

*Consumers Understanding of Interest Rate & APR
Research Executive Summary*

*The Ohio State University's
Consumer Finance Monthly Survey*



Business Problem: As interest rates have increased, your financial institution is seeing more retail customers upset about and unable to pay the higher interest payments required by their mortgages and other loans.

Solution: Financial institutions can use results from this research to improve customer knowledge of the true price of a loan, which reduces surprises when interest rates change.

Research Details: The 1968 Truth in Lending Act was designed to ensure that customers understood how much a loan would really cost them. This research paper analyzes responses from a telephone survey done three decades after the Act was passed and finds consumers still do not really understand the price of a loan.

One key part of the Act was ensuring that banks clearly tell customers not only the contract interest rate but also the annual percentage rate (APR), which also includes points and many fees so that consumers can more easily compare offers. Since the APR is a broader cost measure, it is the same or greater than the contract interest rate. Survey results show that among consumers who had applied for a mortgage or refinanced in the past five years, 40% of the respondents did not understand the APR-interest rate relationship.

Using more sophisticated analysis, the research shows which types of customers have trouble understanding the relationship. Income had no impact on understanding. Richer customers had no more or no less understanding than poorer customers. Education also had almost no impact. The only group who understood the difference were people with a graduate education. Simply being a college or high school graduate did not matter. The research also finds that borrowers in the U.S. South had higher rates of lack of understanding. This tells bankers that almost all groups need more information about the true costs of loans to avoid surprises later.

Research Title: *The Price of Money: Consumers' Understanding of APRs and Contract Interest Rates*

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