

## IS THERE LIFE AFTER APRS?

And could that life be better for both banks and consumers?

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Imagine life without APRs.

Not going to happen?

Actually, it could.

The Consumer Financial Protection Bureau has drafted mortgage loan disclosure forms that do not feature APRs. Instead, the CFPB has discretely tucked the APR away.

It is there--if you try to find it. But it does not hold a position of prominence.

Reassessing the "beloved" APR

Let's face it. APRs are not the most popular thing on the planet.

Consumers have never warmed to--much less understood--the concept of an annualized percentage rate as a measurement of credit cost. And from the creditor side of things, the APR is one of the most common causes of restitution. Clearly, folks at the CFPB aren't taken with APRs.

So, what would life be like without the APR?

Some of us would be forlorn and forsaken. After all, much of our careers have been inspired by or determined by APR calculations and the endless discussions about whether something is a finance charge.

How would compliance life have meaning without its core element? And just think of all the time and effort we have invested in training lending staff to explain APRs to their applicants. What would we do with all that time if we didn't have to spend it training and calculating?

But in spite of the 40 years spent perfecting and understanding APRs, they may be on their way out.

After all, if consumers don't understand the APR, it doesn't serve a purpose, other than as a resource for examiners seeking violations.

Add to the consumers' views, those of the new CFPB staff. They don't like APRs either. Whether they understand them or not, APRs do not seem to be the flavor of the day.

Ignoring the Truth in Lending Act's mandate for prominent placement of the APR, the CFPB's draft disclosure includes the APR almost as a footnote. It certainly isn't prominent. A diligent compliance professional can find it, but consumers are not likely to notice it at all.

APRs in the real world--and what could replace them

Do we really need APRs? And where would we be without them?

The APR was designed to express finance charges--all the costs required to obtain a loan--as a percentage rate that could easily be compared from loan to loan.

As a concept, it carries a certain elegance. Reality, however, is that consumer math skills seem to stop between the second and third grades--certainly before the concept of percentages is introduced.

The result is that the comparison tool designed by TILA is more or less unused.

Rather than mourn its loss, we should consider what can replace APR for the purpose of credit shopping. And while considering that, we can secretly celebrate the dramatic reduction in violations such a change is likely to bring. (Even though APR calculation skills distinguished compliance professionals from the rest of the population. We'll just have to live with that.)

The idea behind the APR is the total cost of the credit. That includes costs present, in the form of fees and charges, and costs future, in the form of interest and the odd inspection or release fee.

Using the total cost for calculation of the APR is an intellectually elegant concept. But consumers don't think that way. In addition to the higher math aspect of the APR, the consumer-think barrier is one of the reasons the APR doesn't work.

Consumers don't look at the APR because they are looking at something else--like the first payment amount or what is due at or before settlement.

The consumer's question is not the total cost of credit over time. The consumer's question is: "Do I have enough to do this?"

Effective disclosures should answer the consumer's "Do I have enough?" question.

But we have also seen the hazards that a consumer can encounter when looking only at a single number or loan phase, such as the first payment. Clever predatory lenders figured out what consumers looked at and played games with the first payment to make it look affordable. By the time reality-level payments hit, the predatory lender had collected fees and moved on down the road.

So much for looking at the initial payment.

If disclosures are limited to consumer-friendly numbers such as itemized fees and charges, they need to be presented in a way that prevents the consumer from looking at and considering only one of them. Tempting as that first payment may look, we want the customer to look beyond and see the whole payment stream. Clearly, the old TILA form (currently in effect) is not exactly eye candy. In fact, many consumers find it less readable than an IRS form.

Something has to change. But what?

What else should consumers use to identify the best credit offer?

Comparing TILA, RESPA, and CFPB concepts

Truth in Lending requires disclosure of all payments--not just the first one. It also requires the itemization of the amount financed to show where the consumer's money is going. The Real Estate Settlement Procedures Act, on the other hand, requires disclosure of settlement service costs.

Because these RESPA disclosures include the elements of the amount financed, it fulfills that part of the TILA disclosure--at least it used to.

Now, with its black boxes, the good faith estimate fails to itemize disclosures required by TILA. Worse yet, it lumps together some of the most important costs that consumers should understand--origination and settlement. And it turns out, based on gripes we hear from customers about the new GFE, that the origination and settlement cost items are the items consumers care about.

They don't like those black boxes.

So what should a disclosure look like? What would do the trick?

What do consumers really want? And how can banks provide it?

The draft mortgage disclosure forms posted by CFPB certainly don't do the trick.

They lump important costs together just like the current GFE. The forms drafted by the CFPB would enable predators to structure loans and disclosures in ways that would conceal the true costs.

We have learned--through experience and from studies--that consumers want basic numbers. They want the interest rate, the loan amount, and the payment amounts. These should be clear and prominent. Disclosures of the APR and Amount Financed can be placed at a lower level so that they illustrate the cost of borrowing (for those who enjoy the math) rather than distract from what the consumer wants to see.

The Federal Reserve Board did this effectively in its proposed revisions to mortgage lending forms, which are now apparently off the table.

Disclosure of payment amounts--all of them--may be one of the most important aspects of a TILA disclosure. The Regulation Z disclosure has always done this. It just isn't particularly pretty. Redesign of how payment information is shown should solve this problem. And in the redesign, the disclosure could call attention to the largest payments and when those payments will occur. That is probably where the bold type and "more prominent than" standard should be applied.

What about all those mortgage settlement service costs that are lumped into the black boxes? Consumers do not like the pig-in-a-poke method of disclosing these costs. Why not throw out that GFE and start over?

When designing the new GFE, HUD focused its thinking on who had control of the service or cost and designed the form to group costs together based on who arranged the service and whether the cost could change.

That isn't how most consumers approach the situation.

- What consumers would like best is an itemization--a list of services and costs.

- They also like knowing when the cost must be paid.

Most banks quickly discovered that when they give an applicant the new GFE, they also had to provide a "worksheet" that itemizes the costs. That worksheet is essentially what the old GFE was and it answers consumers' questions better than the new GFE does.

What a concept! Give 'em what they want

So here's an idea. Why not reformat TILA to provide the information that consumers want?

- Put the loan amount, interest rate, and all payments in big type close to the top.

- Underneath, itemize the closing and service charges.

- Throw out the concept of total finance charge--the second primary cause of restitution.

We don't really need it if we aren't using APRs. Instead, all costs are part of the finance charge and APR.

That's where the Fed was headed and it made a fair amount of sense.

We could also fit all this information onto a single page. This could even be a "green" disclosure!

Will you mourn the APR? Tell us what you think about the APR, the CFPB proposal, and other issues covered in this blog in the comment section below.

### About Lucy Griffin

"Lucy and Nancy's Common Sense Compliance" is blogged by both Lucy Griffin and Nancy Derr-Castiglione, both longtime ABA Banking Journal contributing editors on compliance.

- Lucy, a Certified Regulatory Compliance Manager, has over 30 years experience in compliance. She began as a regulator, including stints with the Federal Reserve Board, the Federal Trade Commission, and the Federal Home Loan Bank Board. For many years she managed the ABA Compliance Division. Since 1993 she has served as a compliance consultant as president of Compliance Resources, Inc., Reston, Va. She is also editor of Compliance Action newsletter and senior advisor with Paragon Compliance Group, a compliance training firm.

In addition to serving as a Contributing Editor of ABA Banking Journal, Lucy serves on the faculty of ABA's National Compliance Schools board. For more than a decade she developed and administered the case study at ABA's National Graduate School of Compliance Management. She can be reached at [lucygriffin@earthlink.net](mailto:lucygriffin@earthlink.net)