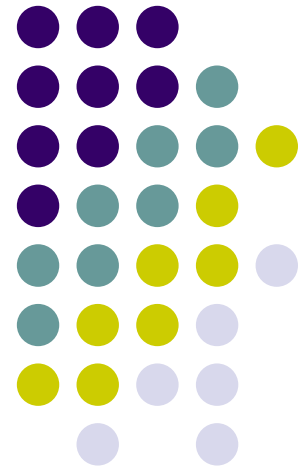
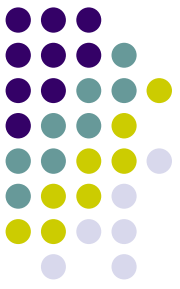


Informational Problems in the Mortgage Market

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FTC, May 29, 2008

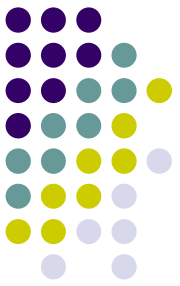


Concerns about Borrower Confusion



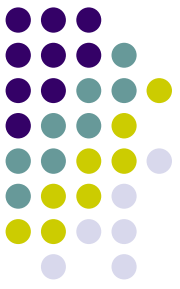
- Mortgage decisions are complex and most people make them only a few times.
- Recent work indicates that borrowers don't fully understand their loan terms.
- Two implications
 - Borrowers may not shop effectively for better terms and may pay excessive fees.
 - Borrowers may put themselves in a financial position they will later regret - i.e. wrong mortgage or wrong house.
- Innovations in mortgage contracts and expansion of credit into subprime exacerbate concerns.

Market disclosure incentives



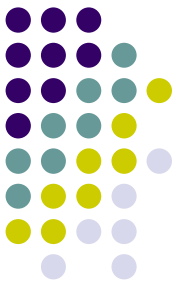
- What do we know about disclosure incentives?
 - Depends on both *buyer sophistication* and *competition*.
 - With sophisticated buyers, sellers have an incentive to disclose fully; with unsophisticated, only disclose if it allows for a mutual gain.
- What are the implications?
 - Typically little incentive to disclose fees, or better APR alternatives, unless there is *competition* over these terms.
 - Traditionally lenders may have had a strong incentive to steer borrowers into sustainable obligations, but arguably undermined by *agency problems* in modern environment.

“Affordability” products in subprime lending



- Difficult problem in subprime lending is that borrowers are (a) highly “payment sensitive, and (b) highly heterogeneous.
- Evidence on (a)-(b): Adams, Einav, Levin (2008, *AER*), Einav, Jenkins, Levin (2008) on auto loans.
 - Purchase decisions *extraordinarily* sensitive to down payments and quite *insensitive* to deferred payments.
 - But defaults are highly sensitive to later payments (flip side of the same coin).
 - Alternative to default is prepayment - not surprising given high loan APRs.

Does better information lead to better decisions?



- Recent work at FTC shows that current mandatory disclosure could be improved and simplified.
- Would this lead to better decisions? And how?
 - Might alert borrowers to fees or penalties, but much less clear if it would lead them to be “better shoppers”.
 - Even with better information, mortgage decision and comparing contracts remains highly complex.
 - Work in behavioral economics suggests *details* of disclosure/shopping process likely to matter a lot.
- Raises the question of whether improved disclosure provides sufficient consumer protection.