FDIC 9th Annual Consumer Research Symposium

Discussion Panel 3: Defaults and Savings Behavior

Yiwei Zhang

University of Wisconsin-Madison

(A Few) Empirical Patterns in Household Saving

- Households do not adequately save for retirement
  - Consumption and income co-move and consumption expenditures fall at retirement (Bernheim et al., 2001b; Angeletos et al., 2001; Haider and Stephens Jr., 2007; Olafsson and Pagel, 2018)
- Households carry high credit card debt balances
  - Total credit card debt balances in the U.S. as of 2019Q2 was approximately $870 billion (NYFed)
- Many households do not appear to be engaging in active buffer stock saving
  - Nearly 40% of U.S. adults report being unable to come up with $400 to cover an emergency expense or would have to borrow or sell something to do so (SHED 2018)

(A Few) Empirical Patterns in Household Saving

- Households do not adequately save for retirement
  - Consumption and income co-move and consumption expenditures fall at retirement (Bernheim et al., 2001b; Angeletos et al., 2001; Haider and Stephens Jr., 2007; Olafsson and Pagel, 2018)
- Households carry high credit card debt balances
  - Total credit card debt balances in the U.S. as of 2019Q2 was approximately $870 billion (NYFed)
- Many households do not appear to be engaging in active buffer stock saving
  - Nearly 40% of U.S. adults report being unable to come up with $400 to cover an emergency expense or would have to borrow or sell something to do so (SHED 2018)

(A Few) Empirical Patterns in Household Saving

- Households do not adequately save for retirement
    - Consumption and income co-move and consumption expenditures fall at retirement (Bernheim et al., 2001b; Angeletos et al., 2001; Haider and Stephens Jr., 2007; Olafsson and Pagel, 2018)
- Households carry high credit card debt balances
    - Total credit card debt balances in the U.S. as of 2019Q2 was approximately \$870 billion (NYFed)
- Many households do not appear to be engaging in active buffer stock saving
    - Nearly 40% of U.S. adults report being unable to come up with \$400 to cover an emergency expense or would have to borrow or sell something to do so (SHED 2018)

Various Levers to Try to Encourage Saving

- Disclosures
- Financial education
- Choice architecture nudges/interventions
- Peer effects
- Changing prices and/or quantities

Choice Architecture as a Tool

- **First Generation Studies:** Do nudges/interventions have an effect on the most immediate (and immediately obvious) outcomes?
- **Second Generation Studies:** Do nudges/interventions have an effect on other, longer-term outcomes?

Choice Architecture as a Tool

- **First Generation Studies:** Do nudges/interventions have an effect on the most immediate (and immediately obvious) outcomes?
- **Second Generation Studies:** Do nudges/interventions have an effect on other, longer-term outcomes?

Moving to Second Generation Studies

- Looking at longer-term outcomes is challenging!
- Two ways of approaching this problem highlighted in this panel:
  - Get data on longer-term behavior/outcomes and study directly
  - Build and calibrate a model to simulate longer-term behavior/outcomes
- Both of these papers are excellent $\rightarrow$ focus my comments on framing/conclusions

The Semblance of Success in Nudging Consumers to Pay Down CC Debt

Benedict Guttman-Kenney, Paul Adams, Stefan Hunt, David Laibson, and Neil Stewart

- **Important question**
  - Can the absence of an explicit automatic minimum payment option help reduce individuals' persistent high-levels of credit card debt holding (and therefore borrowing costs)?
- **Approach**
  - Field experiment with nearly 41K new credit cards issued by a U.K. lender
  - For borrowers who go to set up auto pay, **randomize the absence of an explicit automatic minimum payment option**
  - Choice set is maintained: minimum payment option is replicable through automatic fixed payment option of £5

The Semblance of Success in Nudging Consumers to Pay Down CC Debt

Benedict Guttman-Kenney, Paul Adams, Stefan Hunt, David Laibson, and Neil Stewart

- **Main finding**
  - 21 pp (72%) ↑ in enrollment in the automatic fixed payment option BUT...
  - ...**no meaningful effect on CC debt balance** (or a whole host of other important outcomes)
- **Evidence on offsetting responses**
  - Often fixed payment is binding at minimum
  - Manual payments ↓
  - Participation in any automatic payment ↓

The Semblance of Success in Nudging Consumers to Pay Down CC Debt

Benedict Guttman-Kenney, Paul Adams, Stefan Hunt, David Laibson, and Neil Stewart

- How might we think about the choice the borrower faces?

