


The end of the Great Deferral: credit risk impact of COVID-19 payment relief

Updated research to help lenders predict customer payment behavior after the CARES Act Accommodation period ends





The world has had over two years to learn to live with the global COVID-19 pandemic. While lockdowns and disease had many unpleasant consequences, an in-depth look at Experian credit data shows that the typical U.S. borrower bounced back quickly after the deepest recession in history. Perhaps as a result of stimulus payments, PPP loans and other measures, **U.S. GDP growth was 5.7% in 2021.**¹ Consumers now live in a world with low unemployment and rising wages. Many, particularly consumers who were homeowners and those who held stocks (either in a retirement plan or another account), have increased wealth in the form of home equity and capital gains.

Despite all this good news, consumer lenders know that their customers face new challenges and fears. Besides the constant specter of further waves and new variants of the virus, consumers now face new challenges, including:

- Higher prices, particularly for housing, food, fuel and services
- Rising interest rates
- Fears associated with a faraway war
- Shortages of many goods and of certain categories of workers
- Fears of a potential recession as the Federal Reserve and other central banks take action to respond to inflation

¹OECD, <https://stats.oecd.org/>

In this report, we take a fresh look at the payment performance of consumers who accepted loan accommodations early in the pandemic. We offer fresh insights for consumer credit risk managers about questions such as these:

- What does the credit report and other data related to a consumer who was permitted, for example, to delay their mortgage and student loan payments, indicate to the lender who must evaluate that individual's risk? What do they indicate about the risk inherent in that lender's loan portfolio?
- Similarly, what about the tens of millions of consumers, largely Millennials and younger, who have student loans in a forbearance status? Lenders need insight into what might happen when those student loans eventually come due.

Introduction

This study analyzes the anonymized credit data related to nearly 17 million consumer mortgages, student loans, bankcards and auto loans that were once in an accommodation status. Now that the accommodation period has passed for roughly 40% of those accounts, we've analyzed their credit performance to offer insights into similarly situated consumers and into those who will be exiting such assistance programs in the coming months.

Experian's research confirms that consumer payment behavior during the accommodation period gives consumer credit risk managers insights into how their loan portfolio — and perhaps even individual accounts — will perform as the remaining loan accommodations expire. It also confirms that payment behavior on accounts with pandemic-related extensions or forbearances sends a strong signal about future payment behavior after the payment relief ends.

This document presents five findings. The first two findings have only become evident by studying newly available data about the behavior of millions of consumers between 2020 and 2022 and the remaining reconfirm the conclusions from the 2021 report:

01

Mortgage borrowers with a low loan-to-value (LTV) ratio (high equity) were more likely to receive a payment during an accommodation period.

02

Millions of student loan borrowers made unrequired payments during their deferral period.

03

Accounts exiting an accommodation period remain more likely to exhibit subsequent delinquency than were accounts that didn't receive such an accommodation.

04

Payment on a debt during accommodation is still a strong indicator of reduced risk for subsequent delinquency.

05

Delinquency prior to the pandemic continues to be a strong indicator of future risk.

For each of these findings, we suggest strategies that you — the lender — can implement now:

- To better assess the credit risk in your loan portfolios
- To provide differential service to the customers who need it most
- To better understand the creditworthiness of your account holders or new applicants who might have received forbearances or other accommodations

About this report

The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), enacted by Congress in March 2020, addressed accommodations — payment assistance or relief — granted to consumers affected by the pandemic. Examples of accommodations were agreements to modify a loan or other contract, to defer one or more payments, to accept partial payments or to forbear any delinquent balances. The CARES Act amended the Fair Credit Reporting Act (FCRA). Under that amendment, a consumer whose account wasn't previously delinquent is current on their loan if they've received an accommodation and make any payments required by that accommodation.



[>> Click to view the 2021 Report](#)

01

Mortgages with a low LTV ratio (high equity) were more likely to receive a payment during the accommodation.

Mortgages with a low current loan-to-value ratio were especially likely to receive a payment during the mortgage deferral period. Homeowners with substantial equity in their homes were particularly willing and able to stay current on their mortgage obligations after a mortgage deferral expired.

