE OF RELATIONSHIP**

In connection with this mortgage loan we are acting as an independent contractor and not as your agent. We will enter into separate independent contractor agreements with various lenders. While we seek to assist you in meeting your financial needs, we do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.

**SECTION 2. OUR COMPENSATION**

A. BROKER FEES WHICH YOU WILL PAY:

We are a Mortgage Broker. We do not fund loans. We are charging you fees to arrange a mortgage loan from a mortgage lender. These are the fees we are charging you.

Application fee: $200 Processing Fee: $400 Other : N/A

Broker Fee (points): $2,500 (equal to 1% of loan amount) TOTAL: $3,100

B. BROKER FEES YOU ARE REQUESTING THE LENDER TO PAY:

You may request that the lender pay all or a portion of our broker fees (see above) on your behalf at loan closing in exchange for a slightly higher interest rate on your loan. This payment to us is typically called a yield spread premium. Your interest rate will be higher if you choose a yield spread premium than if you decide to pay our broker fee at closing. We have discussed this pricing option with you and you have decided to [request] ~~[not request]~~ that the lender pay a yield spread premium equal to 1% of your loan amount ($ 2,500).

We also may be paid by the lender based on (i) the value of the Mortgage Loan or related servicing rights in the market place or (ii) other services, goods or facilities performed or provided by us to the lender.

By signing below, applicant(s) acknowledge receipt of a copy of this signed Agreement.

**MORTGAGE LOAN ORIGINATOR**

By:___________________________

Name: Joe Loan officer

Date:___________________________

Address: 123 Commerce Lane Springfield, IL 10101

APPLICANT(S)

By:___________________________

Name: Bob Borrower

Date:______________________________

Address: 666 Daisy Drive Greenbelt, IL 10102

# Appendix F

## Broker Agreements Tested in Round Two

# Appendix F

## Notice Tested on March 25, 2008

Important Facts About Our Fee for Brokerage Services:

- We are a mortgage broker. Our job is to work with different lenders to get you a loan. You will pay us a fee for this service, so it is important that you understand how our compensation works.
- We generally receive more compensation for providing loans with a higher interest rate.
- This means that getting you the best possible loan terms can conflict with our own goal of earning as much as possible on your loan.
- This does not mean that you will always save money by working directly with a lender. Lenders' employees make commissions just as brokers do. The best way to make sure you are satisfied with your mortgage is to compare loan offers from several different sources.
- If you sign this agreement, you are agreeing to pay us a fee for our services. If you prefer not to pay this fee in cash or out of your loan proceeds, we can collect some or all of it by raising the interest rate on your loan.
- The total fee for our services if you close a loan through us will be $6,000. Once you sign this agreement, our fee cannot increase.

## Notice Tested on March 26, 2008

Important Facts About Our Fee for Brokerage Services:

- We are a mortgage broker. Our job is to work with different lenders to get you a loan. You will pay us a fee for this service, so it is important that you understand how our compensation works.
- We generally receive more compensation for providing loans with a higher interest rate.
- This means that getting you the best possible loan terms can conflict with our own goal of earning as much as possible on your loan.
- This conflict is not unique to brokers, so you will not necessarily save money by working directly with a lender and not using a broker. Like brokers, loan officers who work for lenders generally receive higher compensation for providing loans with a higher interest rate. The best way to make sure you are satisfied with your loan is to compare offers from several different sources.
- If you sign this agreement, you are agreeing that if you close a loan through us you will pay us a fee of $6,000. Once you sign this agreement, our fee cannot increase.
- If you choose not to pay this fee in cash or out of your loan proceeds, we can collect some or all of it by raising the interest rate on your loan. Ask us about the trade-off between interest rate and closing costs, and then you can decide how to pay us.

# Appendix G

## Broker Agreements Tested in Round Three

# Appendix G

Notice Tested on April 30, 2008

## Mortgage Broker Services Agreement

_____________ ("You") and Main Street Mortgage, LLC ("We") agree as follows:

1. We will work with different lenders to get you a loan. If you close a loan that we arrange, you will pay us a commission.
2. We generally get larger commissions for arranging loans with higher interest rates.
3. This is true for lenders as well as brokers. Loan officers who work for lenders also generally get larger commissions for making loans with higher interest rates.
4. To get the best rate on a loan, you should compare offers from several different sources, including the loan offer we arrange for you.
5. Our total commission is <u>$3,300</u>. This is for our services only and does not include other loan closing costs. Once you sign this agreement, our commission will not increase.
6. If you do not pay our commission directly to us, the lender will pay it. However, if the lender does so, you will pay the lender back through higher interest payments.

