Minimum Payments and Debt Paydown in Consumer Credit Cards

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Discussion: Umit G. Gurun, UT Dallas
September 25,2015

Discussant's checklist

– Read the paper

– Make a few small observations

– Self citation

– Have a major comment (?)

– Fill 10 minutes

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– Fill 9 minutes

What is the innovation in this paper?

How important are "Liquidity" vs. "Anchoring" in repayment of debt?

- Detailed data on repayment

- <u>Clever</u> idea: exploit patterns around minimum payment formula changes.

  - **Anchoring** predicts a jump around the new minimum amount.

  - Liquidity predicts gradual – especially among those who are constrained.

    - Transitory income or expenditure shocks

   - Lifecycle income patterns.

What is the innovation in this paper?

1) Most accounts are **either paid in full** or **paid near the minimum** amount each month, with very few intermediate payment amounts.
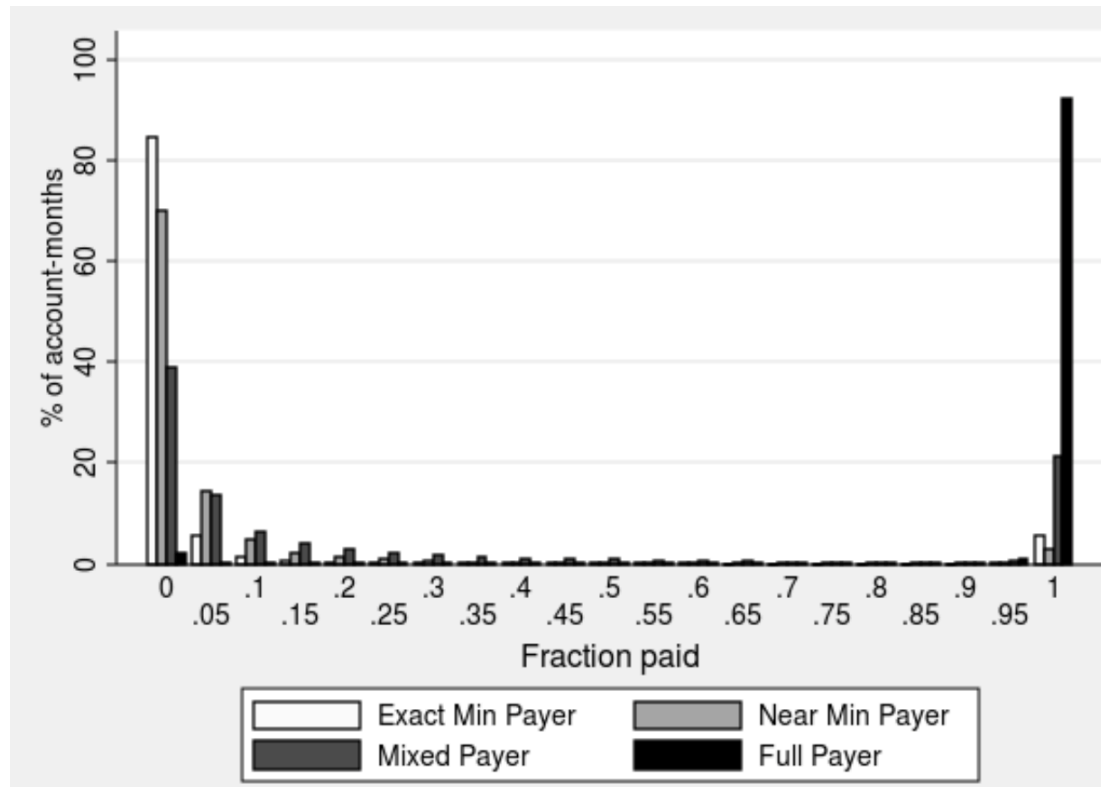
What is the innovation in this paper?

1) Most accounts are **either paid in full** or **paid near the minimum** amount each month, with very few intermediate payment amounts.

2) Minimum payment behavior varies <u>little</u> with income and age.