The years 2021 and 2022 have seen rapidly rising housing costs. Construction and supply issues contributed to cost increases, as did migration because of lifestyle changes during COVID-19 lockdowns and an exodus from high cost-of-living areas. On the one hand, increasing rents and home prices caused hardship for some families. In contrast, homeowners who stayed in place saw a significant increase in home equity. Black Knight reported in February that **tappable equity increased by \$2.6 trillion in 2021, the largest increase on record**. They estimated that the average homeowner gained \$48,000 in equity last year.

Experian data scientists analyzed a statistically relevant sample of mortgages that received forbearance during the CARES Act accommodation period. After merging property data with the trended credit bureau data, they found borrowers with a low current LTV, including those property owners whose equity position rose last year with home values, were less risky than other borrowers.

Additional findings:

- The current LTV was a predictor of whether consumers would exit the loan accommodation during our study period.
- A low LTV indicated an increased probability that a mortgage borrower would exit the forbearance program. In other words, mortgage consumers with less equity were more likely to remain in forbearance status at the end of our study period; those with more equity were less likely.
- People with positive equity were more likely to make unrequired payments during forbearance. Furthermore, the relationship was positively correlated: the more equity homeowners had, the larger number of unrequired payments they tended to make during the accommodation period. This relationship held whether the consumer exited the loan accommodation or not.

What mortgage lenders and servicers can do now

Mortgage lenders and servicers face significant cost pressure and rising interest rates. To succeed in this highly competitive environment, they must develop a holistic picture of their applicants and borrowers during loan acquisition and during account review.

They should understand the borrowers' financial health using data points from before, during and after the accommodation. Trended and alternative data are important, as is income verification. Experian's analysis confirms that a borrowers' equity position is an important indicator of low risk — perhaps just as important as the credit score. Lenders should regard a mortgagee who made unrequired payments during the accommodation period, and who has accumulated significant home equity, as particularly low risk.

In originations:

- For purchase transactions: Lenders should ensure that the down payment amount (and consequently LTV ratio) aligns with the desired risk profile.
- With refinance transactions and second mortgages: Interest rates are still historically low, and there's significant tappable equity for cash-out, debt consolidation and rate-and-term refinance. Accurate property valuation remains important in determining the loan amount to approve. Collateral values are just as important as credit, affordability, and identity verification.
- With home equity lines of credit (HELOCs), it's important to use collateral and other data to set credit limits and prices.

In servicing:

- Home equity is an important factor in expecting an account to perform. Consumers who become delinquent despite significant equity have inherent motivation to cure the debt.
- When considering offering a loan modification, extension or loss mitigation program, the equity in the home is a good predictor of success.

02

Millions of student loan borrowers made unrequired payments during a deferral period.

Borrowers received student loan deferments or otherwise had no payment due on \$800 million worth of student loan accounts during the pandemic. Many of these were federal loans; a repayment freeze announced at the beginning of the pandemic remains in effect.

Experian data scientists sampled approximately 10 million student loan accounts that received such an accommodation and monitored their performance through Q1 2022. Over 20% of the accounts in our sample received a payment during our study period (Figure 1).

