The New Legal Paternalism: Light-Touch Regulation for Consumer Mortgages

Keywords: behavioral law and economics, bounded rationality, default rules, Consumer Credit Directive (2008/48/EC), EU Mortgage Directive, Finnish Consumer Protection Act, US Truth in Lending Act (TILA)

Oskari Juurikkala

Abstract

Consumer mortgages have provoked extensive public debate, but traditional regulatory responses — more disclosure, product restrictions and usury laws — are widely seen as clumsy and ineffective. This article examines the possibility of improving consumer mortgage markets through light-touch regulations inspired by behavioral economics. Three regulatory strategies are investigated: targeted and simplified disclosure rules, cooling-off regulations, and the designing of a model mortgage. These strategies are examined using examples from recent or proposed EU and US legislation as well as ideas proposed by experts. With respect to novel disclosure and cooling-off rules, the proposed EU Mortgage Directive is found to include several positive ideas such as the European Standardised Information Sheet. Yet the most promising path seems to be the creation of a model mortgage for unsophisticated borrowers. In addition to proposing novel regulatory strategies, the article contributes to the wider debate on the acceptability of legal paternalism.

Full Article in English

1 Introduction

Legal paternalism is here understood as the view that people tend to make mistakes and therefore it is legitimate for the law to intervene.[1] Naturally, paternalism is controversial: many philosophical traditions place an absolute value on human autonomy, or hold that personal freedom can only be

1 On the concept of paternalism generally, see Dworkin (2010).

limited when it causes harm to others. This skeptical attitude is shared by standard economic analysis of law, because legal paternalism conflicts with the assumption of rational utility maximization.[2]

The anti-paternalism of mainstream economics has been challenged by so-called *behavioral economics*, which combines economics and psychology—cognitive psychology in particular—to paint a more realistic picture of real human choosing.[3] According to behavioral economics, human decision-making is subject to imperfections which lead us to make suboptimal choices. Not surprisingly, advocates of behavioral economics tend to be pro-regulation and paternalistic.[4]

The paternalistic tendencies of behavioral economics have not gone unchallenged. On one hand, there has been extensive *external critique* claiming that behavioral economics is conceptually obscure; that empirical evidence on the limits of economic rationality is inconclusive; and that its practical relevance may be small.[5] On the other hand, there is *internal critique* to the effect that the regulatory implications of limited rationality are unclear, because regulatory complexity may create more problems, and if everyone is subject to limited rationality, we should be skeptical about the ability of regulators to solve the issues effectively.[6]

The present article accepts much of this criticism, but seeks to establish a more balanced view. The prospects of behaviorally inspired paternalism are

2 Frerichs (2011: 305), Rischkowsky and Döring (2008). A good representative of this tendency in law and economics is Epstein (2006; 2008). In general terms, the rationality postulate implies that bad outcomes can only be explained by external factors such as imperfect information, lack of competition, or weak bargaining power; interventions may be justified to correct these problems, but not to protect individuals from themselves.

3 For an overview, see Frey and Benz (2004) and Rabin (1998). For general application in law, see Jolls, Sunstein and Thaler (1998) and Langevoort (1998).

4 Choi and Pritchard (2003: 4–5), Frerichs (2011: 305), Rischkowsky and Döring (2008). A good representative view is Bar-Gill (2008). Other pro-regulatory arguments from behavioral economics include Cunningham (2002: 770–71), Langevoort (2002: 138–39) and Prentice (2002). An excellent comparison of "traditional" and "behavioral" regulatory approaches can be found in Faure and Luth (2011).

5 See Choi and Pritchard (2003: 9–10) and Posner (1998). Etzioni (2011: 280) also points out that behavioral economists often fail to clearly delineate how universal or particular the anomalies are. Some critics claim that the supposed mistakes made by people are not really mistakes at all (Mitchell 2002; 2003), but it is hardly plausible that behavioral economics is entirely unfounded: see Rachlinski (2003). For a critical assessment, see Juurikkala (2012a: 46).

6 See Juurikkala (2012a: 77–92) as well as Glaeser (2006) and Klick and Mitchell (2006).

studied in the context of consumer mortgages, where there is substantive empirical evidence of problems caused by bounded rationality (see Section 2). In order to overcome the opposition between pro- and anti-regulatory views, the article focuses on so-called *light-touch regulations* inspired by behavioral economics.[7] In particular, three different types of regulatory response are investigated: disclosure rules based on the findings of behavioral economics (Section 3), cooling-off regulations (Section 4), and the possibility of designing default rules based on a model consumer mortgage (Section 5).

2 Behavioral Paternalism and Its Applicability to Consumer Mortgages

2.1 Problems with Consumer Mortgages

According to studies in cognitive psychology, people tend to make imperfect decisions due to a range of cognitive tendencies called biases. In the economic realm, some of the most important biases include the following.[8] *Salience bias* means that people tend to overemphasize vivid evidence and emotional experiences, giving too little importance to facts and logic. *Optimism bias* is the tendency to overestimate the chances of personal success, while underestimating risks to oneself. *Overconfidence bias* means that people overestimate their ability to judge facts and situations correctly. *Confirmation bias* signifies that people often prefer information that supports their past decisions. *Status quo bias* denotes the tendency to avoid making changes even when these would improve personal welfare. Because of these biases, people are said to have *bounded rationality* and *bounded willpower*.[9]

One of the issues with behavioral economics is its applicability in different contexts.[10] There is some evidence suggesting that professionals do not fall

7 To be sure, this is not intended as an argument for the light-touch regulatory philosophy employed by the UK Financial Services Authority. On the problems of modern banking regulation, see Dowd et al. (2011) and Juurikkala (2012a: 63–66, 75–77).
8 See for example Rabin (1998), Frey and Benz (2004), and Juurikkala (2012a: 39–45).
9 See Jolls, Sunstein and Thaler (1998) and Frey and Benz (2004). These authors also talk of *bounded self-interest*, but its regulatory implications are different: see Juurikkala (2012a: 38–39).
10 For a study of context-dependence generally, see Kelman, Rottenstreich and Tversky (1996).

into certain behavioral anomalies that are common in the population at large.[11] In contrast, the behavioral approach is particularly relevant when decision-makers receive great amounts of complex information but lack practical experience.[12] Therefore, there is reason to believe that bounded rationality is especially significant in the context of consumer credit.[13] Indeed, a famous empirical study concluded that, although many households do make sound financial decisions, a significant minority — especially those who are poorer and less educated — make large mistakes that have grave financial consequences.[14] Others have also argued that markets in consumer mortgages and credit cards suffer from imperfections that, on one hand, are caused by bounded rationality, and on the other hand they exacerbate the effects of bounded rationality.[15] In fact, some have argued that the recent global financial crisis was partly caused by the development of complex loan agreements that appeared cheaper and less risky than they really were.[16]

There are many reasons why paternalistic regulations may be justified in consumer mortgages. Firstly, the stakes are huge for ordinary people, and bad decisions may have dramatic consequences. Secondly, consumers take mortgages only rarely, so that there is little opportunity for learning, and the feedback mechanism is so slow and complex that consumers may never understand what mistakes they made.[17] Thirdly, mortgage products involve highly complex issues, and it has been found that understanding them perfectly is difficult even for finance professionals equipped with sophisticated software.[18] Finally, the incentives of banks and mortgage brokers often con-

