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Stark studies loan counseling

Professor says borrowers benefit from forms that fully reveal future payments

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Professor Debra Pogrund Stark uses her experiences as a real estate lawyer and educator to help borrowers gain better access to housing loans.

Stark handled real estate law for about eight years before becoming a professor at The John Marshall Law School.

"I'm glad I had that time in practice first because it ended up being invaluable to the research ideas I've come up with since," she said.

In 1994, she began teaching a real estate transaction course at John Marshall and also started studying whether a judicial or nonjudicial process should get used for foreclosures.

"I did an empirical study in Cook County. I looked at about 1,500 cases that were filed in July back in 1993 and 1994 and traced what happened in all these (foreclosure) deals," she said.

Stark observed certain trends, including many individuals agreeing to high-cost, high-risk loans. She also noticed people applying for adjustable rate loans, which added to their costs.

"Why would someone take out a loan that will end up costing them way more? I don't mean just closing costs but the interest rate as well," she said.

Stark also discovered that some of her law students also took out similar high-interest loans to pay for school.

She hypothesized that these trends show that mortgage lenders skip over important details — mainly highlighting the lowest interest rates and not providing the full picture.

Stark's research later led her to pair up with Jessica Choplin, a psychology professor at DePaul University. They worked together to take a closer look at the loan process.

Through a three-year, \$250,000 award from the National Science Foundation in 2010, Stark and Choplin performed three experiments to determine how borrowers read, assess and recall the information included in the terms of their home loans.

In the first experiment, participants completed the loan forms that future homeowners used before the Truth in Lending Act (TILA) took effect in 2008.

The new forms provide a "good faith" estimate of future payments, which the old process did not require.

Stark said the new forms got designed to "alert borrowers of the basic loan terms, so they know what they're getting and can price shop and compare one loan with another loan."

In the second and third experiments, participants used the new forms. But the third experiment's participants got distracted with conversation to see how that would influence their understanding of the form.

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Debra Pogrund Stark

Stark and Choplin studied how borrowers recalled the terms on disclosure forms and in all three experiments, the impact of confirmation bias on determining the riskiness of a loan. This bias causes borrowers to miss other details in the disclosure documents, Stark said.

"If I tell you you are going to get a loan at 5 percent, when you're looking through that document, your eyes are going to look for confirmation to verify, 'Is that true?' Once you see it, you stop looking," Stark said of confirmation bias.

Borrowers in the first experiment experienced more confirmation bias than participants in the second experiment. But participants in the second experiment showed a better recall of the loan terms.

In the third experiment, borrowers' "confirmation bias increased dramatically" and the distractions made it harder for them to recall the loan terms, she said.

"Distraction can really impede the effectiveness of these disclosure forms," Stark said.

Based on these results, Stark said, "Congress needs to require that all federally-insured home loan borrowers hire a specially-trained attorney or mortgage loan counselor to review the home loan disclosures with the borrower."

Borrowers, especially of a lower economic status, become more susceptible and likely to, "trust the (loan) professional they are working with has their best interest at

heart when that professional has shown them superficial signs of respect," she said.

Loan advisers typically hold a "financial interest" in persuading borrowers to invest in their loans, she said.

A mortgage counselor would "help ensure that the loan is not overpriced or otherwise unsuitable for the borrower's needs. It also gives the attorney or counselor the opportunity to answer questions and otherwise give sound advice to the borrower," Stark said.

"I believe if we had had these mortgage counselors in place, many people would not have entered into these high-cost unaffordable loans that led to so many foreclosures," she said.

Michael P. Seng, co-executive director of the Fair Housing Legal Support Center and a professor at The John Marshall Law School, said Stark's research relates to some of the materials students study in his course.

While in his class, students perform internships and provide "the anecdotal stories" that verify Stark's study results, Seng said.

"Homeowners are not particularly knowledgeable about the loaning process, and mortgage counseling can be very helpful to people," Seng said.

Andrew G. Pizor, a staff attorney at the National Consumer Law Center in Washington, D.C., said Stark reached out to him about using her research in policy-making.

"It's very interesting and good research. She's one of the only researchers I'm aware of that uses the most current (disclosure) forms and seen how consumers react to them. And that makes it especially useful for policy-making," he said.

Pizor said Stark's research helps the National Consumer Law Center in terms of making regulations specifically useful to consumers.

"She's given more of an empirical basis for designing these things (disclosures). ... She's given some good guidance on things that will be practically useful," Pizor said.

Stark said she hopes their research provides support for loan counseling.

"There is counseling now for high cost loans under federal laws," she said. "And the goal is to expand it to all homeowners who fail to pass a financial literacy test."

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