How Resuming Student Loan Payments Will Affect Consumer Credit Risk

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How Resuming Student Loan Payments Will Affect Consumer Credit Risk

Executive Summary

This paper explores the impact that resuming federal student loan payments will have on consumer credit markets and provides lenders with guidance to mitigate the increased risk. We used several years of pre-Covid data and a consumer survey to model the effect of payment increases on a consumer's credit risk—specifically, the probability of the consumer becoming seriously delinquent, defined as 90 or more days past due on one of their credit products, within 12 months. We then applied this model to consumers who resumed student loan payments in October 2023 to produce a series of forecasts for the potential impact.

Our results show that the resumption of federal student loan payments will have a noticeable impact on credit risk for student loans as well as other consumer credit products like credit cards and personal loans. Specifically, **we expect 500,000 to 1.4 million consumers to become seriously delinquent on one or more of their credit products as a result of the resumption of student loan payments**, depending on enrollment levels in the government's new Saving on a Valuable Education (SAVE) program. This means that on average, consumers resuming payments will experience a 1.2x to 1.7x increase in the odds of becoming seriously delinquent.

Although student loans will be the product that most often becomes seriously delinquent, we expect other products will experience increases in serious delinquency, too. For example, based on the payment hierarchy we observed pre-Covid, **we anticipate that in the next 12 months, an additional 191,000 to 600,000 credit card consumers will become seriously delinquent on at least one of their cards**, which equates to a 3% to 10% increase compared to the number of consumers who became seriously delinquent in the 12 months ending July 2023.

The expected increase in serious delinquency is likely manageable for the average lender's portfolio. However, **the resumption of payments, on top of inflation, higher interest rates, and other factors driving delinquencies higher, will create a challenging environment for many consumers**. Lenders with greater exposure to consumers who own student loans, particularly those who present higher credit risk or have lower incomes, must act with urgency to adjust their loss forecasts, underwriting strategies, and account management strategies. They must also ensure that their outreach and loss mitigation programs are scaled up and ready to help consumers adjust.

Many assumptions went into our analysis. The potential impact of the SAVE program is reflected in the ranges for our estimates. The impact of the federal government's on-ramp program, which will delay the reporting of student loan delinquencies until late 2024, is not reflected in our analysis. Since our payment hierarchy was derived from pre-Covid data, our estimates for serious delinquency for products other than student loans may be overstated until the expiration of the on-ramp as consumers deprioritize student loan repayments. On the other hand, our analysis may understate serious delinquency for all products because our model does not include macroeconomic effects such as inflation, higher interest rates, or potential increases in unemployment.

TransUnion and BCG are available to leverage and customize the models used for this paper to create product- and customer segment-specific overlays that can assist in adjusting loss forecasts, originations strategies, and account management strategies. We can also discuss ways to enhance customer communications and loss mitigation programs to ensure readiness for the new credit risk environment.

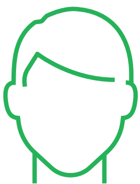
Background

Uncertainty surrounded the consumer credit market as the Covid-19 pandemic began in March 2020. As stay-at-home orders emerged, so did forbearance programs for consumers across the credit spectrum. Many private lenders paused debt payments to insulate consumers from unexpected job losses and income reductions. The federal government passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which effectively placed all federal student loans into forbearance; provided mortgage forbearance on federally backed program loans; and provided stimulus payments and enhanced unemployment benefits to consumers.

In late 2020, as the initial unemployment spike returned closer to pre-pandemic levels and economic uncertainty subsided, most private forbearance programs ended. However, student loan forbearance continued with multiple extensions through August 2023. In September 2023, student loans began accruing interest for the first time in over three years, and consumers were notified that they would need to resume payments in October 2023.

The resumption of student loan payments increases the uncertainty in consumer credit markets. 41.2 million consumers hold $1.6 trillion in student loans, making it the second largest consumer debt class following home mortgages at $12.2 trillion. In addition, late 2021 and early 2022 saw record-breaking lending activity, and student loan holders were among the millions of consumers who took on new debt obligations. 55% originated a new credit card, 37% a new auto loan, and 15% a new mortgage. Alongside these new debt obligations, inflation, higher interest rates, and the spending down of excess savings will put further stress on many student loan borrowers.

Exhibit 1



"I know I am not alone in feeling overwhelmed and drastically uninformed or unaware of what will happen with student loans, when things will change and what that means for all of us still struggling to pay necessary bills."

–Survey Respondent

Source: BCG and TransUnion consumer survey, July 2023.

According to our July 2023 nationally representative survey of 500 student loan consumers, 74% of respondents did not make any payments during the pause while only 9% made full payments monthly. Of the people who did not make payments, 55% indicated that it was because they did not have the funds to cover their monthly payments. This suggests that the forbearance program helped reduce financial hardship for a significant number of loan consumers.