11 See List (2003) and Gneezy and List (2006).
12 In fact, the path-breaking work in behavioral economics by Herbert Simon (1947) focused precisely on complex decision-making contexts.
13 Elliehausen (2010).
14 Campbell (2006).
15 Bar-Gill and Warren (2008: 33–43).
16 For example Barr et al. (2008: 8). More generally on the global financial crisis and mortgages, see Gorton (2010) and Turner Review (2009). However, it has been argued that the misbehavior of housing markets was only a symptom of failed monetary policy and unsound inventions in structured finance: see Dowd and Hutchinson (2010), Taylor (2009).
17 Bar-Gill and Warren (2008: 11–14).
18 Shu (2007). A study by the European Commission (2011a: 4) on mortgage also found that "almost 38 % of EU citizens find it very or fairly difficult to compare offers. […] Consumers also view the information provided as complex and unclear; 59 % of EU citizens find it difficult to understand information on the way their mortgages work and the risks involved."

flict with those of their customers, and unsophisticated shoppers are especially vulnerable to unhelpful advice.[19]

2.2 Traditional Responses and Their Limits

There are three traditional regulatory responses, and none of them seems sufficient. One is to increase *disclosure requirements*. The trouble is that merely requiring more disclosure may backfire — especially if the purpose of the regulation can be avoided by asking applicants to sign complex disclosure forms they do not understand, or do not have time to read carefully.[20] The existing empirical evidence from the United States is little less than shocking:

> For current disclosures, 87 percent of participants could not correctly identify total up-front charges; 74 percent could not identify charges for optional credit insurance; and 68 percent could not identify the presence of a prepayment penalty. Participants had problems not just with terms of complex mortgages. Fifty-one percent of participants could not correctly identify the loan amount; 32 percent could not identify the interest rate; and 23 percent could not identify closing settlement charges. Responses of subprime borrowers were similar to those of prime borrowers for both simple and complex loans.[21]

The second traditional response is *product regulation*. For example, we could prohibit certain contract features, such as prepayment penalties or short-term adjustable-rate mortgages. The problem is that this might go too far, because unusual products are sensible for some individuals — for example those who are planning to sell the house soon — and some consumers are able to make sound financial decisions. Moreover, it is difficult to design well-targeted prohibitions, as markets often find ways of evading them.

The third response is *usury laws*, i.e. imposing limits on interest.[22] But usury laws are rarely sensible in competitive markets: high prices are not exorbitant if they reflect risks and other costs. Moreover, price controls may be ineffective for such complex products as mortgages, because "loan instru-

19 Banks for wealthier clients have stronger incentives to establish a good reputation, and sophisticated buyers are better able to evaluate the quality of the advice they receive. See Bar-Gill and Warren (2008: 17-20), Thaler and Sunstein (2009: 142).

20 Ellinhauser (2010: 31–33).

21 Ellinhauser (2010: 32), summarizing the findings of Lacko and Papalardo (2007).

22 In recent decades, usury laws have seen something of a comeback in the legal literature: see for example Morris (1988) and Rougeau (1996).

ments are so malleable that any limit on one aspect of price can be evaded through restructuring the loan."[23]

2.3 Softer Solutions: The New Legal Paternalism

The objective of the new legal paternalism is to design regulations that reduce cognitive biases and their effects, while limiting personal freedom only marginally. This is "soft" and "weak" paternalism, because it only interferes with the means rather than ends, and because it seeks to ensure knowledgeable decision-making without coercion.[24] In the literature on behaviorally inspired economic analysis of law, there are three models of paternalism that serve as reference points here: libertarian paternalism, asymmetric paternalism, and debiasing through law. Although they are related, their logic is slightly different, as is explained next.

Libertarian paternalism is a highly influential proposal by Cass Sunstein and Richard Thaler.[25] The objective is to "steer people's choices in welfare-promoting directions without eliminating freedom of choice."[26] The way to do that is to influence the decision-making context — also called *choice architecture*[27] — so that people will make better choices while continuing to enjoy full freedom of choice. This is possible whenever people have unclear preferences and their choice is influenced by the way the options are presented.[28]

Asymmetric paternalism is similar, but it builds on the idea that some people are better decision-makers than others.[29] In such circumstances, "good" decision-makers — people who know what they want and how they can get it — should be given more freedom, while "bad" decision-makers should

23 Willis (2006: 817).
24 These distinctions are discussed in detail in Dworkin (2010).
25 See Sunstein and Thaler (2003) and Thaler and Sunstein (2009).
26 Sunstein and Thaler (2003: 1159).
27 See Thaler and Sunstein (2009: chapter 5).
28 However, Hill (2007) and Mitchell (2005) argue that "libertarian paternalism" is not so libertarian in practice, because it implies that regulators know better what people need, and the policy proposals tend to limit personal autonomy in some ways.
29 Camerer, Issacharoff, Loewenstein, O'Donoghue and Rabin (2003).

be treated more paternalistically.[30] In terms of law, the objective is to design regulations that distinguish between good and bad decision-makers.[31]

The third approach is called *debiasing through law*.[32] Here, law is used not to influence the decision-making context, but to directly reduce or eliminate psychological biases.[33] For example, the bias known as *over-optimism* may be reduced by employing the *availability heuristic*: people tend to neglect dry, statistical information, whereas concrete, narrative information has a stronger impact on attitudes.[34] One challenge, however, is how to distinguish between heterogeneous actors, given that some people may not suffer from biases such as over-optimism.[35]

Using these ideas as the theoretical framework, the following sections look at three types of light-touch legal strategies to influence behavior and reduce biases: special types of information disclosure, cooling-off regulations, and the design of model contracts.

3 Information Disclosure for Boundedly-Rational Mortgage Shoppers

The problem with traditional disclosure regulations is that there tends to be too much information, which does not help consumers and may even confuse them further. Mortgage-taking decisions often hinge on factors that financial theory would consider insignificant or irrelevant, but that consumers mistakenly believe to be important, for example the size of monthly payments.[36] Behavioral theory suggests that regulations should be geared towards less information, putting more emphasis on what information is relevant and how it is presented.[37] This section considers five ways of im-

30 Ibid. at 1219.
31 The article by Camerer at al. (2003) provides a range of examples.
32 Jolls and Sunstein (2006).
33 Ibid. at 200.
34 See ibid. at 207–213.
35 Rachlinski (2006). This has been acknowledged by Jolls and Sunstein (2006: 229) trying to reduce optimism bias may “distort the behavior of individuals who did not suffer from optimism bias in the first place. For those who previously had an accurate understanding of the situation, such strategies for debiasing through law could produce a kind of unrealistic pessimism.”
36 Barr et al. (2008: 2).
37 Camerer et al. (2003: 1230–1237). See also van Boom (2011) for a detailed discussion on price intransparency and regulation.

proving decision-making: annual percentage rates (APR), standardized information sheets, the disclosure of conflicts of interest, ex-post disclosure standards, and possibilities for countering over-optimism bias.

3.1 Annual Percentage Rate (APR)

Rules that stipulate the calculation and disclosure of the *annual percentage rate* (APR) are a widespread regulatory strategy that simplifies complex information, making it easier for consumers to focus on key facts and to compare different offers. These rules are not perfect, because there is some discretion and variation on which costs must be included in the calculation of APR; indeed, there are different opinions on what is the optimal specification of APR. Nevertheless, they are a significant help to many consumers, and cause little ongoing cost to creditors.