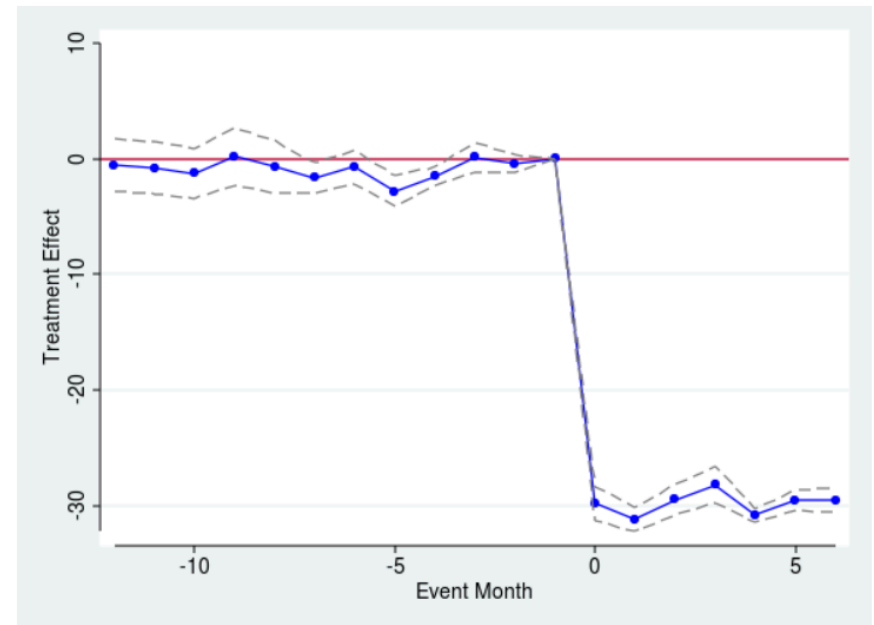3) Accounts exhibiting **anchoring behavior** does not vary with FICO.

Response to "Shifting Anchor"