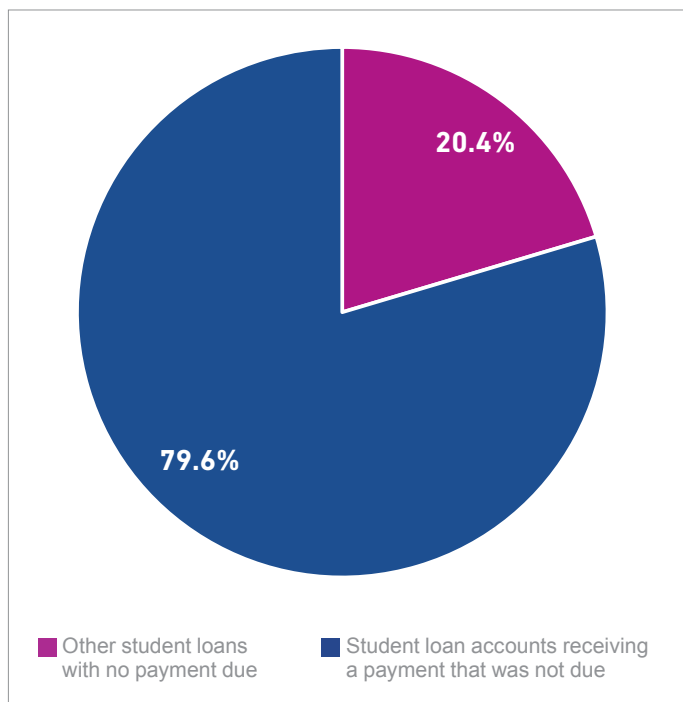


Figure 1

We estimate that 5 million Americans made payments on one or more of their student loans while no payment was due. Most of these people made payments voluntarily — with stimulus checks or other income — in order to pay down their debts. We infer from the following facts that very few consumers made payments either in error or because they were unaware of the repayment freeze:

- Over 200,000 of the student loans in our sample that received a payment during the accommodation period now have a payment due.
- Fewer than 1% of those have become delinquent since their deferments ended.

What lenders can do now

Lenders should be thoughtful about consumers with deferred student loans who may be unprepared to deal with a significantly increased debt burden when those deferrals expire.

But not all student loan borrowers will be equally impacted. Some have been planning ahead, and may have even made payments before they are required.

We now revisit the findings from last year's report and find further support for each of them in our more recent data.

03

Accounts exiting an assistance program were more likely to exhibit subsequent delinquency than were accounts that never received an accommodation

More than 150 million accounts received payment relief under the CARES Act. Approximately one-third of these accounts remain in an accommodation status (Figure 2), but over 100 million accounts are no longer in such a status — the payment holiday has expired, for example.