In Europe, the rules for calculating the APR[38] have traditionally differed widely across EU member states, and some countries have not specified the matter at all.[39] Most countries have adopted a narrow APR, which covers only those costs that the lender levies for its own benefit. In order to reduce variation and discretion, the recent Consumer Credit Directive (2008/48/EC) changed the regulatory landscape by demanding full harmonization of the APRC calculation method, adopting a rather broad definition.[40] In light of behavioral theory, this is a positive step. Importantly, the Directive does not cover home loans, but some member states have extended their implementing legislation to home loans too,[41] and a new Directive proposed by the Commission would expand the same approach to consumer mortgages.[42] This would increase the comparability of loan offers from different member states, thereby facilitating cross-border markets in home loans.

38 Also called the Annual Percentage Rate of Charge (APRC).
39 See London Economics (2009: 168–174).
40 See Article 19 and Annex I of the Directive. The attempt to harmonize APR specifications in the EU has a long history: see Soto (2009).
41 Finland, for example: see Consumer Protection Act (20.1.1978/38), Chapter 7 (amended 27.8.2010/746), Section 1; on the calculation of interest, see Section 6 (*luottokustannukset ja todellinen vuosikorko*).
42 See European Commission (2011b).

3.2 Standardized Information Sheets

The APR alone is hardly sufficient, especially as the development of innovative and complex mortgages has rendered it far too simplistic. According to an impact assessment by the European Commission, many problems in home loan markets are due to difficulties at the stage before the conclusion of the contract: advertising information is often "non-comparable, unbalanced, incomplete and unclear," while pre-contractual information can be "insufficient, untimely, complex, non-comparable and unclear."[43] Indeed, many commentators have argued that the key regulatory goal is to make it easier to compare offers and to facilitate shopping around.[44]

The Consumer Credit Directive (2008/48/EC) and some national laws already stipulate standard information that must be included in advertising: borrowing rate, annual percentage rate of charge (APRC), total amount payable by the consumer, and so on.[45] The proposed EU Mortgage Directive[46] — which unmistakably reflects the theories of behavioral economics — would extend similar requirements to consumer mortgages, but it would also add a *broad standard*, so that a "wording that may create false expectations for a consumer regarding the availability or the cost of a credit shall be prohibited" (Article 7). But this broad standard is coupled with another rule, which demands that the standard information be presented "in a clear, concise and prominent way by means of a representative example" (Article 8(2)). Moreover, the standard information "shall be easily legible or clearly audible as appropriate."

These proposals seem laudable, although they are so broad that their enforceability is an open question. Yet, perhaps the most interesting proposal is the *European Standardised Information Sheet* (ESIS),[47] a version of which

43 European Commission (2011c: 11–14).
44 Willis (2006: 820–828).
45 See, for example, the Finnish Consumer Protection Act 7:8, which (unlike the Consumer Credit Directive) also applies to consumer mortgages.
46 See European Commission (2011b).
47 See European Commission (2011b: Annex II). It is an updated version of an earlier Voluntary Code of Conduct, drawn up by the Commission in March 2001: see *European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans*, available at http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/agreement_en.pdf.

was in the Consumer Credit Directive.[48] It has two objectives: firstly, to make home loan contracts easier to understand by summarizing all the important features of the contract, and secondly, to facilitate the comparison of different offers. An extensive qualitative study of the proposed information sheet suggests that consumers find it helpful in terms of clarity and transparency, although some problems remain.[49]

Similar ideas have attracted attention in the US, and the Consumer Financial Protection Bureau (established in 2011) is investigating options for making mortgage shopping easier. The new regulations of the Department of Housing and Urban Development require all loan originators to issue a new version of the good faith estimate (GFE) to potential borrowers. Among other things, the new GFE is completely standardized across lenders, and it aggregates all fees the lender is charging the potential borrower into one line entitled "Our origination charge."[50] This seems important, because the US market has suffered from a proliferation of disaggregated fees, which in total may amount to as much as 10% of the loan value, "presumably as lenders have seen them as an opportunity to increase revenues without encountering customer resistance."[51]

Thaler and Sunstein have taken a step further by proposing that lenders be required to provide a machine-readable "*RECAP report*"[52]. With mortgages, the report would include all the relevant data on fees and interest rates, including the role of possible teaser rates and what the changes to variable rates will depend on.[53] This data — which shoppers would acquire from a number of potential lenders — could then be handed on to independent third parties who could offer better advice. In fact, well-designed RECAP reports might lead to the development of efficient online-shopping for mortgages.

48 Consumer Credit Directive (2008/48/EC), Annex II. In principle this is already applicable in Finland, although the implementing legislation is flexible: see Finnish Consumer Protection Act 7:9.
49 See Optem (2009).
50 See Entitle Direct (2010) for a detailed exposition of the new Good Faith Estimate.
51 Bar-Gill and Warren (2008: 54–55).
52 From the words "Record, Evaluate, and Compare Alternative Prices": Thaler and Sunstein (2009: 102).
53 Thaler and Sunstein (2009: 146–147).

3.3 Revealing Conflicts of Interest

Another concern is that many consumers may rely too much on their bank's advice. Some commentators speculate that consumers may assume that the bank is offering them the best deal, and that they would not be offered the loan unless the bank thought they would be sure to pay the loan.[54] The extent of this problem is open to debate: the evidence suggests that at least — or should we say, only — a good third of European consumers distrust their bank.[55] Lack of confidence may be caused by various factors, but especially by the perception that banks have conflicting interests.

In the proposed EU Mortgage Directive, there is one provision that seems to try to reduce this problem by stipulating special rules for *credit intermediaries* (Article 10). Among other things, a credit intermediary (i.e. mortgage broker) must "provide the names of the creditor(s) for which he is acting," declare his directorship and ownership rights in the creditor(s), and disclose the fee "payable by the consumer to the credit intermediary for his services." Thus the consumer would become better informed about the specific interests and incentives of the intermediary. This should make it easier for consumers to identify untrustworthy vendors, while improving the incentives of intermediaries to play fair.

However, the proposed rules only apply to credit intermediaries and do not apply to creditors as such. This may be problematic, because when banks and creditors sell their mortgage pools to other investors through securitization or credit derivatives, they too are effectively acting as credit intermediaries as far as their incentives are concerned, and the proposed Directive fails to take this into account.

3.4 Broad Ex-Post Disclosure Standards

As was mentioned earlier, a common difficulty in disclosure rules is that effective compliance with the *spirit* of the rules cannot be externally verified. For example, there may be too much irrelevant information that conceals what really matters, and compliance may become a formality: "Here's the

54 See Barr et al. (2008: 5).
55 See European Commission (2011c: 18).

disclosure form I'm supposed to give you, just sign here."[56] As a way forward, some have proposed that we should move from strictly *ex ante* disclosure regimes towards *ex post* principles: the focus would be on whether the disclosure was really meaningful and sufficient, using a *reasonable person* test.[57]

Fundamentally, this proposal is not as radical as it seems, because similar ideas have been used in general contract law for decades. For example, the *big red hand rule* in common law holds that if a contract term is particularly onerous, "it would need to be printed in red ink with a red hand pointing to it—or something equally startling."[58] What the proposed disclosure regime would do is to develop an analogous principle in disclosure regulation; to be sure, here it goes beyond the requirements of general contract law. Indeed, the proposed EU Mortgage Directive would already take a step in this direction, stipulating that pre-contractual information must be presented "in a clear, concise and prominent way by means of a representative example" (Article 8(2)).

