Adair Morse, UC Berkeley

Discussion of…

- Jesse B. Leary & Jialan Wang, CFPB:

  "The Effect of Income Timing on Short-term Borrowing: Evidence from Social Security Recipients"

- Trevor Bakker, Eva Nagypal, Colin Watson, CFPB:

  "The dynamics of overdraft fees and incidence"

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  "The Effect of Income Timing on Short-term Borrowing: Evidence from Social Security Recipients"

MAIN COMMENT

- I am going to challenge your interpretation a bit because to me, you have a pretty clean result of what you set out to test, but your introduction seems to say otherwise.

- Objective: What pushes people over the edge to bridge borrowing to smooth monthly consumption needs
    - (1) Not having enough money to make regular monthly expenses
    - (2) Not having enough money to make it to next paycheck

- Prior Evidence was mixed on this:
    - Income patterns… e.g., Stephens (2003) and Shapiro (2005)
    - Expense patters… e.g., Vellekoop (2012),
        - Also can interpret the "what constrained people do with helicopter drop" in Bertrand & Morse (AER P&P, 2010) and Agrawal, Liu , Souleles (2007).. Of helicopter drop, what do people spend on utilities?
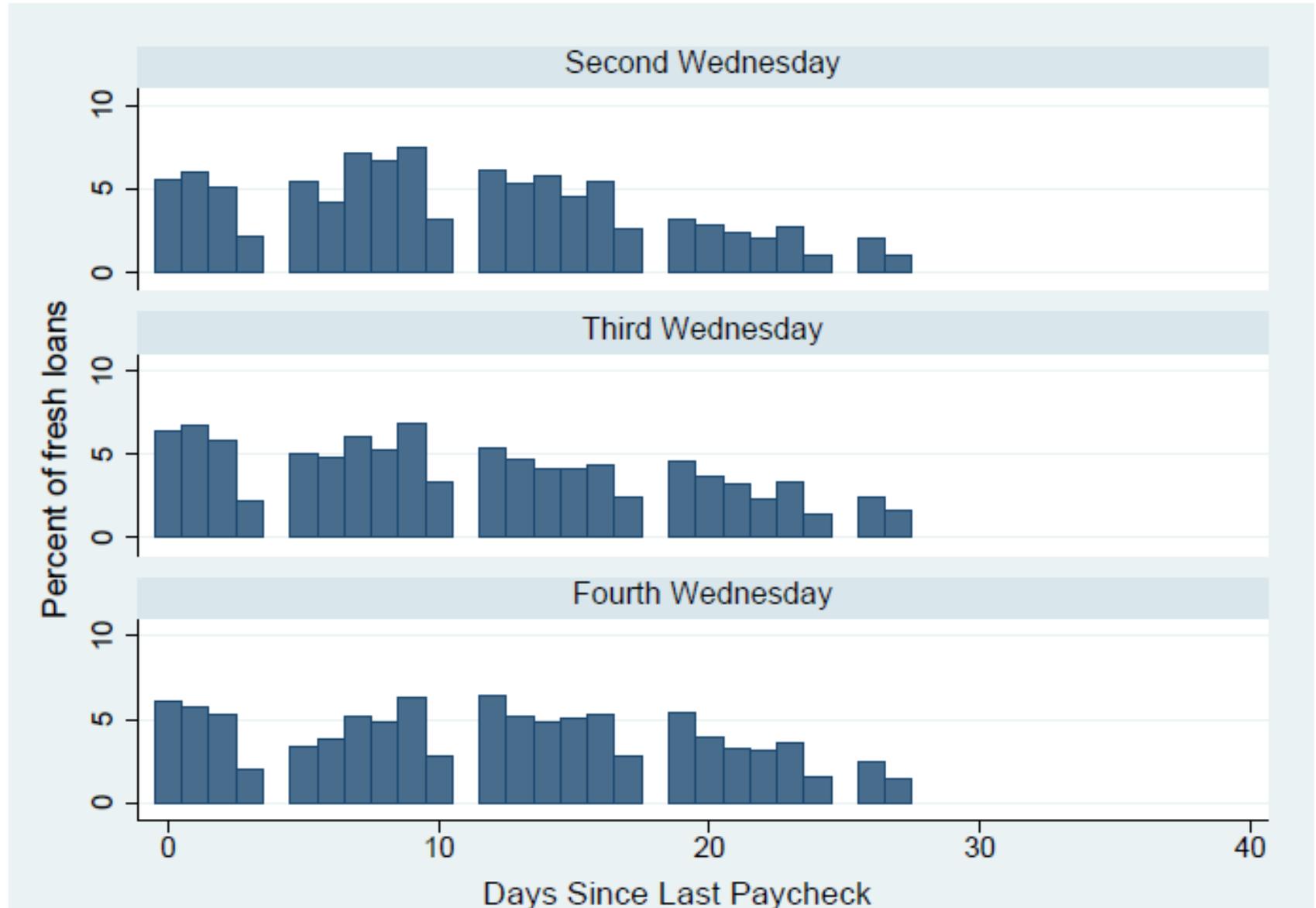
MAIN COMMENT (CONT) PREDICTIONS?