Outstanding balances on accounts receiving accommodations

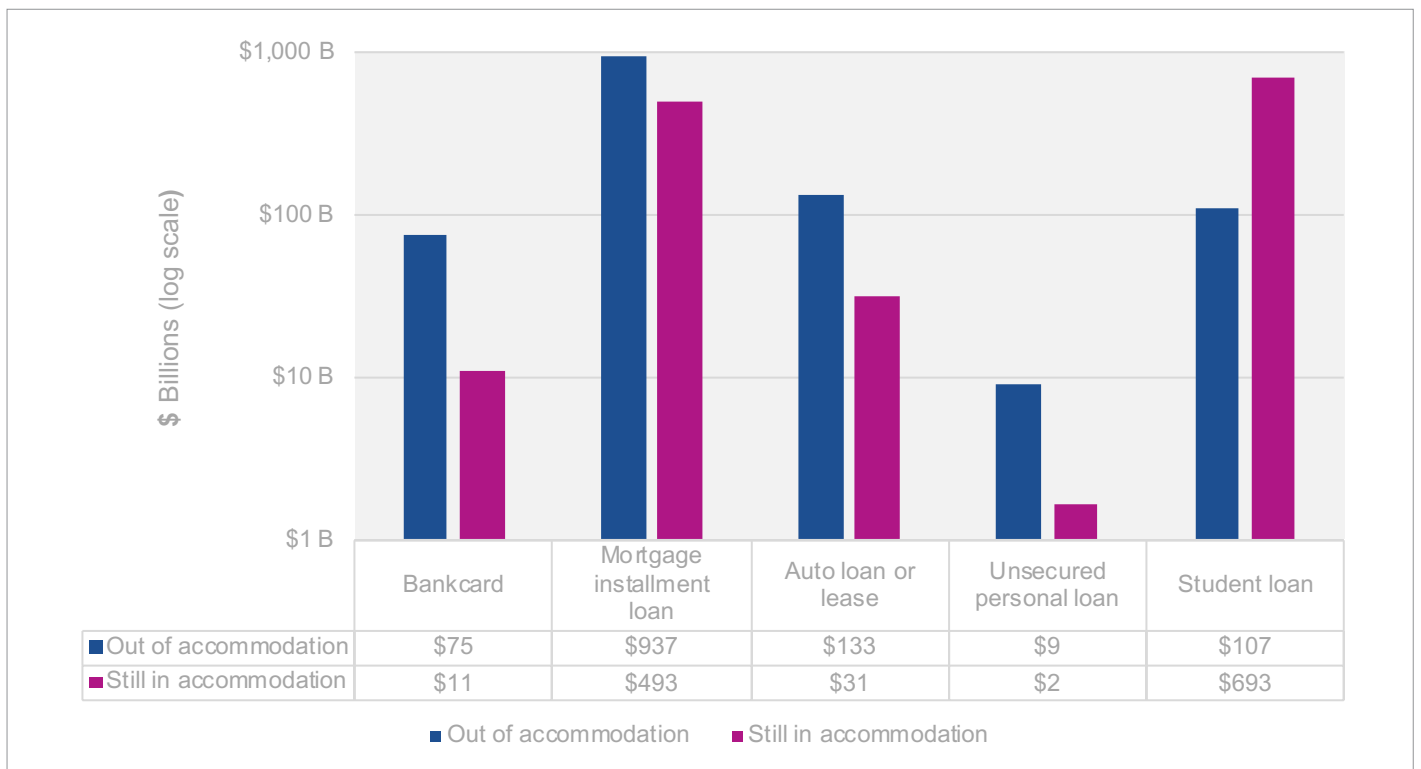


Figure 2. Large numbers of accounts received extensions, payment holidays or similar accommodations.
Source: Experian Ascend™ as of December 2021

A statistical analysis of millions of such accounts showed accounts that received a payment extension or similar accommodation were on average more likely to be delinquent after the extension expires than were accounts that didn't receive such an accommodation (Figure 3).

30+ delinquency (including derogatory)