$$Y_{ijt} = \alpha_i + \eta_t + \sum_{\substack{\tau=-12 \\ \tau \neq -1}}^{6} \beta_\tau \times I_{ij\tau} + \delta I_{ijr} + \gamma X_{ijt} + \epsilon_{ijt}$$
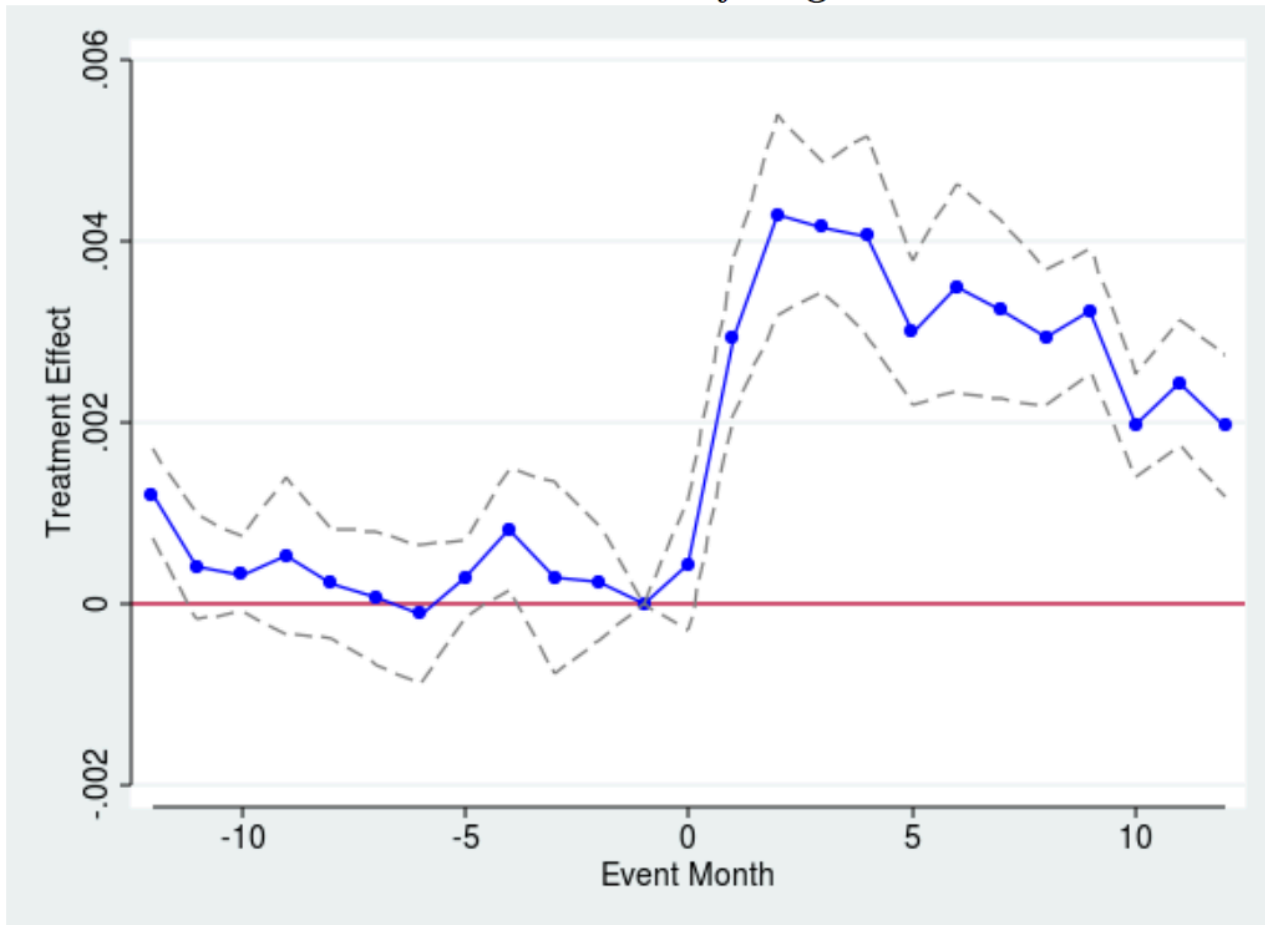
(a) Minimum Formula Increase
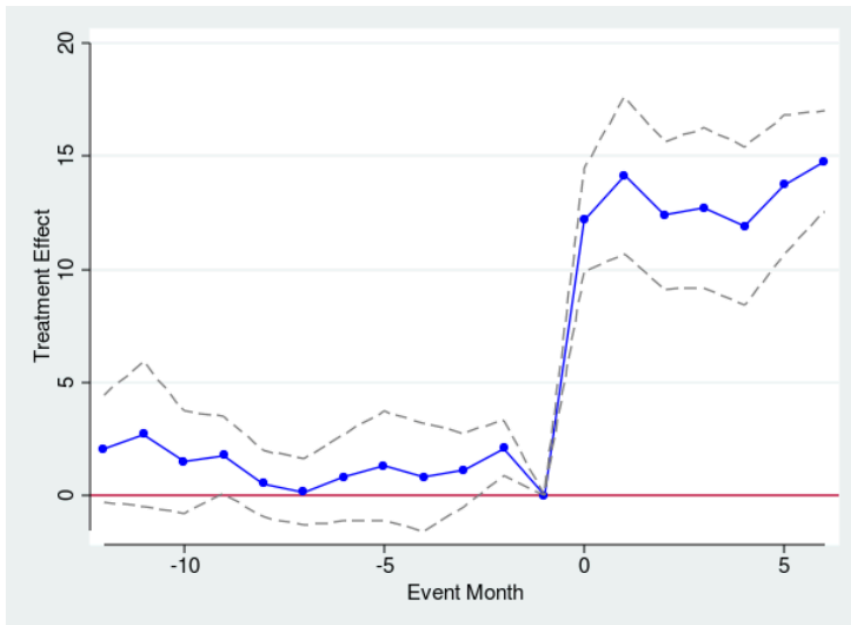
(b) Minimum Formula Decrease

Response to "New Anchor"

$$Y_{ijt} = \alpha_i + \eta_t + \sum_{\tau=-12}^{6} \beta_\tau \times I_{ij\tau} + \delta I_{ijt} + \gamma X_{ijt} + \epsilon_{ijt}$$

Comment #1: How successful is counter factual simulation in modeling "liquidity constrained behavior"?

Behavior changes

- Borrowers in the lower end of the payment distribution — who are most likely to be affected by the minimum payment increase — reduce the purchases made with the card.

- **Switch to other accounts** (Account vs. Individual)
  - One account subsample (how representative)

- **Account closures**

    - most liquidity constrained are likely to shift to another bank (look ahead bias?)

- Existing delinquent borrowers who would otherwise have paid the "old" minimum

    - Probability of curing the account goes further down.

Comment 2:
How Salient are these formula changes?

- Cost comparison
  - Definition of near minimum
    - (Min2-Min1<"near minimum")
  - Complications:
    - revolving debt balance, interest rate
    - reset rates

Comment #3:
Explore other ways to exploit borrower heterogeneity

- Responses to different components of minimum payment

  – Max (**floor**, <u>x% of balance</u>)

- Other low interest rate credit cards (1% credit cards etc.)

- Automatic payments

- Are formula changes opportunistic? Exogenous?