- Why do we care if people don't have enough money to cover regular expenses vs not having enough money generally in pay cycle?
  - To me, the motivation here is what gets people in trouble such that ends don't meet, not use of bridge finance once in trouble
    - Use of payday loans is certainly a relevant welfare question, but that is not your design

- If mistake/ cognitive limitations / salience / fin literacy causes ends not to meet
  - Borrowing should be systematically related to when rent and utilities paid

- If expense [income] shock causes ends not the meet
  - My instinct is that borrowing should be declining in time as people try to "get by" until the next paycheck
    - One come up with other theories as well…. Paper should frame this decision

MAIN COMMENT: WHAT DO YOU FIND?

Figure 7: Distribution of Fresh Loans for Wednesday Groups By Days Since Check

Panel A: 28-day Pay Cycles

MAIN COMMENT (CONT) INTERPRETATION

- As good as it gets… Wednesday people line up in loan principal (or probability of taking a loan) declining linearly in days until payday

- Introduction: "While consumption-smoothing motives imply that borrowing should be highest near the end of pay cycles, when the prior payment is exhausted, our results show the opposite to be the case."
  - Argument ignores that people rationally adjust

- "We also show that loan durations sharply increase and interest rates decrease at the end of pay cycles, so the decline in loan volume is not due to variation in prices."
  - People don't respond to pricing in payday stores. It's fixed in dollars and people generally know ahead of time what the fee is (they may not interpret that rationally, but they know the fee)

CONTEXT COMMENT: PAYDAY LOANS AND SOCIAL WELFARE

- There was a first wave of payday loan papers asking if it is good or bad
  - Answers: Mixed
  - My interpretation: Probably depends on why borrowing

- Since then, I have been arguing that we need to study the heterogeneity of borrowers, in general in high interest consumer finance

- Ideally product design would "evolve" to reflect this heterogeneity
  - Sort individuals such that those who are indeed desiring bridge finance at 350%APR would sort in
  - Those not, would be discouraged with terms

- As it stands, this paper cannot answer good/bad in my opinion (which is fine).

- However, food for thought…..

CONTEXT COMMENT: PAYDAY LOANS AND SOCIAL WELFARE

- Social Security (Retirement/Survival and Disability) & Supplemental Security Income Sample
  - Aside: It strikes me that these are worse expense shock risk and better income shock risk than the average payday loan borrower…

- My Ignorance
  - I'm interested in knowing more upfront about differences among Social Security categories
  - Not just in your results or timing, but profile of people

- Why not use some differences here… are we not interested in disability vs retirement? Or income risk.
  - Eg: Survivor usually means this person had no (or a lower) income throughout life. Good proxy for total income with no income risk other than financial income

SECONDARY COMMENT 1 SIGNIFICANCE?

- Without the tails, (picture next slide)

- It does not look like my favorite result is significant in regressions
  - Testing, e.g. 5 days from last paycheck vs 25 days since last paycheck