- Failure to pay minimum → cost of borrowing, ding on credit score, late fees, default
- Failure to pay last statement balance (net of minimum) → cost of borrowing

The Semblance of Success in Nudging Consumers to Pay Down CC Debt

Benedict Guttman-Kenney, Paul Adams, Stefan Hunt, David Laibson, and Neil Stewart

- How might we think about the choice the borrower faces?

- Failure to pay minimum $\rightarrow$ cost of borrowing, ding on credit score, late fees, default
- Failure to pay last statement balance (net of minimum) $\rightarrow$ cost of borrowing

The Semblance of Success in Nudging Consumers to Pay Down CC Debt

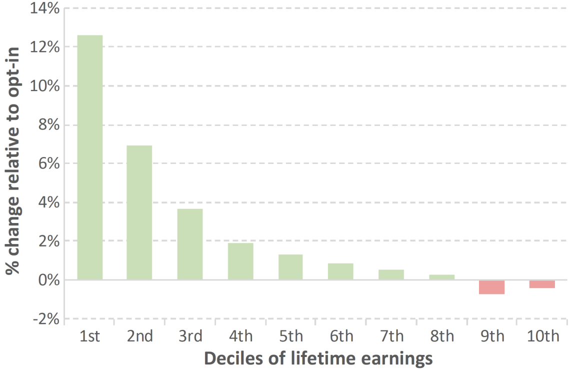
Benedict Guttman-Kenney, Paul Adams, Stefan Hunt, David Laibson, and Neil Stewart

- How might we think about the choice the borrower faces?

- Payment of minimum → avoidance of ding on credit score, late fees, default, **opportunity cost of funds**
- Payment of last statement balance (net of minimum) → **opportunity cost of funds**

- Borrowers facing uncertainty may place a high value on the option to redirect funds that otherwise would have been paid above the minimum
- This would be consistent with the offsetting responses that are observed
- To the extent that this is true, the offsetting responses may actually be a good thing and reflect real preferences
- For the nudge to have "failed" requires you to believe that borrowers are overvaluing this option

- **Important Question**
  - Does auto-enrollment (AE) in employer defined contribution plans affect long-term savings and welfare?
- **Approach Part I**
  - Documents that AE $\downarrow$ savings in subsequent jobs
  - That increasing the default contribution rate $\downarrow$ participation
  - And that non-AE catch up in contributions to AE at the median
- **Approach Part II**
  - Builds a (very detailed) dynamic life-cycle model to look at effect of AE in the long-term



- Inertia around savings defaults can be explained by relatively modest opt-out cost of ~$250
- Long-term effect of auto-enrollment lifetime wealth is small on average...
- ...EXCEPT for those at the bottom of lifetime earnings distribution

- The model captures how AE may have different effects along the distribution of lifetime earnings

- But it assumes that people are relatively homogeneous outside of lifetime income

- That may not to be true $\rightarrow$ effects of AE on welfare may not be fully captured
  - The "undersaving" problem may be severe at the low end of the income distribution
  - Those at the low-end of the income distribution may have differential ability/tendency to contribute to non-401k retirement savings

- More broadly, distributional effects seem just as interesting (and perhaps more important) than the average effects

Final Thoughts

- People dynamically adjust → hard to nudge in a way that affects long-term outcomes
- Although this is a bit of a feature, not a bug → people can "undo" nudges
- Doesn't mean that people are necessarily saving optimally. Just that they might be saving at the level they *believe* to be optimal
- Both of these papers are excellent and push the literature forward by focusing on long run versus just short run
- More on the distributional effects of nudges/interventions seems like an important next step

Thanks!