Effects of Debt Restructuring Session

Discussion by
Felicia Ionescu

Federal Reserve Board

FDIC Consumer Research Symposium
October 18
Decomposing Present Value Effects: Evidence from a large-scale restructuring experiment

by Deniz Aydin
What the paper is about

Goal

1. to study contributions of different types of debt relief on defaults
2. to decompose present value vs payments effects on default.
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  1. to study contributions of different types of debt relief on defaults
  2. to decompose present value vs payments effects on default.

- **Approach**: Bank randomized trial control large scale experiment on borrowers of unsecured credit in Turkey
  - Stratify participants in bins: late pay, balances, geography.
  - Participants are randomly assigned into treatment legs wrt three contract features: rate reduction, maturity increase, relief.
  - Design of a debt relief program for delinquent borrowers: new contract terms (lower rate, higher maturity and several months of forbearance)
  - Debt relief type *unexpected and exogenous* shock: permanent vs temporary
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Findings

- Interest rate reductions have LR effects while short-term forbearance has SR effects
- Rate reductions create larger variation in PV while short-term forbearance in monthly payments
1. Clarity of the paper

- Need to know specifics about unsecured credit in Turkey (focus in Section 3)
  - Regulatory environment - credit card reforms (2014) on cap on interest rate and maturity limits
  - Contractual arrangements - What about borrower risk?
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- Methodology - provide explanations
  - RTC experiment
  - How are the amounts of rate reduction, maturity increase and number of months for payment relief chosen?
  - How do the participants sample compare with delinquent/similar risk borrowers in Turkey?
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  - Effectiveness of debt relief type. What about effects on loan portfolio performance?
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  - Effectiveness of debt relief type. What about effects on loan portfolio performance?
- Use specific terms instead of generic (intro)
  - balance sheet effects, monetary vs fiscal payments, borrower friendly loan program.
2. How to reconcile this study with theories of unsecured credit/U.S. data

- Borrower risk and contractual arrangements
  - Borrowers are asked about the *nature of financial distress* - individually tailored rates and maturity recommendations
  - Don’t existing credit terms and outstanding balances vary by borrower risk (US data and unsecured credit theory)?
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  - Borrowers are asked about the *nature of financial distress* - individually tailored rates and maturity recommendations
  - Don’t existing credit terms and outstanding balances vary by borrower risk (US data and unsecured credit theory)?

**Figure:** Terms and balances by borrower risk
2. How to reconcile this study with theories of unsecured credit cont.

- **Theory:** In equilibrium credit terms vary with borrower risk (Dempsey and Ionescu (2019))

\[
q(x, \ell; s) = \frac{p(x, \ell; s')}{(1+\eta)(1+i)} \text{ if } \ell < 0 \tag{1}
\]
2. How to reconcile this study with theories of unsecured credit cont.

- Theory: In equilibrium credit terms vary with borrower risk (Dempsey and Ionescu (2019))

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2. How to reconcile this study with theories of unsecured credit cont.

- Consider high risk borrowers in the experiment:
  1. Interest/principal ratio is higher (high rates, low credit limits, low balances)
  2. Have higher incentives to accept low rate offers compared to low risk borrowers (R)
  3. How would the bank cover this cost? One option would be to adjust terms for other borrowers (increase rates)
  4. In equilibrium: Direct relationship between interest rates and credit risk - counterfactual and in conflict with the theory
  5. How to interpret outcome response?
Concluding remarks

- Clever exercise
  - Great deal of effort to design and conduct the experiment and collect data
- Paper needs more clarity
  - Urge authors to rewrite the paper to be reader friendly
- Qualitative effects on default not surprising (by construction)
  - Focus on quantitative assessment
- Redirect focus on implications for bank policies
  - Effectiveness of various debt relief plans
- Difficult to reconcile with unsecured credit literature
  - Maybe related to a different type of unsecured credit environment?
Second Chance: Life Without Student Debt

by Marco Di Maggio, Ankit Kalda, Vincent W. Yao
What the paper is about

Uses data on lawsuits filings for borrowers in default matched with credit bureau data to study effects of student debt discharge on credit and labor outcomes.
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- **Data** on lawsuits filing by National Collegiate, holder of *private* student loans that failed to prove chain of title on debt it was trying to collect
  - Debt relief *exogenous* to borrowers’ choices.