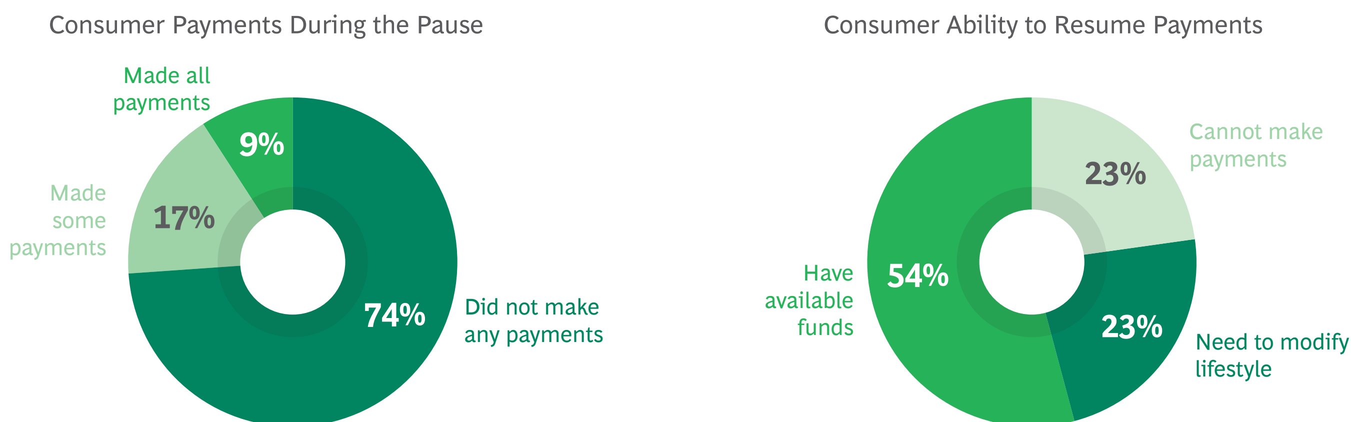
With repayments set to resume, we expect that many consumers will struggle to make their payments. Only 54% of survey respondents indicated that they would have liquid funds available to make their payments, while the remaining 46% were split evenly between those who thought they could make up the difference with lifestyle changes and those who did not think they would be able to pay. Exhibit 2 summarizes our survey results.

The government's new Saving on a Valuable Education (SAVE) program is a significant expansion of existing income-driven repayment programs (IDRs) and is likely to help many consumers. The SAVE program calculates student loan payments based upon family size and disposable income, and it ultimately forgives remaining balances after a certain amount of time. In addition to SAVE, the government is also implementing an on-ramp program that will require student loan servicers to not report student loan delinquencies to credit bureaus until September 30, 2024.

Research Objective

Our research assesses the impact of resuming student loan payments on the consumer credit market. We provide estimates for the percentage of consumers expected to experience serious delinquency—defined as 90 days or more past due on any consumer credit product—within 12 months of the resumption of payments. We also estimate the increase in serious delinquency for the different credit product types these consumers hold, and we assess the impact of the SAVE program under various assumptions.

Exhibit 2 - Survey results



Source: BCG and TransUnion consumer survey, July 2023.

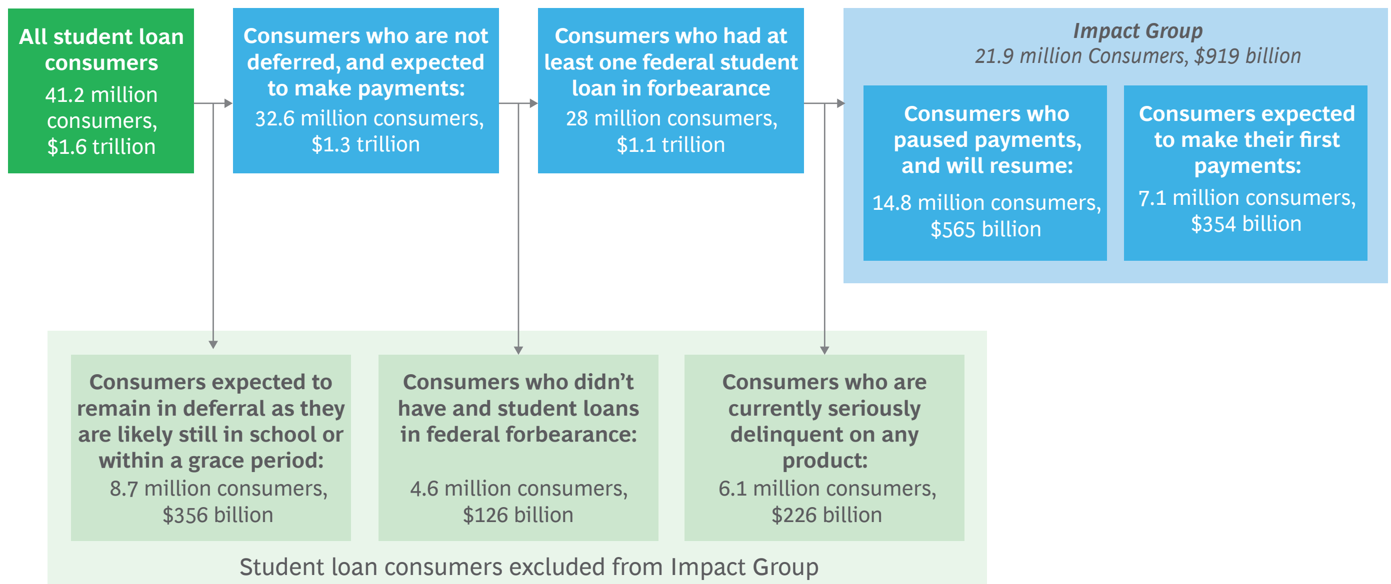
We produced these estimates using a regression model built with pre-Covid data. Our model measures the increase in the probability of serious delinquency among consumers who experience a payment increase without an increase in overall debt (often due to the expiration of a promotional offer or the end of the draw period on a line of credit) relative to consumers who did not experience a payment increase. We used the same data, supplemented by our July 2023 survey of 500 federal student loan debt holders, to understand payment hierarchy and estimate the increase in serious delinquency by consumer credit product type. To estimate the impact of the SAVE program, we evaluated two scenarios with different assumptions for household size and level of enrollment. More information regarding our methodology appears throughout the paper.