But this approach has its problems.[59] A broad standard may encourage honesty, but it also creates significant *uncertainty costs*.[60] The classic common law concept of a "reasonable person" is a useful theoretical tool, but in many concrete cases its application is prone to such subjectivity that it replaces one problem with another.[61] In fact, cognitive psychology suggests that although the clarity of a contract may be easier to verify after the event, *hindsight bias* is likely to distort the judgment; if a case goes to court after something has gone wrong, a boundedly rational judge is likely to infer that the events that took place were more likely than they would have appeared to a reasonable person at the time of making the loan.[62] This would give undue importance to external events, and one can predict that judgments would be biased in favor of lenders in good times and in favor of borrowers in bad times.

56 Barr et al. (2008: 6).
57 Barr et al. (2008: 6–7).
58 *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163, per Denning LJ.
59 See Warren (2006: 817–820).
60 On the choice between narrow rules and broad standards, see Kaplow (2000).
61 See DiMatteo (1997).
62 On this problem generally, see Rachlinski (1998).

3.5 Reducing Optimism

Many mortgage-related tragedies are related to *over-optimism bias*, as borrowers tend to overestimate their financial prospects and to underestimate such risks as unemployment. To reduce this bias, it is usually not sufficient to provide statistical facts, but to appeal to a phenomenon called *loss aversion*.[63] Some existing disclosure rules seem to be motivated by this idea. For example, the US Truth in Lending Act (TILA) requires lenders to state: "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."[64] The proposed EU Mortgage Directive includes similar statements in the European Standardised Information Sheet: "Your income may change. Please make sure that if your income falls you will still be able to afford your [frequency] repayment instalments. *(Where applicable)* Your home may be repossessed if you do not keep up with payments."[65]

Statements such as these include practically no new information; their objective is merely to remind of risks and to encourage consumers to consider the decision carefully. Unfortunately, there is reason to be sceptical about the efficacy of such statements. As Donald Langevoort has explained, "we can readily see why the law's prized warnings and disclosure will so often have relatively little practical effect, especially if they are formalized into boilerplate. Investors and consumers want to think the warnings are meant for someone else, not them."[66]

One could imagine more effective ways of *debiasing* overoptimism.[67] For example, mortgage offers could be combined with information about the amount of payment difficulties in similar types of loans over a specified period of time. But as generalized warnings tend to be ineffective, this could be combined with tragic real-life stories.[68] Naturally, one must ask how far

63 Jolls and Sunstein (2006: 205–206).
64 15 U.S.C. § 1639(a)(1)(B).
65 European Commission (2011b: Annex II, para. 14).
66 Langevoort (1995: 880).
67 See Sunstein (2006: 261–263).
68 Jolls and Sunstein (2006: 212–216).

it is appropriate to take this, as we do not want to turn people into *over-pessimists*.[69]

4 Taking It Easier: Cooling-Off Rules

Cooling-off periods play a major role in consumer protection laws.[70] For example, consumers have statutory cancellation rights, which cannot be withdrawn by agreement. Traditionally, the justification for these has been based on informational asymmetries (especially in distance transactions) and situational monopolies (for example in door-to-door selling). Additionally, cooling-off periods are a way of reducing decision-making biases due to lack of self-control and bounded willpower.[71]

In consumer protection laws, cooling-off periods normally take the form of *withdrawal periods* (or *cancellation rights*). These are *ex post* cooling-off rules, because they become effective after the transaction has taken place. The other form—much less used in law—is *waiting periods* (*ex ante* cooling-off), during which the transaction cannot be completed. The difference is not huge, but psychology suggests that it may influence outcomes: in light of status quo bias and the so-called endowment effect, people are reluctant to withdraw once they have completed a contract, especially if they are in possession of the goods.[72] Therefore, waiting periods will have a stronger effect on behavior.

4.1 Cooling-Off in Recent EU and US Mortgage Regulations

In Europe, the proposed EU Mortgage Directive includes some cooling-off features. In terms of traditional *ex post* cooling-off rules, Article 18 requires that member states provide consumers with a right to early repayment. (This is not a cooling-off rule in the strict sense, but it is functionally similar.) The exercise of this right may be subject to certain conditions, and creditors should be entitled to fair compensation, but these conditions must not render the exercise of the right "excessively difficult or onerous for the

69 Jolls and Sunstein (2006: 213–214).
70 See Haupt (2003: 1147–1151).
71 See Camerer et al. (2003: 1238–1247), Sunstein and Thaler (2003: 1188).
72 Haupt (2003: 1149). See also Kahneman, Knetsch and Thaler (1990), discussing empirical evidence on the endowment effect.

consumer".[73] Further, in accordance with the Doorstep Selling Directive (85/577/EEC), consumers "should have a right of withdrawal for credit agreements relating to residential immovable property concluded off-premises and should be informed about the existence of that right."[74]

In the proposed Mortgage Directive, there is also an interestingly broad *ex ante* cooling-off standard in Article 9(2):

Member States shall ensure that when an offer binding on the creditor is provided to the consumer, it shall be accompanied by an ESIS. In such circumstances, Member States shall ensure that the credit agreement cannot be concluded until the consumer has had sufficient time to compare the offers, assess their implications and take an informed decision on whether to accept an offer, regardless of the means of conclusion of the contract.[75]

> In the US, the Mortgage Disclosure Improvement Act of 2008,[76] an amendment to the Truth in Lending Act (TILA), seeks to improve consumer choice through a strict *ex ante* cooling-off rule known as the "3/7/3 Rule."[77] Within three business days after receipt of the loan application, an initial good faith estimate (GFE) disclosure must be provided. Next, a seven business day waiting period follows during which the deal cannot be closed. Finally, the borrower must receive an accurate annual percentage rate (APR) calculation at least three business days prior to closing. If the final APR is off by more than 0.125% from the initial GFE disclosure, then the lender must re-disclose and wait another three business days before closing on the transaction.

It would be interesting to see an empirical study of how the new US rules have influenced behavior, and what the costs are. Also, if the proposed EU directive is approved, empirical comparative studies would be helpful for understanding the effects of different approaches.

---

73 There is a similar article in the Consumer Credit Directive, which has been implemented in Finland in Consumer Protection Act 7:28 (consumer loans excluding mortgages) and 7:29 (consumer mortgages).

74 European Commission (2011b: preamble 13). On the relevant rules in Finland, see Consumer Protection Act 7:20 and 7:22.

75 European Commission (2011b). Of course, this standard is so broad that it needs more specification at national level. In the current Finnish Consumer Protection Act, there are no specific rules to this effect; there is a general two-week cancellation right (7:20), but it is not applicable to normal home loans (7:3.2).

