

Hot Topic Panel: The Financial Crisis
The Consumer Perspective: The Foreclosure Crisis

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Consumers



“Intermediaries”



Investors

Investors



“Intermediaries”



Consumers*

“Intermediaries”



Investors



Consumers

Consumer Perspective

Old World:

- level payments
- few features
- commodities
- credit rationing
- avg. cost pricing

New World:

- payments change
- many features
- tailored products
- return forecasting
- risk-based pricing

Consumer Perspective

Old World:

- Disclosure:
 - payment
 - APR
- Rules of thumb
- Shoppers
- Credit rationing

New World:

- Disclosure:
 - some payments
 - APR (today's index)
 - rate structure, PPPs, option/neg am features, balloons, IO structure

HOEPA - 1994

You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application.

If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.

Too dry, too generic, & too late

Markets do tend to self-correct. In response to the...losses incurred by investors, the market for subprime mortgages has adjusted sharply....

The...resulting increase in the attention to loan quality should help prevent a recurrence of the recent subprime problems.

– Federal Reserve Chair Bernanke
Sept. 20, 2007

We must continue to keep mortgage credit available and support the housing market, so that we can more quickly turn the corner on the housing correction.

-Treasury Secretary Paulson
Oct. 8, 2008

HOEPA: underwrite mortgages at fully-indexed price using real borrower data.

Modern mortgage lending profit model:

Some loans perform & some do not.

Nonperforming loans can produce return if equity in home after foreclosure expenses.

Risk-based pricing & pool-based profitability: only some loans need to perform, so long as returns on others compensates for nonperforming loans.

Why Do Consumers Buy Risky Mortgages?

- Incomprehension: do not know whether or by how much monthly payment can change
- Discounting over time & uncertainty
- Fail to consider joint probabilities
- Bimodal responses to risk
- Avoid & deny thoughts of risk /
Overconfidence & overoptimism

Why Do Consumers Buy Risky Mortgages?

Unmoored Risk Preferences

- Malleability of Responses to Risk
- Intractability of Cost-Benefit Calculations

**Lesson of the foreclosure crisis for consumer law:
need innovative, new regulation for
innovative new mortgage world**