Payment Increase Amounts and Scope

Of the 41.2 million consumers with student loans, we estimate the impact of the resumption of payments for 21.9 million consumers (the "Impact Group"). The Impact Group includes 14.8 million consumers whose payments were paused in March 2020 and will be resuming, as well as another 7.1 million consumers who were still in school when the pandemic began and will make their first payments in October 2023.

Our Impact Group excludes 19.3 million consumers. 8.7 million are expected to remain in school or in a grace period and therefore will not begin making payments yet; federal loan programs provide a grace period of up to six months after leaving school to allow for consumers to find employment before they are expected to begin repaying their loans. 4.6 million consumers hold private student loans or federal loans that were not eligible for forbearance; these consumers therefore will not face an increase in payments in October 2023. Finally, we removed 6.1 million consumers who already had at least one current serious delinquency as of July 2023. We chose not to analyze the 6.1 million consumers who were already seriously delinquent for two reasons. First, lenders already know these consumers are higher risk and should already be taking measures to mitigate additional delinquency. Second, we do not believe that the resumption of student loan payments will have as large of an incremental impact on this group as we expect many of them will be eligible for payment relief through SAVE or other forbearance programs. (See Exhibit 3.)

Exhibit 3 - How we selected the Impact Group



Source: TransUnion US consumer credit database.

To estimate the required payments for the Impact Group, we modeled two payment amount scenarios. Our scenarios incorporate assumptions about enrollment levels in the SAVE program as well as household size, which impacts the calculation of discretionary income and, by extension, repayment amount. The high coverage scenario assumes that every borrower who stands to benefit from the SAVE program enrolls in it. This scenario also assumes a household size of three, which is slightly higher than the average household size suggested by census data. The low coverage scenario assumes similar enrollment levels to current IDR programs (approximately one-third of all holders of federal student loans) and assumes everyone in the Impact Group has only one household member: themselves. Per the SAVE program's design, both scenarios use 10% of disposable income to calculate the payment amount. For consumers who are not enrolled in the SAVE program, we assume their payments are 1% of the student loan balance amount.[1] Exhibit 4 summarizes these assumptions.

Exhibit 5 shows the distribution of estimated payments under the low and high coverage scenarios. The high coverage scenario has a significant impact on lowering payments. In this scenario, 37% of consumers will have no payment and 63% of consumers will have a payment under $100. In contrast, in the low coverage scenario, only 36% of consumers will have a payment below $100.

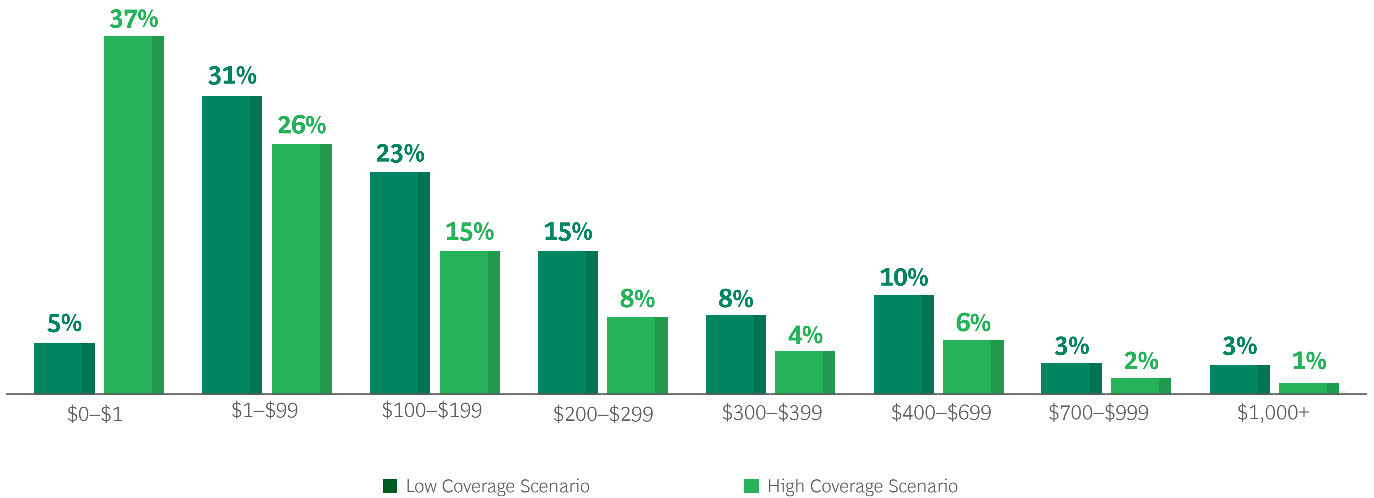
Exhibit 4 - Summary of Assumptions for the high and low coverage scenarios