____________________  ______________________

Betty Borrower Date  Main Street Mortgage Date

Notice Tested on May 1, 2008

## Mortgage Broker Services Agreement

_____________ ("You") and Main Street Mortgage, LLC ("We") agree as follows:

1. We will work with different lenders to get you a loan. If you close a loan that we arrange, you will pay us a commission of $3,300. This amount is for our services only and does not include other loan closing costs.
2. We make larger commissions if we charge customers higher interest rates than they may be able to get if they shop around.
3. You would not necessarily save money by working directly with a lender rather than using a broker. Like brokers, most loan officers who work for lenders can also increase the size of their commissions by charging their customers higher interest rates.
4. If you do not pay our commission directly to us, the lender will pay it for you at closing. But in that case you will pay the lender back through a higher interest rate.
5. To be sure that you are getting the best loan terms available, you should shop and compare offers from several different sources. These should include loan offers you get from other brokers or lenders, as well as any offers we make to you.

| | |
|---|---|
| _____________________ | _______________________ |
| Betty Borrower (Date) | Main Street Mortgage (Date) |

# Appendix H

## Broker Agreements Tested in Round Four

# Notice Tested on May 13, 2008

## Mortgage Broker Services Agreement

_____________("You") and Main Street Mortgage, LLC ("We") agree as follows:

1. We will work with different lenders to get you a loan. If you close a loan that we arrange, you will pay us a commission of $1,650. This amount is for our services only and does not include other loan closing costs.
2. The loans that we offer you may not have the lowest interest rate that you could get because we can increase the interest rate on any loan before we offer it to you. We generally receive a payment from lenders for selling loans with higher interest rates. This means that we have a conflict between getting you the best possible loan terms and earning the highest possible compensation.
3. This conflict is not unique to brokers, so you will not necessarily save money by working directly with a lender and not using a broker. Like brokers, loan officers who work for lenders generally receive higher compensation for providing loans with a higher interest rate.
4. For this reason, you should shop and compare offers from several different sources to be sure that you are getting the best terms available. These should include loan offers you get from other brokers or lenders, as well as any offers we make to you.
5. There are three different ways that you could pay our commission:
   a. You could pay the entire amount at closing.
   b. You could add our commission to your loan amount and pay it back with interest over time.
   c. The lender could pay our commission for you. However, in this case the lender will increase the interest rate on your loan so that you pay this amount back.

   In any case you will end up paying the full amount shown above, either directly or by paying the lender back.

______________________ ________________________

Betty Borrower (Date) Main Street Mortgage (Date)

# Notice Tested on May 14, 2008

### Version 1

## Mortgage Broker Services Agreement

_____________ ("You") and Main Street Mortgage, LLC ("We") agree as follows:

1. We will work with different lenders to get you a loan. If you close a loan that we arrange, we will receive a commission of $1,650. This amount is for our services only and does not include other loan closing costs.
2. There are three different ways that our commission could be paid:
   - You could pay the entire amount at closing.
   - You could add our commission to your loan amount and pay it back with interest over time.
   - The lender could pay our commission for you. However, in this case the lender will increase the interest rate on your loan so that you pay this amount back.

   In any case you will end up paying the full amount shown above, either directly or by paying the lender back.
3. We generally receive a payment from lenders for making loans with higher interest rates. We have assumed such a payment when calculating the commission shown above. The fact that we receive this payment means that we have a conflict between getting you the best possible loan terms and earning the highest possible compensation.
4. This conflict is not unique to brokers, so you will not necessarily save money by working directly with a lender and not using a broker. Like brokers, loan officers who work for lenders generally receive higher compensation for providing loans with a higher interest rate.
5. For this reason, you should shop and compare offers from several different sources to be sure that you are getting the best terms available. These should include loan offers you get from other brokers or lenders, as well as any offers we make to you.

| | |
|---|---|
| _____________________ | _______________________ |
| Betty Borrower (Date) | Main Street Mortgage (Date) |

# Notice Tested on May 14, 2008

### Version 2

## Mortgage Broker Services Agreement

_____________ ("You") and Main Street Mortgage, LLC ("We") agree as follows:

1. We will work with different lenders to get you a loan. If you close a loan that we arrange, we will receive a commission of $1,650. This amount is for our services only and does not include other loan closing costs.
2. There are three different ways that our commission could be paid:
   - You could pay the entire amount at closing.
   - You could add our commission to your loan amount and pay it back with interest over time.
   - The lender could pay our commission for you. However, in this case the lender will increase the interest rate on your loan so that you pay this amount back.

   In any case you will end up paying the full amount shown above, either directly or by paying the lender back.
3. We generally receive a payment from lenders for making loans with higher interest rates. We have assumed that we will receive a payment like this, and have included it in the amount listed above. The fact that we receive this payment means that we have a conflict between getting you the best possible loan terms and earning the highest possible compensation.
4. This conflict is not unique to brokers, so you will not necessarily save money by working directly with a lender and not using a broker. Like brokers, loan officers who work for lenders generally receive higher compensation for providing loans with a higher interest rate.
5. For this reason, you should shop and compare offers from several different sources to be sure that you are getting the best terms available. These should include loan offers you get from other brokers or lenders, as well as any offers we make to you.

_____________________ _______________________

Betty Borrower (Date) Main Street Mortgage (Date)

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**Calverton, MD 20705**
**www.macrointernational.com**

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**20th and C Streets, NW**
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