# Discussion of:
# The Cost of Being Late

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# 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

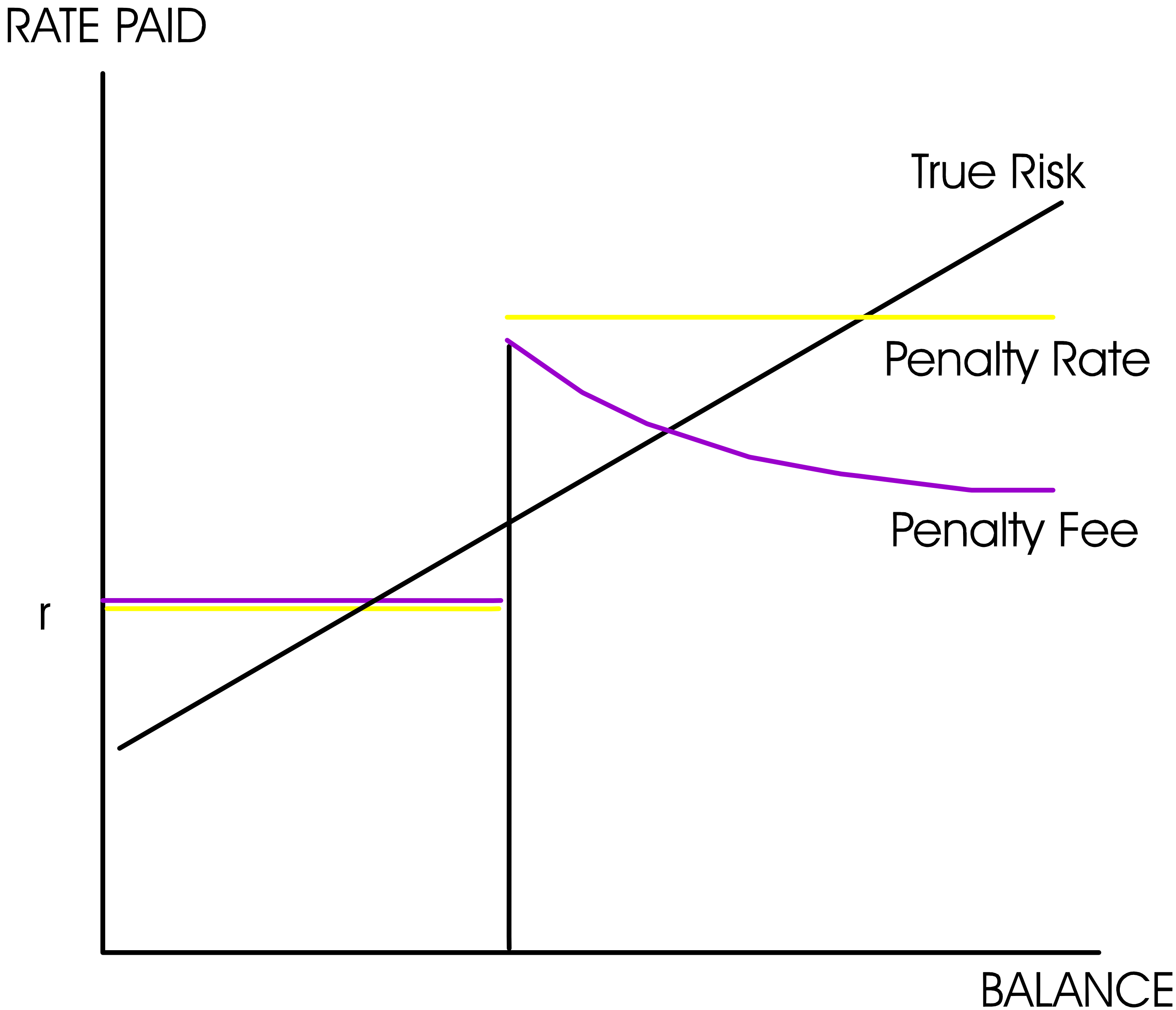
# Bank Fees

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

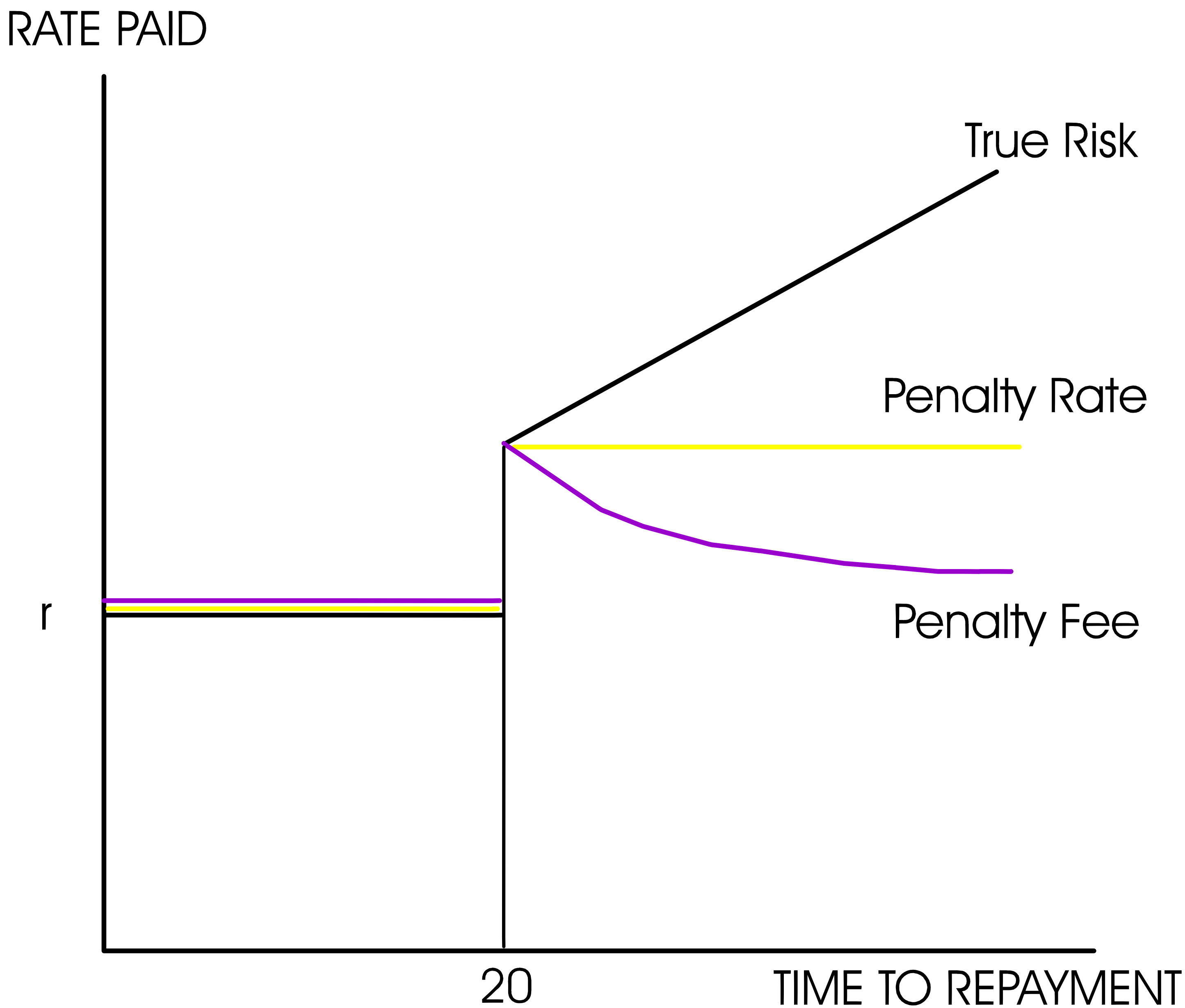
# Pricing Structure

- 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



# Late Fee


RATE PAID
True Risk
Penalty Rate
r
Penalty Fee
20
TIME TO REPAYMENT

# Level of Risk

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

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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?

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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 $\Sigma\ m_i$ 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