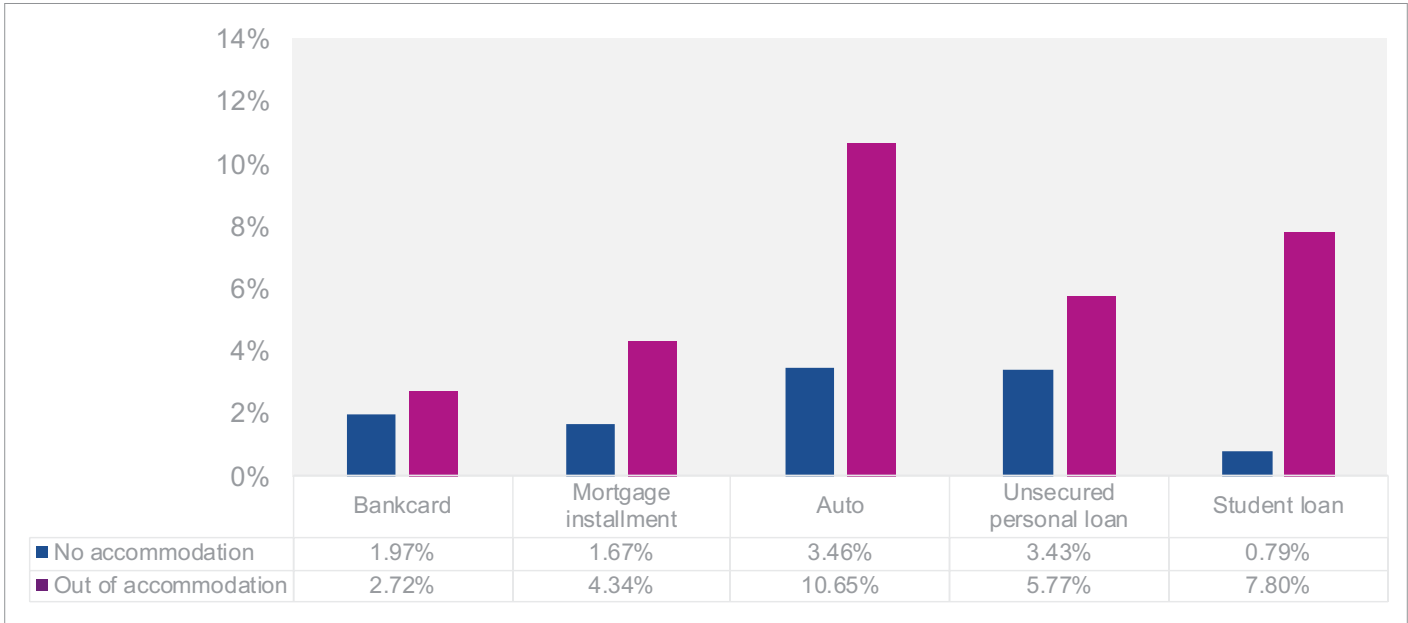


Figure 3. Accounts exiting an accommodation period exhibit increased rates of delinquency. Source: Experian Ascend as of December 2021

What lenders can do now

For many consumers, the financial implications of the pandemic were less than they had anticipated. But for others, they and their families experienced unprecedented trauma, requiring that you pay extra careful attention to servicing these accounts as their payment extensions expired.

Lenders for certain types of credit, such as auto loans, continued to see rising delinquency rates among accounts that were once reported to the bureau as having suffered a “natural disaster” during COVID-19. The collateral for these auto loans was more than three times as likely to be repossessed as for accounts that didn't receive such treatment. In most cases the lender incurred substantial loss severity after these repossessions.

Some of these losses might have been preventable by providing differentiated service, which would have yielded at least three benefits to lenders:

- Lending sympathetic support to your customers in their time of need may guarantee you loyal customers for life.
- Providing differential treatment to distressed consumers may make them easier to contact and more willing to stay in touch should collections activity or loss mitigation treatments become necessary later.
- Keeping accounts in a delinquency status for a longer period of time (rather than a derogatory status, such as charged off) may reduce both loss frequency and severity.

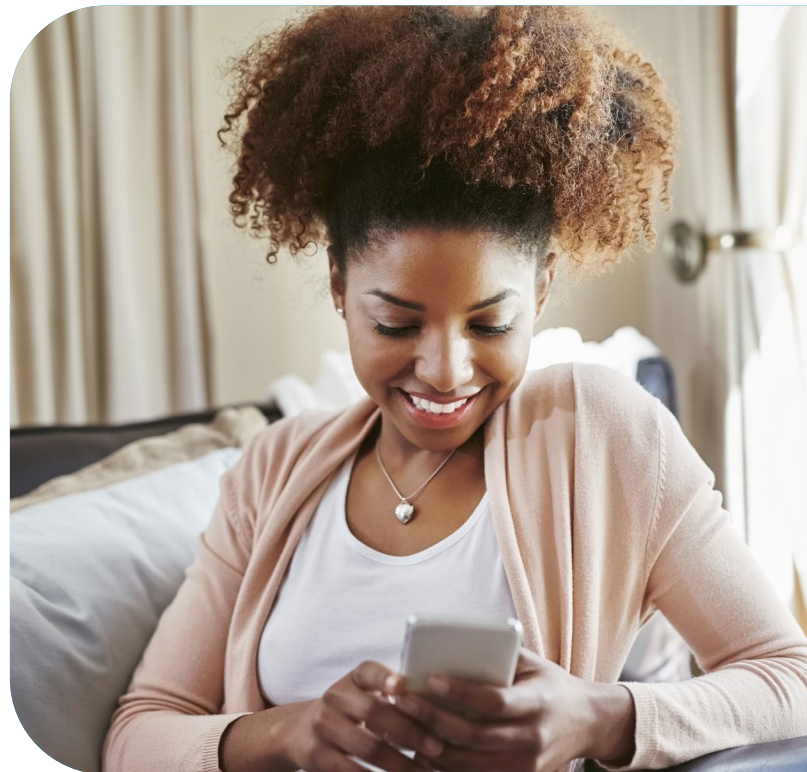
04

Payment on a debt during accommodation indicated reduced risk for subsequent delinquency

While it's true that an account that received a payment extension or similar accommodation is on average more likely to be delinquent after the extension expires than is one that didn't, it has become clear that some people were less impacted financially than others.