76 Pub. L. No. 110-289, §§ 2501-03, 122 Stat. 2654, 2855 (2008) (to be codified as amended at 15 U.S.C. § 1638(b)(2)).

77 See Miller (2009).

4.2 Encouraging Search and Competition

Cooling-off rules mainly seek to reduce harm due to transitional emotions, but they could have an additional role as an *accompaniment* to behaviorally motivated disclosure rules.[78] Consumers rarely shop around for better loan offers, perhaps partly because there are significant application fees, which makes people psychologically more committed to the first offer due to loss aversion bias. Willis has proposed prohibiting significant pre-contract fees, and imposing an explicit *pro-shopping declaration* in the mandatory disclosure sheet:

> My proposed language is: "It is possible that this loan is not the lowest priced available. This paper is the Price Tag for this loan. You should use it to shop with other lenders or brokers for the best loan at the best price, just as you would for any major purchase."; and a non-too-subtle double entendre, "*Time to go shopping!*"[79]

5 Making It Easier: A Model Mortgage

Whereas traditional product regulation tends to go from freedom to prohibitions, behaviorally inspired paternalism suggests a more nuanced approach. Using default rules — with the possibility of opting out — the law may help people make better choices without fundamentally reducing contractual freedom.[80] There are at least two psychological reasons why default rules are important. On one hand, *status quo bias* means that people tend to stick to default options unless the alternatives are clearly — not just marginally — better. On the other hand, the *anchoring heuristic* implies that, when a different option is chosen, it tends to be "anchored" to the default rule, which forms a standard reference-point for evaluating alternatives. Thus default rules can shape markets fundamentally without imposing any prohibitions. This section discusses the possibility of a particular type of default rule: a ready-made model mortgage.[81]

78 See Willis (2006: 823-824).
79 Willis (2006: 824, footnote 462).
80 See Korobkin (1998a, 1998b, 2000) for extensive general discussions on default rules in light of behavioral economics.
81 The idea was first developed seriously by Barr et al. (2008: 8–11).

5.1 A "Plain Vanilla" Mortgage Contract

The idea is simple: a default mortgage contract — a "plain vanilla" mortgage — would be specifically designed by an independent third party, and it would avoid any hard-to-understand details or complex interest rate calculations that exploit common psychological biases. This contract would have to be offered and explained to all mortgage applicants — perhaps with the independent party's label — before other alternatives can be presented.[82]

The potential advantages of this approach are numerous. Firstly, a model mortgage would be easier to compare across different offers, reducing transaction costs to unsophisticated shoppers and improving the quality of their choice. Secondly, it would hinder dubious innovation, because people would anchor their choice to the default option, which would be relatively simple and safe. Thirdly, the default rule would function selectively in the sense that it would be especially relied on by unsophisticated customers, who feel uncertain about taking a mortgage; sophisticated shoppers would remain free to explore other options (this is the principle of asymmetric paternalism). Finally, a model mortgage would permit opting out, which may be entirely reasonable if, for example, someone's circumstances or preferences clearly differ from the standard assumptions — or if the default mortgage is poorly designed. Regulatory costs would thus be small.

There are several questions that would have to be answered in designing a model mortgage (or menu of model mortgages). It is worthwhile to consider them in some detail in order to assess the practical implementation of this idea.

5.2 Which Rate? Variable vs. Fixed-Rate Mortgages

The fundamental variables of any loan include the loan term and the interest rate determination. The issues are complex, but the basic question here is: What would an average consumer prefer if he were capable of making an optimal choice? Some answers can be gathered from finance theory, and the

82 See Barr et al. (2008: 8–11). They also speculate with the idea of making default rules "stickier" by imposing different interpretative principles to default and alternative contracts, so that the latter would imply additional legal exposure for lenders through increased scrutiny.

default mortgage could be periodically revised by a relevant regulatory body, for instance using statistical and survey research.

As far as loan term is concerned, the prudent rule would be to avoid very long terms (e.g. 25–30 years), because the longer the loan term, the larger the total interest paid. In fact, psychology suggests that consumers tend to be misled by long-term mortgages, because they give undue importance to the size of monthly payments. Therefore, the model mortgage should be based on a relatively short loan term (e.g. 15–20 years). This would have the indirect benefit of discouraging large loan amounts, which are more likely to cause tragedies.

Regarding interest rates, the question is more complicated. Currently, mortgages in many European countries are predominantly tied to variable short-term rates (e.g. LIBOR or EURIBOR). In the US, fixed-rate mortgages (FRMs) are the standard, but it is precisely complex adjustable-rate mortgages (ARMs) that have caused problems in recent times. The question is highly important, because it has been shown that most consumers do not correctly understand under what conditions one alternative is better than the other.[83]

Variable (or adjustable) rate mortgages may sometimes be the better option, but overall they contain many disadvantages to consumers. Firstly, they are unlikely to obtain an *efficient allocation of risk*. Due to economies of scale, banks are better able to bear and hedge interest rate risks. Banks also have better access to relevant knowledge and expertise in order to make an accurate risk assessment. Thus variable-rate loans impose the risks on the wrong party.

Secondly, consumers tend to be ignorant of the fact that short-term interest rates tend to change considerably over the lifetime of a mortgage, and they therefore underestimate the risk of rapidly rising interest costs. Thirdly, unhedged interest rate risk also tends to coincide with *macroeconomic downturn risk*, which means that borrowers often end up paying more while be-

83 Campbell (2006: 1577–1580).

ing more likely to be unemployed.[84] Finally, it has been found that complex variable-rate mortgages often cause *error costs*, which consumers tend to pay without noticing.[85]

The details of a generally optimal mortgage are still debated, but the consensus seems to favor either fixed rates or variable rates indexed to inflation. Reviewing the literature, David Miles concludes that variable-rate mortgages are riskier in terms of default probabilities, as they are more sensitive to both interest rate risk and changes to factors such as payment-to-income ratios.[86] Miles' study finds that, under most specifications, households should prefer a mortgage based on a long fixed interest rate.[87] John Campbell writes in a similar fashion (summarizing earlier literature) that "economists have often recommended mortgages that adjust interest and principal payments for inflation, thereby combining the best features of nominal FRMs and ARMs," while more recently some "have proposed an automatically refinancing nominal FRM that would eliminate sluggish refinancing and also save consumers' considerable costs of current refinancing procedures."[88]

5.3 Shaping the Market

Given the extensive expert critique of traditional variable-rate mortgages, one is forced to ask: why on earth are they so common? In the UK, only a quarter of mortgages have a fixed interest rate, and even then of only 2–3 years (which in reality makes it more like a variable-rate mortgage). Only as few as about 2% of all mortgages are fixed for more than 5 years. Miles discusses various hypotheses that could explain this,[89] concluding that the only convincing explanation is psychological: "imperfect understanding of risks and of the likely profile of future interest rates, a tendency to focus on

---

84 On the issue of personal macroeconomic risk management, see Shiller (2004) for an extended discussion.
85 A 1995 study by the Federal Savings and Loan Insurance Corporation (FSLIC) found that 50–60% of all US ARMs contained an error regarding the variable interest rate charged to the homeowner. The estimated total amount of interest overcharged to borrowers was over $8 billion. See Renert (1995).
86 Miles (2004: 91).
87 Miles (2004: 15).
88 Campbell (2006: 1586).
89 Miles (2004: 17–21).

initial payments on mortgages, and a pricing structure that plays to that tendency."[90]

In other words, variable interest rates make it extremely difficult for non-professionals to estimate the total cost of the mortgage. Given that the risks of variable rates are largely hidden (as future is unknown), and that consumers tend to give too much importance to initial monthly payments, the market will in times of low short-term rates be biased towards variable rates.[91]

Interestingly, it turns out that *disclosure rules* may also influence the choice between fixed and variable rate mortgages. Miles explains that in the UK — where there is practically no market for long-term fixed rate mortgages — the APR is calculated under the assumption that *interest rates will not change* during the life of the loan.[92] But in times of expected increases to interest rates (an upward-sloping yield curve), the APR will *understate* the real expected costs of the mortgage; yet most consumers do not know this and will only pay attention to the APR. That causes a harmful bias towards variable rate mortgages when the spot rates are low. A partial solution, albeit complicated, has been proposed:

> A potentially more informative measure of APR could be calculated based on expected interest rates over the life of the debt. This would provide a better figure for comparing the likely cost of variable-rate mortgages with fixed-rate mortgages; it could be used instead of, or in addition to, the standard APR. Such a figure could be based on the forward rates implied by the yield curve.[93]

Unfortunately, the costs of providing such APR figures might be significant. Besides, it might add to confusion, given that consumers already misunderstand the meaning of APR. Therefore it seems that a model mortgage, based on a fixed rate, would be a better way of guiding the market away from variable rates.

