The Effectiveness of Mandatory Mortgage Counseling: Can One Dissuade Borrowers from Choosing Risky Mortgages?

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We explore the effects of mandatory third-party review of mortgage contracts on consumer choice--including the terms and demand for mortgage credit. Our study is based on a legislative pilot carried out by the State of Illinois in a selected set of zip codes in 2006. Mortgage applicants with low FICO scores were required to attend loan reviews by financial counselors. Applicants with high FICO scores had to attend counseling only if they chose "risky mortgages." We find that low-FICO applicants for whom counselor review was mandatory did not materially change their contract choice. Conversely, applicants who could avoid counseling by choosing less risky mortgages did so. Ironically, the ultimate goals of the legislation (e.g., better loan terms for borrowers) were only

achieved among the population that was not counseled. We also find significant adjustments in lender behavior as a result of the counseling program.

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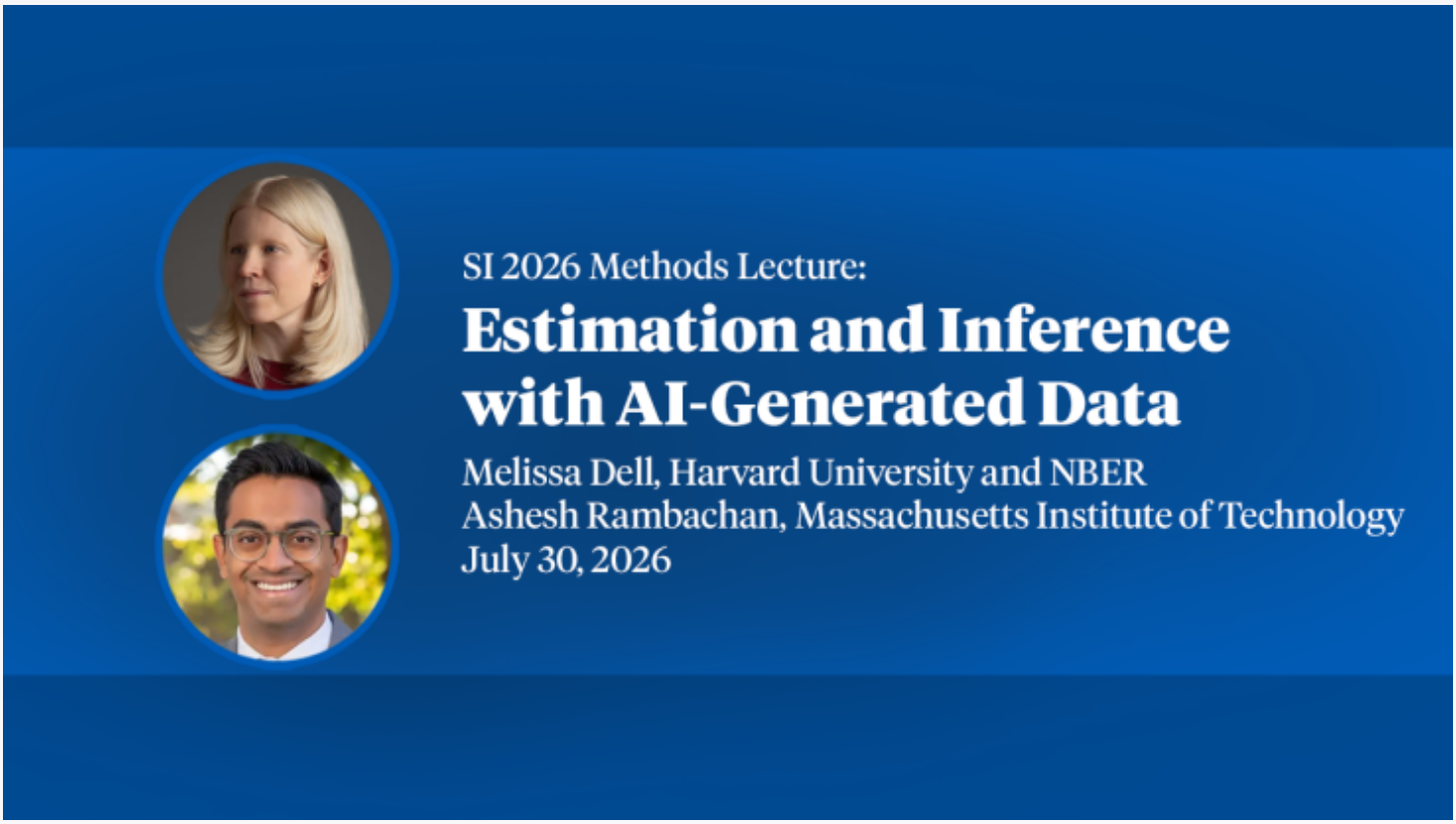


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