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< Financial Education versus Costly Counseling: How to Dissuade Borrowers from Choosing Risky Mortgages?



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Financial Education versus Costly Counseling: How to Dissuade Borrowers from Choosing Risky Mortgages?

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Abstract

This paper explores the effects of mandatory third-party review of mortgage contracts on consumer choice. The study is based on a legislative pilot carried out in Illinois in 2006, under which mortgage counseling was triggered by applicant credit scores or by their choice of risky mortgages. Low-credit score applicants for whom counseling or review was mandated materially altered their contract choice. Conversely, higher credit score applicants who could avoid counseling by choosing nonrisky mortgages did so, decreasing their propensity for high-risk contracts between 10 and 40 percent. In the event, one of the key goals of the

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legislation—curtailment of high-risk mortgage products—was only achieved among the population that was not counseled.

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D18 Consumer Protection

G21 Banks; Depository Institutions; Micro Finance Institutions; Mortgages

R21 Urban, Rural, Regional, Real Estate, and Transportation Economics: Housing Demand

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