	High Coverage Scenario	Low Coverage Scenario
Household Members	3	1
Payment if Enrolled in SAVE	$10\% \times \frac{(\text{Annual Income*} - \$55{,}935)}{12}$	$10\% \times \frac{(\text{Annual Income*} - \$32{,}805)}{12}$
SAVE Enrollment	All in Impact Group who would benefit	1/3 of Impact Group

Source: BCG and TransUnion analysis.

1. Our low and high coverage scenarios are intended to provide lower and upper ranges for the impact of the SAVE program. In terms of household size, if all student loan holders had their own households, the average household size would be 2.8 based on census data. Since some still live with their parents and others are married to someone else with a student loan, we believe the assumption for a household size of 3 in the high coverage scenario is conservative.

Exhibit 5 - Distribution of expected payment amounts



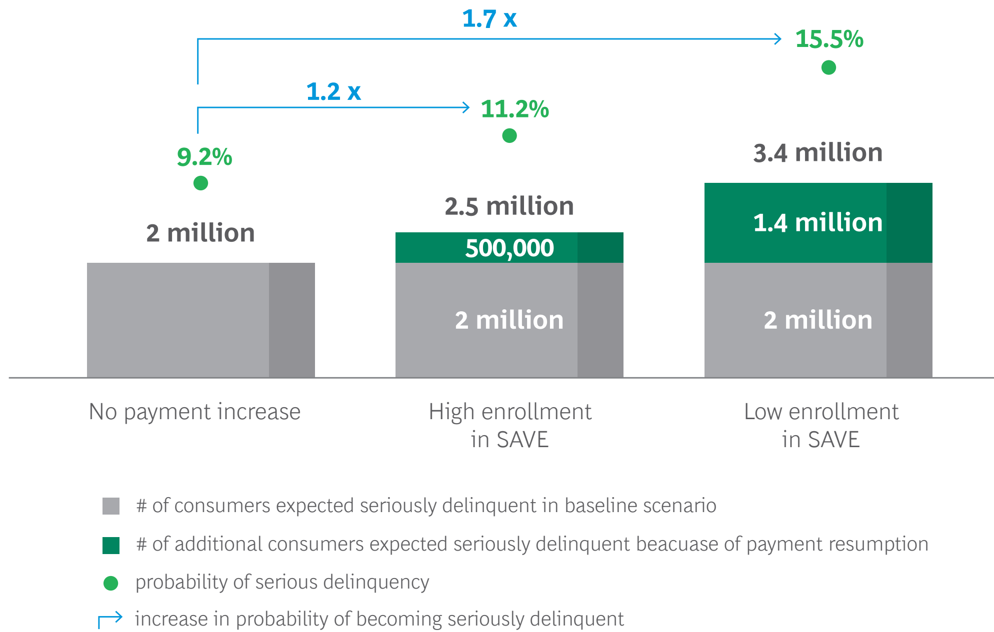
Source: TransUnion US consumer credit database.

Estimates for Consumer Serious Delinquency

To understand the impact of payment resumption on the 21.9 million consumers in the Impact Group, our first step was to forecast a baseline scenario. This scenario forecasts the number of consumers who will become seriously delinquent in 12 months without experiencing any increase in their payments. Reasons these consumers might become seriously delinquent include job loss or unexpected expenses. The estimate for the number of consumers who will become seriously delinquent on any product in our baseline scenario is 2 million (9.2% of the Impact Group). Again, this figure excludes the 6 million consumers who are already seriously delinquent on at least one product.

The next scenarios we forecasted were the high and low coverage scenarios, which assume payment increases for consumers in the Impact Group. Under the high coverage scenario, we estimate that an additional 500,000 consumers will become seriously delinquent on one or more of their products, for a total of 2.5 million consumers (11.2% of the Impact Group). Moving from the high coverage scenario to the low coverage scenario increases the estimate for seriously delinquent consumers by an additional 900,000 for a total of 3.4 million (15.5% of the Impact Group). This represents a 1.2x to 1.7x increase in the probability that a consumer in the Impact Group will become seriously delinquent. (See Exhibit 6.)