In aggregate, many high-income consumers and those employed in certain sectors may have experienced improved financial health. **Our data shows that 63% of the people whose accommodation has expired have used less than 20% of their available credit; this is the same rate as the general population prior to COVID-19.**

Large numbers of these consumers made a payment that wasn't required pursuant to a payment deferral or similar accommodation (Figure 4). For example, focusing on mortgage borrowers who accepted a forbearance or other relief, and who are no longer in the accommodation period, almost 87% made a payment that wasn't required. Likewise, over 43% of borrowers with auto loans that are still in an accommodation status have made a payment.



Percent of accounts receiving payments during the accommodation period

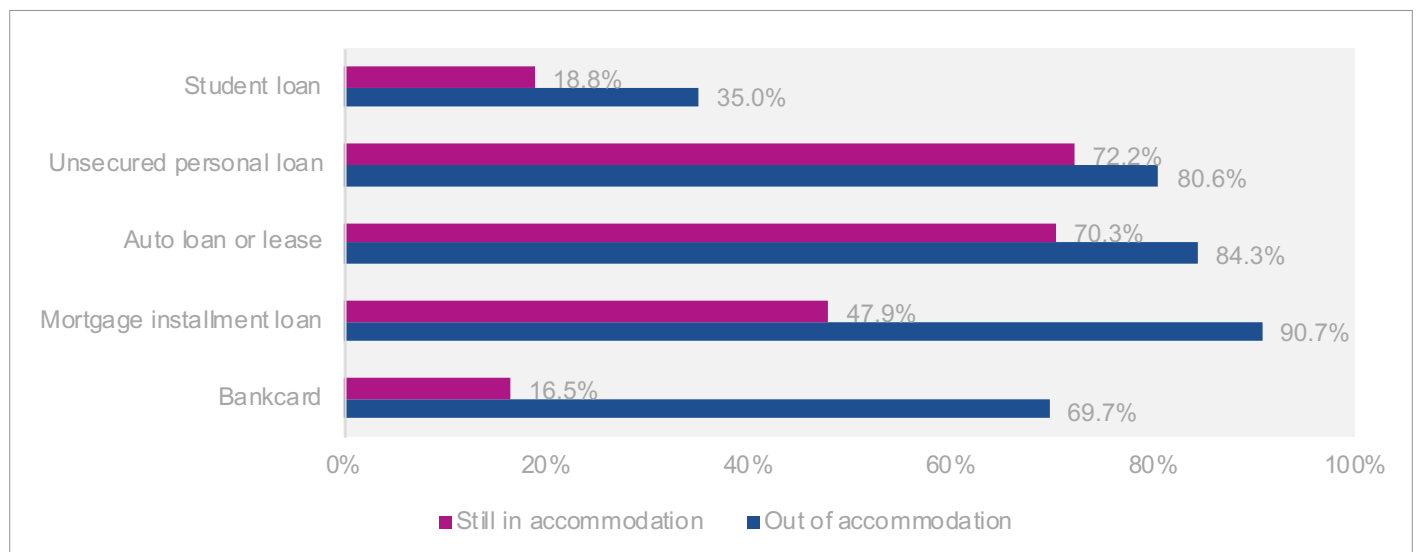


Figure 4. Large numbers of accounts received payments despite being in an accommodation status.

We reported in 2021 that debt payments made by consumers who aren't required to pay weren't a statistically significant signal of creditworthiness. Now the statistical evidence is much stronger, and we can report for the first time that this finding is especially true for student loan borrowers exiting a forbearance or similar program (Figure 5).

