How Do Borrowers Respond to a Debt Moratorium?

Experimental Evidence from Consumer Loans in India

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Motivation

- **Debt moratoria that allow borrowers to postpone payments are a popular policy tool to soften the impact of economic downturns**
  - More than 80 countries enacted debt moratoria for households and businesses in response to Covid pandemic (World Bank, 2022)
  - In U.S. $2 trillion forbearance for 60 million borrowers (Cherry et al, 2021)
- **Moratoria are common in many settings where they are not mandated**
  - *Liquidity*: Moratoria can ease liquidity constraints, help households and businesses weather transitory shocks, reduce insolvencies and defaults
  - *Relational contracting*: Lender can **strengthen banking relationships** with its borrowers by signaling that they are valued customers
  - *Moral hazard*: But moratoria may create moral hazard by generating expectations of lenient credit enforcement or future forbearance
- **This paper**: How do borrowers respond to a debt moratorium?

This Paper

- **We use a nationwide field experiment in India to study the borrower response to debt moratorium offers**
- **Setting:** Experiment in the context of India's economic policy response to the pandemic. India initiated a large financial support package, which included a nationwide debt moratorium on consumer loans
- **Design:** We partner with a leading consumer lender to issue randomized debt forbearance offers. Treatment conditions vary whether:
  i. Borrowers are offered repayment flexibility (or not)
  ii. Offer is presented as
    - **initiative of the lender** (⇒ improving banking relationships)
    - **initiative of the regulator** (⇒ avoiding loss of reputation)
- **Follow-up:** Product adoption experiment after forbearance offers
- Natural, real stakes setting to test whether borrowers who have been offered debt forbearance
  - Improve their repayment rates
  - Increase their demand for other products offered by the lender

Setting and Sample

- **Experiment with customers of a large Indian consumer lender**
- **Loans**: consumer loans linked to purchase of a mobile phone, currently 12 million loans outstanding
  - Median loan amount of Rp 10,955 (US$150), tenor of 8 months, interest rate of 12% APR – similar to the typical consumer loan in India
- **Sample**: 46,605 borrowers who are 30-60 days late on their monthly payment, of which 9,623 were reached and assigned to treatment
- **Moratorium offer**: three-months payment deferral for Rp 350 (US$5) fee
- **Truthful messages**: experiment takes place at a time when banks were encouraged but not required to offer moratorium
- **Treatments**: Late-paying borrowers are randomly and individually assigned to receive a moratorium offer or control/placebo treatment

Experimental Treatments

1. Moratorium: "relationship offer"

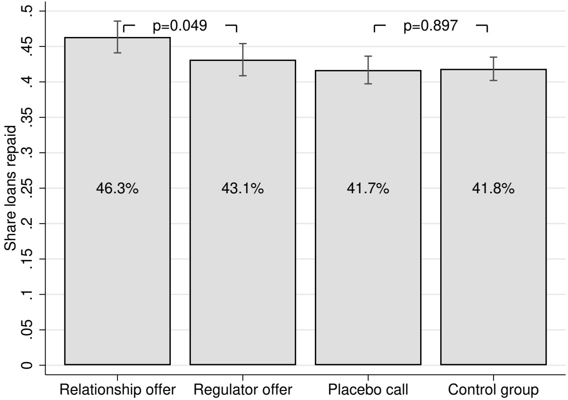
   > At [lender name], we care about our customers and truly value your business. We understand that people all over India are facing great hardships due to the current economic situation. Helping our valued customers in these challenging times is our first priority at [lender name]. That is why we are offering you repayment flexibility [...].

2. Moratorium: "regulator offer"

   > We are extending an offer in accordance with guidelines issued by the Reserve Bank of India to all lending institutions to help customers manage their finances in the current economic crisis. As a result of guidance issued by Reserve Bank of India, we are offering you repayment flexibility comparable to programs offered by other lenders.

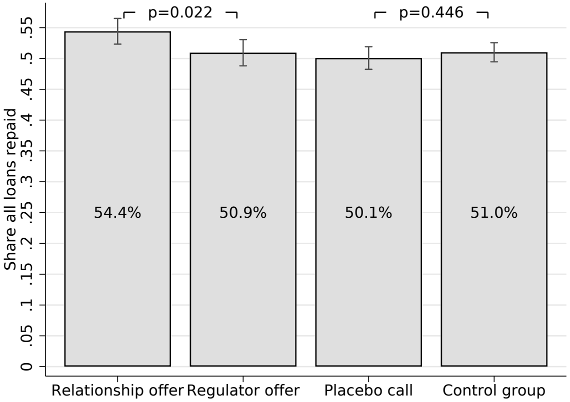
3. Placebo: friendly call
4. Control: debt collection call

Main Result: Loan Repayment



- Relationship offer reduces default by more than 3 ppt (about 6%)
- Not due to reminder effects
- Robust to controlling for fixed effects

Results: Repayment of All Loans



- Borrowers mobilize additional resources to pay down loans

Interpreting the Results

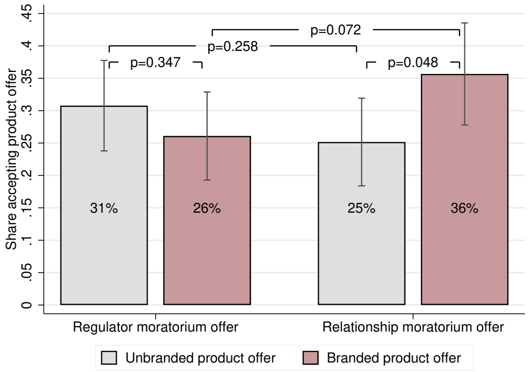
Why do forbearance offers affect repayment?

- Ability to repay? ⇒ No
- Willingness to repay? ⇒ Yes
  - Pure (altruistic) reciprocity
  - Relational contracting and strategic reciprocity

The Product Adoption Experiment

- Relational contracting: Respondents in relationship offer more likely to believe that offer given to *most* creditworthy borrowers
- **Test:** Do borrowers who were granted forbearance by their lender have higher demand for the lender's products?
- **Design:** We contacted borrowers who had received a forbearance offer in the main experiment between 3 and 12 months after treatment
- We cross-randomize the relationship vs regulator conditions from the main experiment with experimental variation along two dimensions:
    i. Treatments vary whether product is marketed as a product of the lender (*"branded"*) or not (*"unbranded"*)
    ii. Borrowers receive either an offer for a *"non-credit product"* sold in a one-shot interaction or a *"personal loan"* that requires repeated interaction

Product Adoption Experiment – Non-credit Product



- Borrowers offered a moratorium by the lender have 10 ppt higher demand for non-credit product marketed by the lender
- No meaningful differences in demand for loans
  - Rules out that effect is driven by possibility to renegotiate with the lender
- Suggestive evidence that repayment flexibility fosters higher-value banking relationships in the longer term

Conclusion

- How do borrowers respond to offers of repayment flexibility? We examine this using a nationwide experiment in India
- Source of repayment moratorium offers matters: forbearance framed as initiative of the lender increases loan repayment
- Relational contracting interpretation: moratorium offers signal to the borrowers that they are valued customers, strengthen banking relationships, and increase demand for the lender's products

Thank you!