Exhibit 6 - Estimates for consumer serious delinquency by scenario



Source: BCG and TransUnion analysis.

Because our model was built on pre-Covid data, during which time consumers experienced a more benign economic environment, our forecasts for serious delinquency across all three scenarios are likely lower than what could actually occur.

Even with the SAVE program in place, the tougher economic environment, resumption of payments, and potential increases in unemployment will create a new and challenging fiscal reality for many consumers, lenders, and servicers. This reality will be particularly challenging for lower-income and lower credit quality borrowers who will experience even higher rates of serious delinquency. (See Exhibit 7.)

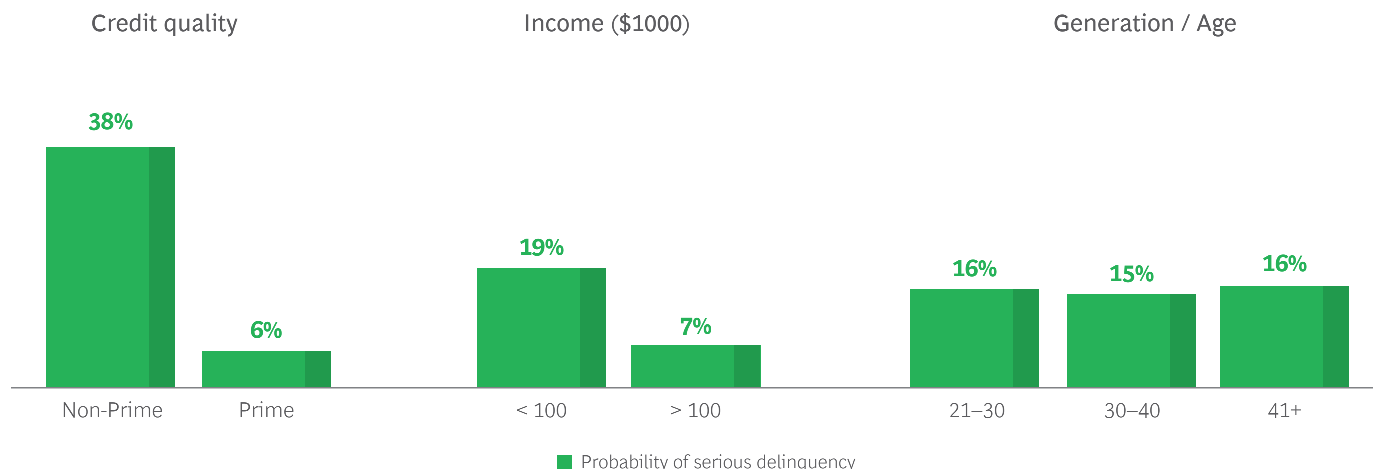
Methodology for Estimating Consumer Serious Delinquency

We used a logistic regression to estimate the increase in serious delinquency under the baseline, high coverage, and low coverage scenarios.

Our regression model estimates the probability of a consumer becoming seriously delinquent within 12 months of experiencing a payment increase not caused by an increase in debt. Such payment increases often occur when, for example, a teaser rate for a credit card expires or the draw period on a line of credit ends. We considered a consumer to be seriously delinquent if any of their trade lines became 90 days or more past due, or if they experienced bankruptcy, charge-off, repossession, or foreclosure. We excluded situations involving death or reported fraud.

The timeframe for model development data included 2017, 2018, and the first quarter 2019. We excluded subsequent data to avoid timeframes when credit was severely impacted by Covid-19 or the CARES Act. To model sensitivity to a payment increase, we compared consumers who did not experience a payment increase to those who did. To help our development data mirror the Impact Group, we excluded consumers who were 90 days delinquent or worse within the 90-day period prior to incurring a payment increase.

Exhibit 7 - Differences in rates of serious delinquency among consumer groups



Source: BCG and TransUnion analysis.

Note: Estimates are for the low coverage scenario.

We sourced the raw data for our model from TransUnion's consumer credit database. In addition, we used several TruVision Credit Attributes related to the consumer's underlying credit risk, such the TruVision Account Management Score (an overall indicator of credit risk), credit line utilization, and past delinquency information. We combined these attributes with additional variables closely tied to the payment increase, such as the size of the payment increase relative to income, debt-to-income ratio including the new payments, residual income, and a binary payment increase indicator. We used the TransUnion TruVision Trended Income Estimator to estimate consumer incomes. We also tested whether including economic conditions increased the accuracy of our model; because they did not, we did not include them.

Our model has strong predictive power on our development and validation samples, as well as the second quarter of 2022, which was our out-of-time sample (0.885, 0.884, and 0.885 in AUC, respectively). We also compared the model's predictions to the observed serious delinquency rates between the groups with and without payment increases, controlling for multiple variables. We found that the model successfully captures the difference between the non-payment-increase and payment-increase groups across the ranges of the variables.