Delinquency rate after accommodation (30+ DPD including derogatory)

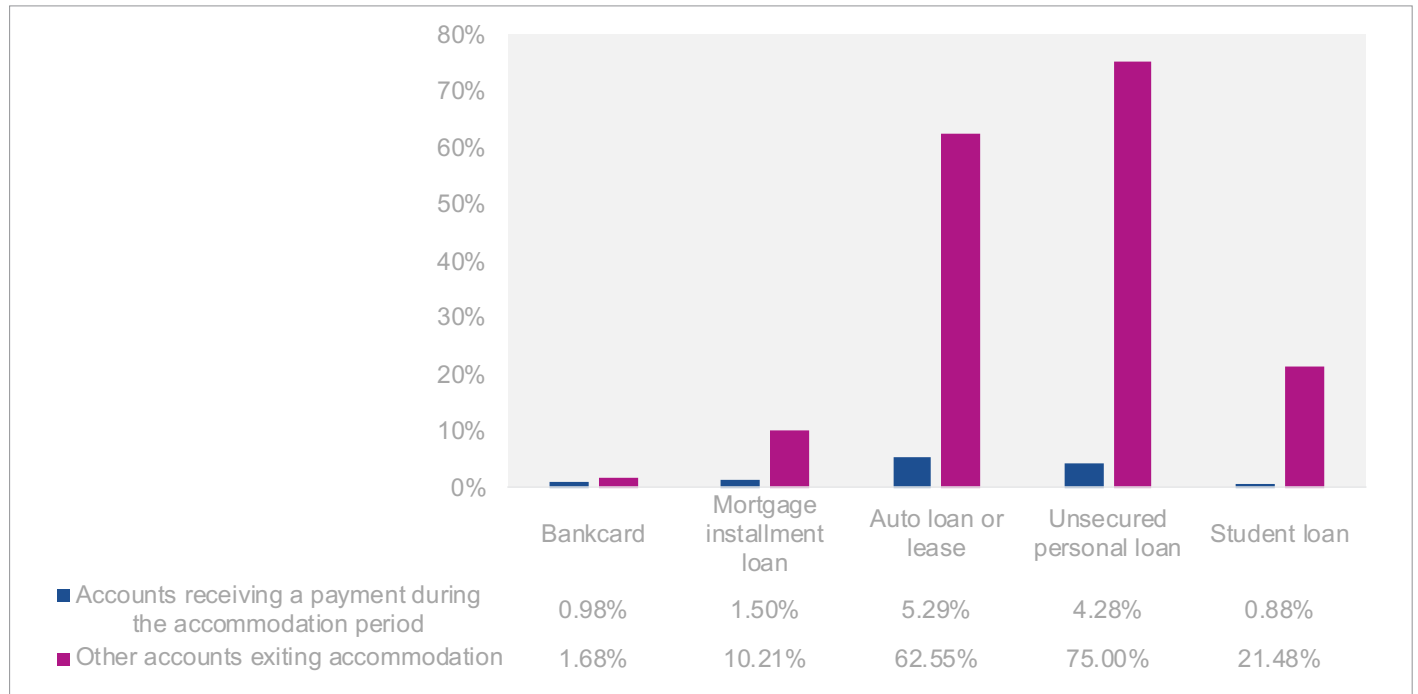


Figure 5. Accounts that receive payments during an accommodation are significantly less likely to become delinquent after the accommodation period has expired.

What lenders can do now

Consumers who pay on an account even while that account is in an extension status are sending you a strong signal of financial ability and willingness to pay in the future. Models and strategies built before the pandemic may miss that very strong signal.

Update your lending, servicing and portfolio management practices to place more importance on recent payment history.

05

Delinquency prior to COVID-19 is still a strong indicator of future risk

For some consumers who were already experiencing financial hardship at the beginning of 2020, the economic impacts of the pandemic compounded their troubles. As these borrowers' payment holidays, extensions or other accommodations came to an end, accounts that were 30 days or more past due at the beginning of 2020 were significantly more likely to become delinquent when the accommodation period ended than were accounts that were current before the pandemic (Figure 6).