## Discussion by Felicia Ionescu (FRB)

### Effects of Debt Restructuring Session

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What the paper is about

Uses data on lawsuits filings for borrowers in default matched with credit bureau data to study effects of student debt discharge on credit and labor outcomes.

- **Data** on lawsuits filing by National Collegiate, holder of *private* student loans that failed to prove chain of title on debt it was trying to collect
  - Debt relief *exogenous* to borrowers’ choices.
- **Approach**
  - Treatment: 10K individuals involved in the failed collection lawsuits
  - Control: 94K borrowers in Equifax that were *similarly* in default
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- **Data** on lawsuits filing by National Collegiate, holder of *private* student loans that failed to prove chain of title on debt it was trying to collect
  - Debt relief *exogenous* to borrowers’ choices.
- **Approach**
  - Treatment: 10K individuals involved in the failed collection lawsuits
  - Control: 94K borrowers in Equifax that were *similarly* in default
- **Results:** Discharge leads to
  - Decreased debt usage, driven by unsecured credit (ext margin)
  - Decreased delinquency, driven by unsecured credit (both margins)
  - Increased mobility and income
Treatment and control groups differently selected?

Argument: Control group = Delinquent borrowers on *similar* debt levels, same code area, same age.
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Two concerns:

1. How about risk type?
   - Different risk profiles
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Two concerns:

1. How about risk type?
   - Different risk profiles

2. How about debt type?
   - *Not similar* – private (treatment) vs public student debt (90+% of loans in control)

1. Risk profiles of borrowers affected
2. Provision of debt relief embedded ex-ante in the two types of debt is different.
1. Selection: Different risk profiles across groups

- Portfolio allocation differs across groups (collateralized debt vs unsecured debt)

<table>
<thead>
<tr>
<th>Loan type</th>
<th>Delinq SL Population</th>
<th>Sample Treated Individuals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit card balance</td>
<td>269</td>
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- Some thoughts:
  - Simply use risk score in Equifax
  - Look at other measures that point to risk profiles: Credit limits; minimum scores on credit accounts
  - Can also use debt to income ratio measures; (income proxy in merged Equifax and Census data)
  - Results for credit outcomes should distinguish by type of debt (later)
Private (treatment) vs federal student loans (control)

Private student loans = mix between unsecured credit and federal student loans (Ionescu and Simpson (2016))

- Both types are non dischargeable
- Different eligibility criteria: need based vs credit score based
  - Unlike for private loans, no credit score and collateral requirement for public loans
  - Implications for risk profiles
- Subjected to different contractual terms
  - credit limits fixed vs varying
  - interest rates fixed vs varying accounting for risk
  - debt relief of some sort embedded in public loans; can choose repayment options for public loans – different degree of insurance
- Collection procedures are different
2. Private (treatment) vs federal student loans (control)

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- Ideally, you would have only private loan borrowers in your control group
Some concluding remarks

- Nice contribution on data collection to overcome the empirical challenge of finding exogenous variation in the borrowers’ exposure to student debt
- Polished, clearly written

**Main concerns:** Debt relief across control and treatment groups not comparable for a variety of reasons
  - Some work on risk profiles and private vs public student debt

**Additional thoughts:** Is there really an improvement in outcomes?
  - Separate by loan types to make that statement
  - Redo figures 3 and 5 by types of debt
  - Might be useful to look at debt burden and at how close borrowers are to credit limits by loan categories
  - Figure 6 by DTI rather than income
  - Try different measures of delinquency, in particular 120+