Panel B: Days Since Check
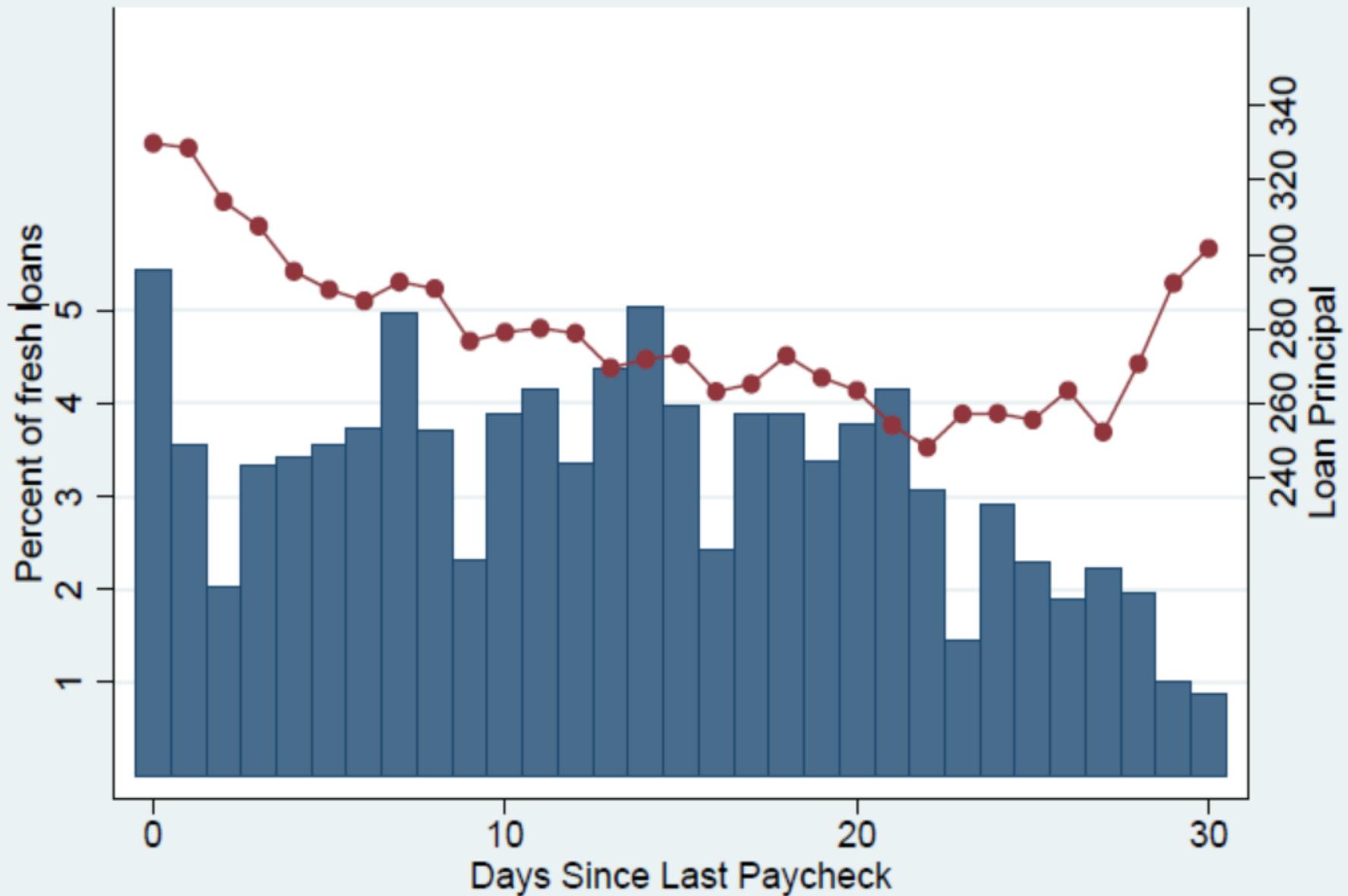
Not a U shape………
Aren't the tails of this figure 0-3 and 27-30 likely to be rollovers? I would drop them.

SIDE COMMENT 2

- I only like the Wednesday analysis
  - Said better: really focus on the Wednesdays analysis

- The 35 day months… too hard to compare apples to apples in whether people are just behind on the monthly obligations those months because they do not get a paycheck

- I would just show stats from first and last of the month for motivation and set up wednesdays as test.

- Q: Why not do some analysis around the year they switched to the Wednesdays system

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Discussion of…

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Type of transaction considered for overdraft	If you don't opt in	If you do opt in
Checks and other payments using your account number (like ACH)	✓	✓
Recurring debit card transactions	✓	NSF fee $35 ✓
ATM withdrawals		✓
Everyday debit card transactions (non-recurring)		Overdraft fee $35 ✓

SAMPLE & SELECTION

- To be in the sample, one has to have an overdraft or NSF fee

- 3 groups:
  1) Always opt in
  2) Always opt out
  3) Switch (which way?)
     - These are the most interesting… why not use?
     (Answer: Endogenous switch problem, but selection in using 1 & 2)

- I started thinking about where I am among these 3?
  - First answer: I have no idea
  - Second answer: Not in dataset, because even if I opted out, I had to incur a NSF

SAMPLE & SELECTION

- Where am I?
  - Third answer: If I were living paycheck to paycheck, would I opt in?
  - It depends
    - If I knew I could stay abreast of my balances and use my overdraft facility when I needed it, I would opt in.
    - If that was hard for any reason, I would opt out and change to opt in when I needed it.
      - Why does opt out not stochastically dominate? Frequent use? But that is the result.

- My point here:
  - I agree with the authors that limited attention could be this selection.
    - But who is incurring NSF when they opt out?
    - And who is opting in in the first place, when can change to opt in at any time?
      - Lots of selection going on here.

CAUSALITY?

- The paper is about who incurs more fees

- But really about selection of what we can learn about individuals who select in versus out….perhaps a critique and <u>opportunity</u>

- <u>Can we really attribute effect of more fees paid to overdraft facility?</u>
  - More likely the selection.
  - Importantly, <u>what is the counterfactual for what they would have done in the months when the ends don't meet?</u>
    - Lusardi and Tufano: People can't cope
    - Maybe the selection of opt-in are longer-term borrowers (that is a `good' use of overdraft perhaps)
  - Also, is this that is being identified just a "run" of overdrafts cumulating to $5 more per month? If so, it is not so much.

OPPORTUNITY

- This selection is hugely important
  - 152,000 accounts select in and more than 1/3rd have a NSF/ODF
  - Not naifs but who know that they face future problems with making ends meet, whether through general life or through reacting to cognitive limitations that they cannot control

- For regulatory importance: Anything we can learn about what triggers their being in such a situation (switchers) and how their accounts evolve is useful

- For academic work:
  - My recommendation is to embrace the selection,
    - Overall effect is convolution of selection and potentially moral hazard
  - Then seek variation to allow for identifying moral hazard.
    - Geography?
    - The source (store) of the overdraft?