Estimates for Product Serious Delinquency

We expect that serious delinquency will climb for other consumer credit products in addition to student loans. Estimating the increase in serious delinquency by product is challenging because it requires assumptions for payment hierarchy. We derived a payment hierarchy from the model development data and also included questions regarding payment hierarchy in our survey. Because the results of our survey and our analysis were largely aligned, we used the payment hierarchy derived from the development data to estimate the increase in serious delinquency by product. We believe that our assumed payment hierarchy is somewhat pessimistic for the October 2023 to October 2024 time period, during which time the on-ramp will suppress reporting of delinquency on federal student loans.[2]

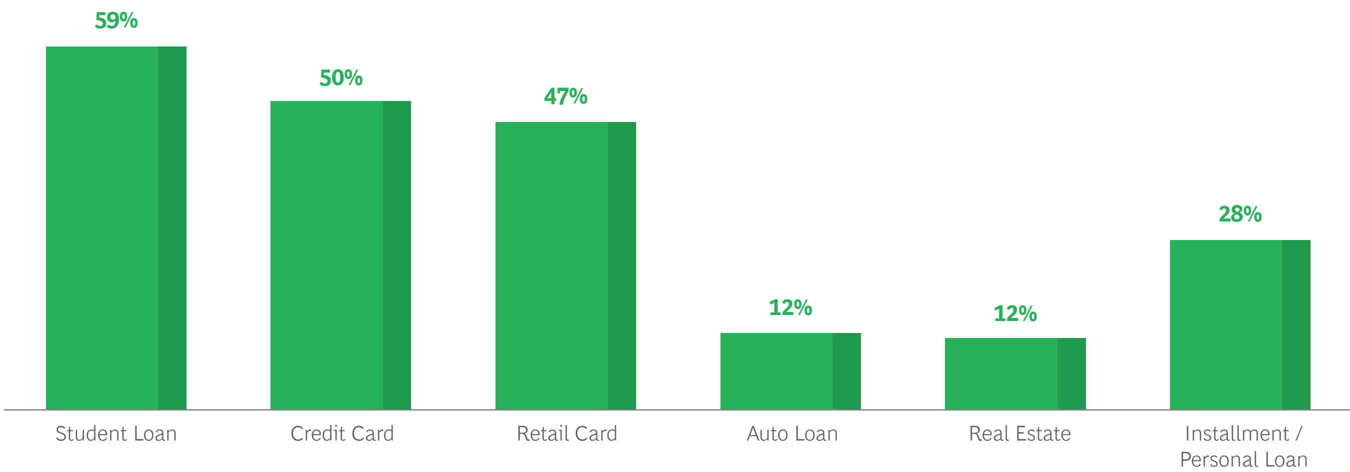
2. The on-ramp program, which will suppress reporting of federal student loan delinquency until October 2024, may mean that student loans occupy a lower place in the payment hierarchy than our model predicts. This could cause our model to overestimate serious delinquency for products other than student loans until the expiration of the on-ramp.

Based on our development data, when a consumer with a student loan experiences serious delinquency, there is a 59% probability that the student loan is the product that will become seriously delinquent. Credit cards are next lowest on the payment hierarchy at 50%. Real estate loans are highest on the payment hierarchy at 12%. (See Exhibit 8.)

The findings from our consumer survey are largely consistent with the findings from our analysis, with real estate (mortgage and home equity) being higher priority, followed by auto loans, then credit cards, and then student loans. Results for personal loans differed between the analysis and the survey, with survey respondents ranking them below credit cards while the analysis showed them above credit cards. We believe this difference is due to the fact that consumers usually prioritize their preferred credit card over their personal loan and other credit cards. (See Exhibit 9.)

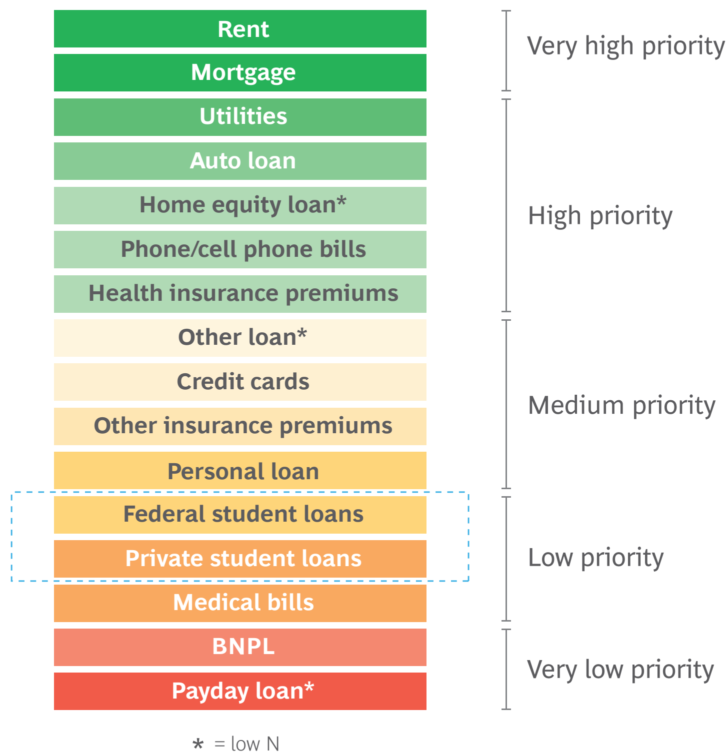
To estimate the incremental number of consumers with a specific product who will become seriously delinquent for that product, we first sized the number of consumers in the Impact Group for that product. We then sized the subset of this group that would become seriously delinquent on at least one type of product because of the payment increase, and finally incorporated the payment hierarchy to estimate the number of consumers who would become seriously delinquent on that specific product. Exhibit 10 shows the details of our analysis for credit card delinquency in our low coverage scenario. In this example, we find that an additional 600,000 consumers who have a credit card will become seriously delinquent on one of more of their cards over the next 12 months as a result of the resumption of student loan payments.