The ongoing proposal may be criticized by claiming that, in an efficient market, variable rate mortgages may be cheaper on average, and some com-

90 Miles (2004: 21).
91 See Campbell (2006: 1588), Miles (2003).
92 Miles (2004: 38–40).
93 Miles (2004: 39).

mentators have favored variable rates for many consumers.[94] But mortgage markets are unlikely to be efficient given psychological biases, and presently the market for fixed-rate mortgages is underdeveloped in most countries.[95] As Campbell has pointed out, this is due to the peculiar herding dynamics of loan markets:

> [U]nsophisticated households tend to use whatever financial contracts are standard in a particular country, possibly because they follow the lead of relatives and neighbours. It is expensive for would-be financial innovators to reach such households, particularly if they need to explain a complex new financial product.[96]

Moreover, the incentives to offer new products to sophisticated clients may be weak, because "existing products often involve a cross-subsidy from naive to sophisticated households. [...] Sophisticated households gain by pooling with naive households, and will not be attracted to a new mortgage if it is only taken up by other sophisticated households."[97]

This insight reveals another benefit of the model mortgage approach: by encouraging all consumers to choose a mortgage with a long fixed-term interest, it would also make those mortgages relatively cheaper. In economics jargon, the market is currently stuck in a suboptimal equilibrium, and the model contract is a light-touch intervention that could move the market towards a better equilibrium.

5.4 A Customized Model Contract

It remains true that people have different preferences, and that a variable-rate loan will be optimal to some borrowers. This could be taken into account at least in two ways. One is to create two different model mortgages, one fixed-rate and the other variable-rate — perhaps labeled "safer" and "riskier" respectively, so as to nudge in favor of the former. Both would be based on a relatively short loan lifetime and avoid complexities (e.g. teaser rates and bullet or balloon payments) that exploit cognitive quirks and confuse unsophisticated consumers.

94 See Milevsky (2001).
95 In fact, Milevsky's study uses Canadian data in which the "fixed rate" refers to a 5-year interest rate.
96 Campbell (2006: 1586).
97 Ibid.

The other way is to develop "smart defaults," for example by developing a standardized formula that creates a *customized default mortgage* based on key borrower characteristics: age, income, family situation, and other personal finance factors.[98] This would be consistent with the fact that the optimal contract depends on many factors, such as whether the loan is taken by young parents buying their first home, or a mature couple acquiring a house in the country for retirement purposes. According to one study, a variable-rate loan is better according to some parameters, but a first-time homebuyer should lock in at a fixed rate.[99]

6 Conclusion

Behavioral economics provides an interesting framework for a new legal paternalism, which avoids the pitfalls of traditional regulatory approaches and helps consumers without imposing major costs. This article has demonstrated that the new behavioral paternalism is particularly promising in the context of consumer mortgages. The examples show that policymakers are already taking modest steps in this direction — especially in the design of cooling-off rules and behaviorally-designed information disclosure — but much more could be done by way of default rules. The model mortgage approach seems particularly promising, both as a way of assisting consumers and as a method for guiding markets towards more risk-efficient practices. Note, however, that these regulatory strategies should not be considered in isolation, because they can be combined. For example, different cooling-off periods might be imposed on non-default mortgage offers, so that consumers would be encouraged to consider them more prudently.

While this article has focused on mortgages, similar concerns abound in other areas of consumer finance, particularly in credit cards and instant loans.[100] Proposals have been made to the effect that targeted information

98 See Barr et al. (2008: 10–11).
99 Milevsky (2004).
100 On problems with credit cards, see Bar-Gill (2004), Loewenstein and O'Donoghue (2006: 196–198), Mann (2007), Thaler and Sunstein (2009: 148–150). Instant loans have attracted heated discussion in Finland: see Jakobsson (2008), Määttä (2010), Juurikkala (2012b); recently, tight interest restrictions have been imposed to instant loans of 2000 euros or less (Consumer Protection Act 7:17a (15.3.2013/207)), but it is speculated that providers will simply cease to offer loans of that size.

regulation and default rules might also improve credit card usage.[101] In relation to instant loans, it has been argued that the key issue is lack of self-control, so that special cooling-off rules would be appropriate.[102]

We should not, however, get overly excited about the new legal paternalism. Some commentators have raised the concern that behavioral paternalism may cause a flood of new regulations, which seem light and low-cost in isolation but together impose a significant regulatory burden.[103] Indeed, if the behavioral theory is correct, it implies that lawmakers will tend to *overestimate benefits* and *underestimate costs*, because experts tend to suffer from overconfidence, and there are many non-measurable and dynamic costs that cannot be observed at the time of rulemaking. Some advocates of legal paternalism have raised the defense that "objections to paternalism should be empirical and pragmatic […] rather than a priori in nature"[104], but perhaps the burden of proof should be on the paternalists' side.

In any case, empirical work is of critical importance — both on consumer behavior and on the effects of paternalistic policies. At present, our knowledge of the facts is far from perfect. For example, there is an ongoing debate on the extent to which widespread credit card use is rational,[105] and whether credit card users choose optimal deals or not.[106] This being so, there is reason to fear that ideologically motivated commentators will exaggerate their case.[107]

Finally, it is worth asking whether it is the government that should intervene. It is notable that almost all the examples of positive "nudging" re-

101 See Barr et al. (2008: 13–15), Thaler and Sunstein (2009: 148–149).
102 Juurikkala (2012b).
103 Ginsburg and Wright (2012), Whitman and Rizzo (2007).
104 Sunstein (1997: 1178).
105 For example, Ausubel (1991) claims that accumulating significant credit card debt is inconsistent with sound financial planning, but Elliehausen (2010: 24–31) presents contrary views. There is clear evidence, however, that credit (and debit) cards have a major effect boosting willingness to buy: see Prelec and Simister (2001) and Moore and Taylor (2011).
106 Brown and Plache (2006) found that most people choose their credit card optimally and are not misled by the difference between short-term and long-term rates in some credit cards; whereas Agarwal, Liu, Souleses and Chomsisengphet (2006) discovered that a substantial fraction (about 40%) of consumers choose suboptimal cards initially, and a small minority persisted in holding substantially suboptimal contracts.
107 For example, Wright (2007) argues that advocates of paternalism exaggerate or misrepresent the findings of behavioral economics, but this seems to happen both ways.

ported by Thaler and Sunstein are taken from the private sector.[108] Maybe that is not surprising: market actors tend to be more innovative and creative, because they are driven by the discovery procedure of entrepreneurship and competition, exploiting vast amounts of decentralized information and learning through trial and error.[109] Firms may lack the incentives to improve consumer decision-making, but that is not always the case — it depends on customer segment, reputational benefits, the relevant time-horizon and other factors — and some regulations might improve and harness the positive creativity of markets for the benefit of consumers. How to do so is an important question for future research.

108 See throughout Thaler and Sunstein (2009).
109 See Hayek (1949), Kirzner (1973; 1997).

Bibliography

Literature

Agarwal, Sumit, Souphala Chomsisengphet, Chunlin Liu and Nicholas S. Souleles (2006), *Do Consumers Choose the Right Credit Contracts?*, Federal Reserve Bank of Chicago WP 2006-11, November 2006, available online at http://ssrn.com/abstract=943524.

