Discussion of:
The Cost of Being Late
by Massoud, Saunders, Scholnick

Discussion: Marc Anthony Fusaro
Outline

• Overview
• Pricing Risk
• The Model
• The Empirics
• Relation between model and empirics
Overview

• Question
  – Are bank credit card fees abusive to customers?

• Model
  – Creates a scenario where fees are pricing risk

• Estimates:
  – Test the model
  – Answer question directly

• Result: Banks Are Not Abusive
Bank Fees and Risk Pricing

• Bank Fees in general
• Pricing Structure
• Level of Risk
Bank Fees

• Bank Fees are getting more common
• Change in focus from interest revenue to fee revenue
• EG. Overdrafts
  – Though there are legal reason behind this
Pricing Structure

• This is a strange way to price risk
• Risky Consumers $r+F$
• Safe Consumers $r$
• Bank can not identify risky consumers
  – So they charge at late payment fee
• Why not charge late penalty interest rate?
Overlimit Fee

RATE PAID

True Risk
Penalty Rate
Penalty Fee

BALANCE
Late Fee

Rate Paid

True Risk

Penalty Rate

Penalty Fee

r

TIME TO REPAYMENT

20
Level of Risk

- **Paper**: risk is correlated with late payment
- **Question**: is it priced effectively?
- **interest rate**: \(1 + r_{\text{ontime}} = (1 + r_{\text{late}}) \mu\)
- **fees**: \(B(1+r) = [B(1+r)^* + F] \mu\)
- **Implies**: \(F = B(1+r)(1-\mu)/\mu\)
- **Numbers**: \(14.68 = B \times (1.014)(.047)/.953\)
  - Or \(B = $294\)
Outline

✓ Overview
✓ Pricing Risk
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The Model

• The math is well done
• What does it mean?
• What do locations represent?
  – Physical location like ATM model
  – Product attributes
• Search Cost: only to chosen bank?
• Why use Hotelling Model?
Outline

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The Empirics – Market Share

• Market share = \( m_i / M_i \)
  – Where \( m_i \) is from call reports
  – And \( M_i \) is from Card Industry Directory

• Two problems
  – Inconsistent
  – Card Industry Directory is rather inaccurate

• Use \( \sum m_i \) from Call Reports
The Empirics – IV GMM

• What Are The Instruments?
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Model & Empirics

- H3: The Average Income Hypothesis
- Consumer Bankruptcy Filings
- Overlimit Fees
H3 Average Income Hypothesis

• Empirics
  – Claim: banks abuse the poor
  – Empirical Test: fees increase with income
  – Good

• But the model
  – Vary $\varphi$, probability of negative income shock
  – True, This does vary income
  – But it also changes composition
  – Why not vary $q$?
Consumer Bankruptcy Filings

- Model: Assume random income shock
  - Homogeneous consumers
- In reality consumers have information
  - Moral Hazard problem
- And bankruptcy is endogenous
Overlimit Fees

• Not Modeled
  – Empirically it appears that overlimit fees are correlated with risk
  – But I don’t understand why
    • Which means it is hard to attach causation
• This is in excellent paper.

• Thank you for the opportunity to discuss it.