Exhibit 8 - Probability of product serious delinquency when a consumer with a student loan who has the product experiences serious delinquency



Source: BCG and TransUnion analysis.

Exhibit 9 - If you couldn't afford to pay all of your bills, how would you prioritize the bills you do pay?



Source: BCG and TransUnion consumer survey, July 2023.

Note: Heatmap derived from total average rank score.

Exhibit 10 - Calculation for the increase in serious delinquency for credit cards for the low coverage scenario

Group Description	Group Size (000s)
Current number of consumers who have credit card and are not seriously delinquent on any product	**180,479**
Subset of those consumers who have a student loan (15.7%)	**28,335**
Subset of those consumers who are in the impact group (67%)	**18,977**
Subset of those consumers who will become seriously delinquent as a result of the payment increase (6.3%)	**1,196**
Subset of those consumers who will become seriously delinquent on one of their credit cards (50%)	**600**

Source: BCG and TransUnion analysis.

The sources for the numbers used in calculating the example are described below:

- 180 million is from the TransUnion Consumer Credit Database.
- 15.7% is the portion of credit card customers who are not seriously delinquent who have a student loan, sourced from the TransUnion Consumer Credit Database.
- 67% is the number of consumers in the Impact Group (21 million) divided by the number of consumers with a student loan who are not seriously delinquent on any product (32.7 million).
- 6.3% is the share of consumers who will become seriously delinquent in the low coverage scenario less the share in the baseline scenario who would have become seriously delinquent even without a payment increase. (See Exhibit 6.)
- 50% is from Exhibit 8.

The calculations for all products in both low and high coverage scenarios are shown in Exhibit 11 below. To put these numbers into context, we established a benchmark of the number of consumers who became seriously delinquent on each product in the 12-month period ending July 2023. Based on our estimates, we expect an additional 191,000 to 600,000 consumers who have a credit card to become seriously delinquent on at least one of their cards over the next 12 months. Relative to our benchmark, this would represent an increase of 3% to 10% in the number of consumers who become delinquent.

Real estate showed the largest increase in the number of consumers expected to become seriously delinquent at 5% to 14% relative to our benchmark. We believe this is due to the very low percentage of consumers with real estate loans who became seriously delinquent in the last 12 months. Personal loans showed the smallest increase in the number of consumers expected to become seriously delinquent at 1% to 4% relative to our benchmark. We attribute this to the high number of consumers with personal loans who became delinquent during the benchmark period.

Exhibit 11 - Estimates for the increase in serious delinquency by product

Product	Number of consumers who have this product and are not seriously delinquent on any product (000s)	% who became seriously delinquent on this product during the benchmark period	Incremental number who will become seriously delinquent on this product in the next 12 months (000s)		% increase relative to our benchmark period	
			High Coverage	Low Coverage	High Coverage	Low Coverage
Card	180,479	3.2%	191	600	3%	10%
Retail	104,674	2.6%	110	346	4%	13%
Auto	72,083	1.5%	23	73	2%	7%
Real Estate	71,016	0.4%	14	44	5%	14%
Personal loans	17,016	5.3%	13	41	1%	4%

Source: BCG and TransUnion analysis.

What Lenders Can Do

Consumers with student loans who experience a payment increase present a higher risk of serious delinquency than those who do not. To help consumers and mitigate the increase in risk, lenders with exposure to these consumers will need to revise loss forecasts, adjust strategies for originations and account management, and ensure their customer outreach and assistance programs have the appropriate remedies and are ready to scale.

Revise Loss Forecasts and Adjust Strategies for Originations and Account Management

The increase in risk among consumers experiencing a payment increase will lead to negative performance deviations in expected good/bad odds. Furthermore, the risk increase will be different for each consumer, based on the size of their payment increase as well as their income, debt profile, and eligibility for government payment programs. Lenders, therefore, will need adjust credit loss forecasts, originations strategies, and account management strategies, factoring in all these dynamics as they do so.