Ausubel, Lawrence M. (1991), The Failure of Competition in the Credit Card Market, *American Economic Review* 81, 50–81.

Bar-Gill, Oren (2004), Seduction by Plastic, *Northwestern University Law Review* 98, 1373–1434.

Bar-Gill, Oren (2008), The Behavioral Economics of Consumer Contracts, *Minnesota Law Review* 92, 749–802.

Bar-Gill, Oren and Elizabeth Warren (2008), Making Credit Safer, *University of Pennsylvania Law Review* 157, 1–101.

Barr, Michael S., Sendhil Mullainathan and Eldar Shafir (2008), *Behaviorally Informed Financial Services Regulation*, New America Foundation, October 2008, available online at http://www.fdic.gov/about/comein/behaveApril1a.pdf.

Brown, Tom and Lacey Plache (2006), Paying with Plastic: Maybe Not So Crazy, *University of Chicago Law Review* 73, 63–86.

Camerer, Colin, Samuel Issacharoff, George Loewenstein, Ted O'Donoghue and Matthew Rabin (2003), Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism", *University of Pennsylvania Law Review* 151, 1211–1254.

Campbell, John Y. (2006), Household Finance, *Journal of Finance* 61, 1553–1604.

Choi, Stephen J. and A. C. Pritchard (2003), Behavioral Economics and the SEC, *Stanford Law Review* 56, 1–73.

Cunningham, Lawrence A. (2002), Behavioral Finance and Investor Governance, *Washington & Lee Law Review* 59, 767–837.

DiMatteo, Larry A. (1997), The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment, *South Carolina Law Review* 48, 343–356.

Dowd, Kevin and Martin Hutchinson (2010), *Alchemists of Loss: How Modern Finance and Government Intervention Crashed the Financial System*, Chichester, UK: Wiley.

Dowd, Kevin, Martin Hutchinson, Simon Ashby and Jimi M. Hinchliffe (2011), *Capital Inadequacies: The Dismal Failure of the Basel Regime of Bank Capital Regulation*, Cato Institute Policy Analysis No. 681, available online at http://www.cato.org/sites/cato.org/files/pubs/pdf/pa681.pdf

Dworkin, Gerald (2010), Paternalism, in Edward N. Zalta (ed.), *The Stanford Encyclopedia of Philosophy (Summer 2010 Edition)*, available online at http://plato.stanford.edu/archives/sum2010/entries/paternalism.

Elliehausen, Gregory (2010), *Implications of Behavioral Research for the Use and Regulation of Consumer Credit Products*, FEDS Working Paper No. 25, available online at http://ssrn.com/abstract=1783770.

Entitle Direct (2010), *The Smart Consumer's Guide to the New Good Faith Estimate*, available online at http://www.entitledirect.com/static/entitle/The%20Smart%20Consumers%20Guide%20to%20the%20New%20Good%20Faith%20Estimate.pdf.

Epstein, Richard A. (2006), Behavioral Economics: Human Errors and Market Corrections, *University of Chicago Law Review* 73, 111–132.

Epstein, Richard A. (2008), The Neoclassical Economics of Consumer Contracts, *Minnesota Law Review* 92, 803–835.

Etzioni, Amitai (2011), Behavioural Economics: Next Steps, *Journal of Consumer Policy* 34, 277–287.

European Commission (2011a), *Creating a fair single market for mortgage credit – FAQ*, MEMO/11/205, Brussels, 31.3.2011.

European Commission (2011b), *Proposal for a Directive of the European Parliament and of the Council on Credit Agreements Relating to Residential Property*, COM(2011) 142 final, Brussels, 31.3.2011.

European Commission (2011c), *Impact Assessment, Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on Credit Agreements Relating to Residential Property*, SEC(2011) 356, Brussels, 31.3.2011.

Faure, Michael G. and Hanneke A. Luth (2011), Behavioural Economics in Unfair Contract Terms: Cautions and Considerations, *Journal of Consumer Policy* 34, 337–358.

Frerichs, Sabine (2011), False Promises? A Sociological Critique of the Behavioural Turn in Law and Economics, *Journal of Consumer Policy* 34, 289–314.

Frey, Bruno S. and Matthias Benz (2004), From Imperialism to Inspiration: A Survey of Economics and Psychology, in John B. Davis, Alain Marciano and Jochen Runde (eds.), *The Elgar Companion to Economics and Philosophy*, Cornwall, UK: Edward Elgar, 61–84.

Ginsburg, Douglas H. and Joshua D. Wright (2012), Behavioral Law and Economics: Its Origins, Fatal Flaws, and Implications for Liberty, *Northwestern University Law Review* 106, 1033–1088, available online at http://www.law.northwestern.edu/lawreview/v106/n3/1033/LR106n3Wright.pdf.

Glaeser, Edward L. (2006), Paternalism and Psychology, *University of Chicago Law Review* 73, 133–156.

Gneezy, Uri and John A. List (2006), Putting Behavioral Economics to Work: Testing for Gift Exchange in Labor Markets Using Field Experiments, *Econometrica* 74, 1365–1384.

Gorton, Gary B. (2010), *Slapped by the Invisible Hand: The Panic of 2007*, Oxford University Press.

Haupt, Stefan (2003), An Economic Analysis of Consumer Protection in Contract Law, *German Law Review* 4, 1137–1164.

Hayek, Friedrich A. (1945), The Use of Knowledge in Society, *American Economic Review* 35, 519–530.

Hill, Claire A. (2007), Anti-Anti-Anti-Paternalism, *NYU Journal of Law & Liberty* 2, 444–454.

Jakobsson, Niko (2008), Pikaluotot – hämärää markkinointia, kohtuuttomia sopimusehtoja ja koronkiskontaa? (Instant Loans – Unclear Marketing, Unreasonable Terms and Usury?), *Helsinki Law Review* 2008, 145–173.

Jolls, Christine, and Cass R. Sunstein (2006), Debiasing through Law, *Journal of Legal Studies* 35, 199–241.

Jolls, Christine, Cass R. Sunstein and Richard Thaler (1998), A Behavioral Approach to Law and Economics, *Stanford Law Review* 50, 1471, available online at http://digitalcommons.law.yale.edu/fss_papers/1765.

Juurikkala, Oskari (2012a), The Behavioral Paradox: Why Investor Irrationality Calls for Lighter and Simpler Financial Regulation, *Fordham Journal of Corporate & Financial Law* 18, 33–93.

Juurikkala, Oskari (2012b), Pikavippien sääntely: ei korkokattoa, vaan erityinen harkinta-aika, *Oikeus* 2012/3, 452–460.

Kahneman, Daniel, Jack L. Knetsch and Richard H. Thaler (1990), Experimental Tests of the Endowment Effect and the Coase Theorem, *Journal of Political Economy* 98, 1325–1348.

Kaplow, Louis (2000), General Characteristics of Rules, in Boudewijn Bouckaert and Gerrit De Geest (eds.), *Encyclopedia of Law and Economics, Vol. V: Economics of Crime and Litigation*, Cheltenham, UK: Edward Elgar, 502–528.

Kelman, Mark, Yuval Rottenstreich and Amos Tversky (1996), Context-Dependence in Legal Decision Making, *Journal of Legal Studies* 25, 287–328.

Kirzner, Israel M. (1973), *Competition and Entrepreneurship*, Chicago: University of Chicago Press.

