Discussion of "Modeling the Credit Card Revolution: The Role of Debt Collection and Informal Bankruptcy" by Lukasz A. Drozd and Richardo Serrano-Padial

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Summary of the Paper
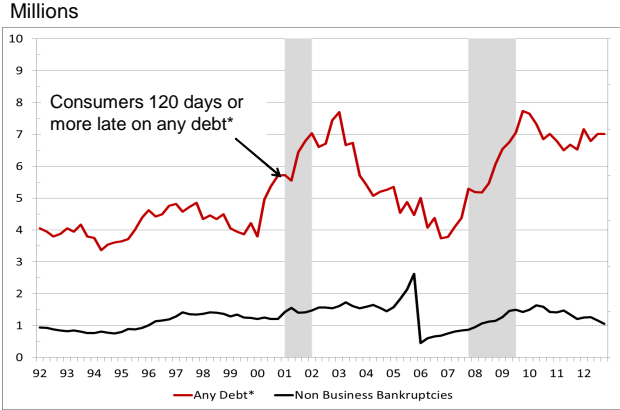
- Introduce enforcement costs in the presence of asymmetric information and moral hazard in a model of consumer credit with default

- Main results: Improvement in debt collection led to: rising credit card debt to median household income; rising net credit card charge-off rate; declining credit card interest premium

- Contribution relative to the literature: existing models of adverse selection do not account for increased default exposure of debt, i.e., discharged debt to income increased over time

Comments

- Paper well motivated, well written
- Theory: extension to dynamics need a bit more thought
- Calibration: tighter link to collection technology story
- Relative to the literature: maybe just another channel, neither superior nor inferior

Motivation: Most Defaults are Informal

Borrowers in Trouble

Millions

Consumers 120 days or more late on any debt*

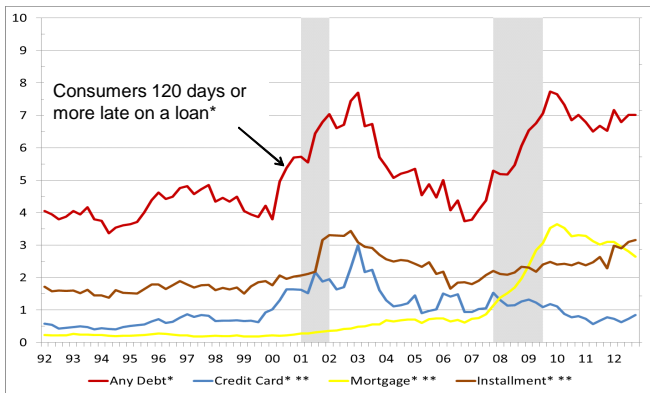Legend: — Any Debt*   — Non Business Bankruptcies

Sources: Administrative Office of U.S. Courts, TransUnion Trend Data, & author's calculations

*: Excludes accounts charged off

Motivation: Most Defaults are Informal

Composition of Serious Delinquencies

Sources: TransUnion Trend Data, & author's calculations

*: Excludes accounts charged off; **: These categories are not mutually exclusive

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Model: How to Think about B?

- The ex ante debt level that was brought into the period, can always be rolled over. E.g., in the two period case when the borrower decides to default in the subperiod after the realization of the shocks

$$
\begin{aligned}
c &= Y - B + L + b \\
c' &= (1-\theta)Y - (1-\phi)dE - b - \\
&\quad m(1-d)[(\underline{\theta} - \theta)Y + L(1+\overline{R})]
\end{aligned}
$$

- In the dynamic setting, who is making this loan? How is it different from b? Is it counted in all calculation of loan to income, etc.?

Calibration: A Tighter Link to the Collection Story?

Totally agree that collection technology has improved, But

- ▶ Evidence on involvement from "carpet" monitoring to "selective" monitoring?
    - ▶ cited evidence narrow and special (Hynes work on Virginia and a county of Illinois)

- ▶ Can calibration target more explicitly on some moments from collection?
    - ▶ recovery rates probably hard (hasn't really changed significantly perhaps because of selection issue)
    - ▶ may need to formally model informal bankruptcy/default and formal bankruptcy and target the statistics there (default rate, filing rate, debt written off outside of bankruptcy, debt written within bankruptcy, etc.)

Calibration: Other Parameters

- Monitoring cost that amounts to 30% of median household income per monitored borrower way too big
  - in levels, $5000 monitoring cost per consumer (annual) even if we assume 20% of median household income?!
  - credit card balance typically not very big, mean $15,000 for those with credit card debt, but median less than $3000
  - does not seem to go well with the 5 cents on a dollar recovery rate in the industry

Contribution Relative to the Literature

There are perhaps more similarities than improvements

- ▶ Without transaction cost, the current paper also predicts
    - ▶ low risk guys borrow more and default more
- ▶ With transaction cost, the existing literature should also be able to deliver the same results
- ▶ Spread out of interest premium?

Conclusion

I may sound critical, but
This is a very nice paper that can be even better with a bit more work!