For **credit loss forecasts**, Current Expected Credit Loss (CECL) reserves, and troubled debt restructuring (TDR) accounting processes, our study results provide an overall view of the magnitude of the impact of payment resumption. Some of the information shared earlier could serve as a starting point for making adjustments. However, specific increases in risk will vary based on the product as well as the consumer composition of the portfolio.

For **originations**, lenders will need to adjust their credit models and revise new account origination policies to reflect both the increase in risk and the lack of reporting of federal student loan delinquency for the 12 months following payment resumption. Lenders also may benefit from adding new information sources to add more insight to consumer risk (e.g., deposit cash flow data and use of trended behavioral attributes).

For **account management**, actions for revolving credit products, including line management, authorizations, and retention will provide an opportunity to engage with consumers to increase loyalty and payment preference. Here too, lenders will need to adjust their risk outlook for each consumer facing a payment increase. When it comes to specific actions, line reductions tend to work better than line closures, but both should be used judiciously, as a loss of product utility can backfire and lead to higher delinquencies. In many cases, helping consumers in their times of need through more positive and neutral actions (e.g., limiting overlimit expansion in authorizations for at-risk credit card consumers and providing retention offers for good customers at risk of attrition) can also reduce risk.

Consumer Outreach and Assistance

As we saw during the Covid-19 pandemic and the global financial crisis, lenders that proactively reach out to their customers during difficult times build stronger relationships that can lead to payment preference in times of stress and higher loyalty once the hardship passes. For this crisis, lenders can take several steps to help consumers navigate the resumption of payments, including increasing consumer awareness, educating them on their options, and providing short- or long-term assistance.

When it comes to raising awareness and communicating with consumers, our survey substantiates that most consumers are worried about the resumption of their student payments and are not sure what to do. Survey results indicate that 24% of respondents are not sure what their next bill amount will be. Lenders should be prepared to reach out across multiple channels, including digital, email, text message, chat, in-app, and mail, and to leverage the full capabilities of their customer services and marketing teams to communicate clearly and comprehensively.

As for what messages to communicate, lenders should encourage all consumers to take advantage of the SAVE program and to investigate the many other federal and state programs designed to help consumers with student loans. Websites such as https://studentaid.gov offer helpful information. Lenders should also proactively communicate their willingness to help consumers, as well as the types of programs available if consumers need them.

When it comes to providing assistance, lenders will need to ensure they have a broad range of programs available. For lower-risk consumers, shorter-term payment programs may be sufficient. This is particularly true for consumers who qualify for the SAVE program because payments under this program are set to decrease in July 2024, when the payment amount drops from 10% of residual income to a blended rate of between 5% and 10%, depending on the portion of the consumer's loans that are undergraduate vs. graduate. Loan modifications, interest-only payments, and matched payments can be effective for helping consumers and should reduce the risk of loss by moving the lender's payments higher in the payment hierarchy. More broadly, demonstrating empathy for what consumers are experiencing can help maintain positive relationships.

For higher-risk consumers, lenders likely need more significant, longer-term solutions, as many of these people will face fundamental ability-to-pay issues due to a combination of the payment increase, inflation, and higher interest rates. One key lesson from the global financial crisis is that single product loan modifications by themselves (except for the first mortgage, which typically represents about a third of someone's monthly gross income) typically will not help consumers afford all of their payments. If a consumer needs more relief than a lender can offer, refinancing debts to reduce payments, enrolling in Non-Profit Consumer Credit counseling services, and using External Debt Management (EDM) plans should all be considered.

When offering consumer assistance, lenders must balance the costs and benefits. High-quality segmentation and leveraging consumer-level value-at-risk analytics are essential to being able to identify the right treatment strategy for each consumer. As part of segmentation efforts, lenders should evaluate several factors including probability of default (currently defined as 90 or more days on a trade line or high likelihood in the near future), large balance exposures (could be to high-risk individuals or households with large numbers of government loans experiencing payment increases), and low ability-to-pay (due to low income, high debts, or both). Once a lender builds a segmentation model, a test-and-learn strategy should be used to optimize program benefits.

BCG and TransUnion have significant experience working in the consumer credit space and are ready to work with lenders to ensure they are prepared for the challenges ahead. For adjustments to loss forecasts as well as origination and account management strategies, we can leverage and customize the models used for this paper to make revisions or create overlays. In addition, we can enhance customer segmentation strategies based on value-at-risk and customer behaviors. From a customer engagement perspective, we can review loss mitigation programs to ensure communications strategies are aligned with consumer needs and channel preferences. Finally, we can help ensure the appropriate short- and long-term assistance programs are in place.

Conclusion

The resumption of student loan payments comes at a challenging time for consumers and lenders. Many factors are already pushing delinquencies higher, and a cooling economy may further worsen conditions. Lenders with exposure to consumers who have student loans—particularly consumers with lower incomes or higher credit risk—have the most at stake. These lenders must take immediate and comprehensive action, both to help consumers adjust and to protect their portfolios.

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