Kirzner, Israel M. (1997), *How Markets Work: Disequilibrium, Entrepreneurship and Discovery*, London, UK: Institute of Economic Affairs.

Klick, Jonathan and Gregory Mitchell (2006), Government Regulation of Irrationality: Moral and Cognitive Hazards, *Minnesota Law Review* 90, 1620–1663.

Korobkin, Russell (1998a), The Status Quo Bias and Contract Default Rules, *Cornell Law Review* 83, 608–687.

Korobkin, Russell (1998b), Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms, *Vanderbilt Law Review* 51, 1583–1652.

Korobkin, Russell (2000), Behavioral Economics, Contract Formation, and Contract Law, in Cass R. Sunstein (ed.), *Behavioral Law and Economics*, New York: Cambridge University Press, 116–143.

Lacko, James M. and Janice K. Pappalardo (2007), *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Staff Report, Federal Trade Commission, Washington DC.

Langevoort, Donald C. (1995), Ego, Human Behavior, and Law, *Virginia Law Review* 81, 853.

Langevoort, Donald C. (1998), Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review, *Vanderbilt Law Review* 51, 1499.

Langevoort, Donald C. (2002), Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation, *Northwestern University Law Review* 97, 135.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny (1998), Law and Finance, *Journal of Political Economy* 106, 1113–1155.

List, John A. (2003), Does Market Experience Eliminate Anomalies?, *Quarterly Journal of Economics* 118, 41–71.

Loewenstein, George and Ted O'Donoghue (2006), "We Can Do This the Easy Way or the Hard Way": Negative Emotions, Self-Regulation, and the Law, *University of Chicago Law Review* 73, 183–206.

London Economics (2009), *Study on the Costs and Benefits of the Different Policy Options for Mortgage Credit*, Final report to the European Commission, Internal Market and Services DG, prepared by London Economics and Achim Dübel (Finpolconsult) in association with institut für finanzdienstleistungen e.V. (iff), November 2009.

Mann, Ronald (2007), Bankruptcy Reform and the "Sweat Box" of Credit Card Debt, *Illinois Law Review* 2007, 375–403.

Miles, David (2003), *The UK Mortgage Market: Taking a Longer-Term View. Interim Report: Information, Incentives, and Pricing*, London: HM Treasury.

Miles, David (2004), *The UK Mortgage Market: Taking a Longer-Term View. Final Report and Recommendations*, London: HM Treasury.

Milevsky, Moshe A. (2001), *Mortgage Financing: Floating Your Way to Prosperity*, Research Report #01-01, IFID Centre, University of Toronto.

Milevsky, Moshe A. (2004), *Mortgage Financing: Should Your Still Float? Four Answers*, IFID Centre, University of Toronto.

Miller, David A. (2009), New Truth in Lending Rules for New Homebuyers, *Article Alley*, July 13, http://davemillerloans.articlealley.com/new-truth-in-lendingrules-for-new-homebuyers-1008568.html.

Mitchell, Gregory (2002), Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law, *William and Mary Law Review* 43, 1907–2021.

Mitchell, Gregory (2003), Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence, *Georgetown Law Journal* 91, 67.

Mitchell, Gregory, (2005), Libertarian Paternalism Is an Oxymoron, *Northwestern University Law Review* 99, 1245–1277.

Moore, Amy and Michael Taylor (2011), Time to Cut Up Those Debit Cards? Effect of Payment Mode on Willingness to Spend, *Journal of Consumer Policy* 34, 415–422.

Morris, Robin A. (1988), Consumer Debt and Usury: A New Rationale for Usury, *Pepperdine Law Review* 15, 151–179.

Määttä, Kalle (2010), Pikaluottojen sääntely oikeustaloustieteellisestä näkökulmasta, *Lakimies* 2010/3, 265–279.

Optem (2009), *Consumer Testing of Possible New Format and Content for the ESIS on Home Loans*, Final Report, European Commission, Directorate-General for Internal Market and Services, October 2009.

Posner, Richard A. (1998), Rational Choice, Behavioral Economics, and the Law, *Stanford Law Review* 50, 1551–1575.

Prelec, Drazen and Duncan Simister (2001), Always Leave Home Without It: A Further Investigation of the Credit-Card Effect on Willingness to Pay, *Marketing Letters* 12, 5–12.

Prentice, Robert (2002), Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for Its Future, *Duke Law Journal* 51, 1397.

Rabin, Matthew (1998), Psychology and Economics, *Journal of Economic Literature* 36, 11–46.

Rachlinski, Jeffrey J. (1998), A Positive Psychological Theory of Judging in Hindsight, *University of Chicago Law Review* 65, 571–625.

Rachlinski, Jeffrey J. (2003), The Uncertain Psychological Case for Paternalism, *Northwestern University Law Review*, 97 1167–1225.

Rachlinski, Jeffrey J. (2006), Cognitive Errors, Individual Differences, and Paternalism, *University of Chicago Law Review* 73, 207–229.

Renert, Ian L. (1995), Government Study Concludes 50%–60% of All Adjustable Rate Mortgages Contain Errors, *National Public Accountant*, Vol. 40, No. 12 (December 1, 2005).

Rischkowsky, Franziska, and Thomas Döring (2008), Consumer Policy in a Market Economy: Considerations from the Perspective of the Economics of Information, the New Institutional Economics as well as Behavioural Economics, *Journal of Consumer Policy* 31, 285.

Rougeau, Vincent D. (1996), Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates, *University of Colorado Law Review* 67, 1–46.

Shiller, Robert J. (2004), *The New Financial Order: Risk in the 21st Century*, Princeton University Press.

Shu, Susanne B. (2007), *Choosing for the Long Run: Making Trade-offs in Multiperiod Borrowing*, UCLA Working paper.

Simon, Herbert A. (1947), *Administrative Behavior*: *A Study of Decision-Making Processes in Administrative Organizations*, New York: MacMillan.

Soto, Gloria M. (2009), *Study on the Calculation of the Annual Percentage Rate of Charge for Consumer Credit Agreements*, European Commission, Directorate-General Health and Consumer Protection.

Sunstein, Cass R. (1997), Behavioral Analysis of Law, *University of Chicago Law Review* 64, 1175.

Sunstein, Cass R. (2006), Boundedly Rational Borrowing, *University of Chicago Law Review* 73, 249–270.

Sunstein, Cass R. and Richard H. Thaler (2003), Libertarian Paternalism Is Not an Oxymoron, *University of Chicago Law Review* 70, 1159–1202.

Taylor, John B. (2009), *Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*, Stanford, CA: Hoover Institution Press.

Thaler, Richard H. and Cass R. Sunstein (2009), *Nudge: Improving Decisions About Health, Wealth and Happiness* (revised edition), Penguin.

Turner Review (2009), *The Turner Review: A regulatory response to the global banking crisis*, Financial Services Authority, March 2009, London, available online at http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

van Boom, Willem H. (2011), Price Intransparency, Consumer Decision Making and European Consumer Law, *Journal of Consumer Policy* 34, 359–376.

Willis, Lauren E. (2006), Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price, *Maryland Law Review* 65, 707–840.

Whitman, Douglas Glen and Mario J. Rizzo (2007), Paternalist Slopes, *NUY Journal of Law & Liberty* 2, 411–443.

Wright, Joshua D. (2007), Behavioral Law and Economics, Paternalism, and Consumer Contracts: An Empirical Perspective, *NUY Journal of Law & Liberty* 2, 470–511.