30+ delinquency rates (including derogatory) after accommodation

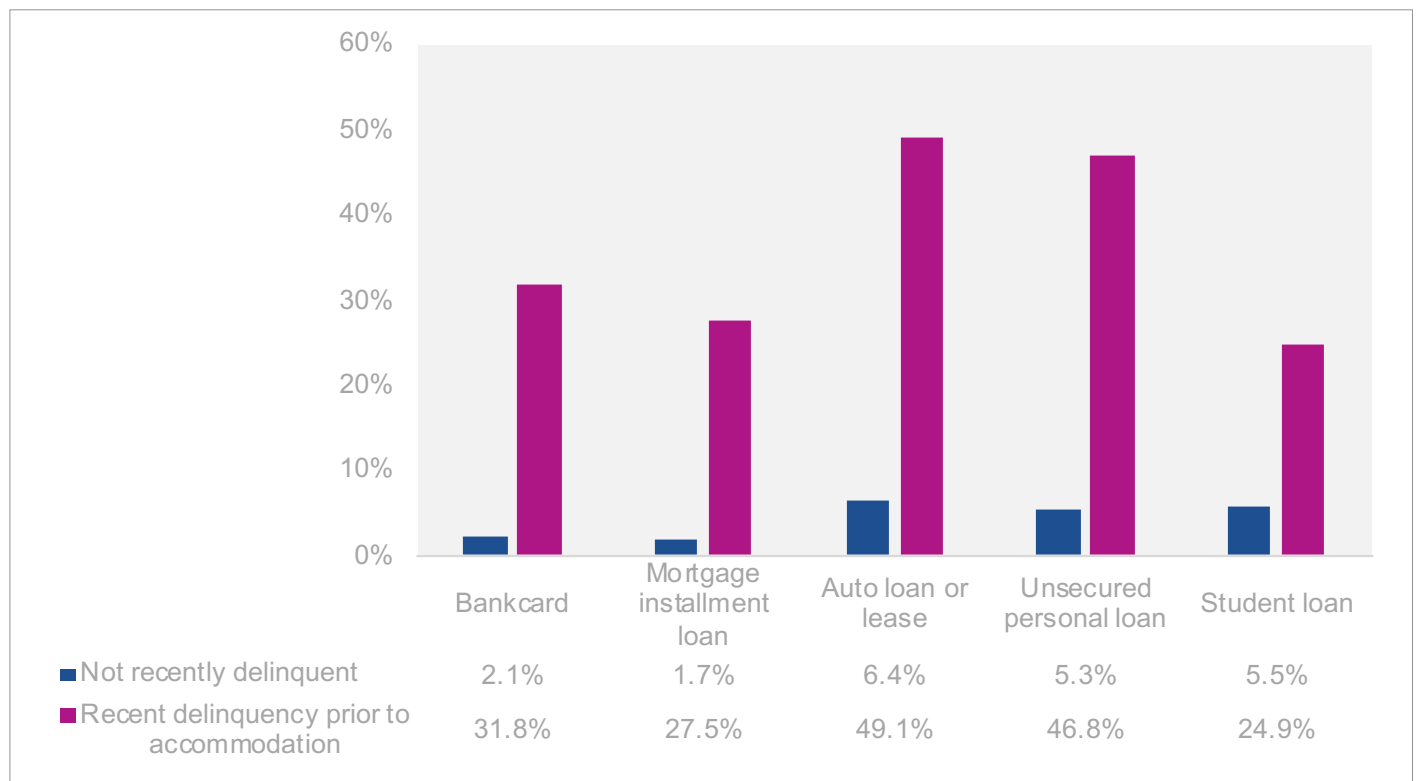


Figure 6. Accounts that were delinquent prior to the onset of the emergency were significantly riskier than other accounts emerging from an accommodation.

What lenders can do now

When underwriting applications or reviewing your portfolio, are you used to looking primarily — or even exclusively — at the most recent payment and delinquency data?

Lenders can't ignore data from late 2019 and early 2020. A delinquent status dating prior to the pandemic is a statistically significant indicator of subsequent risk. Such information can give insight into consumers who may be more likely to come out of an accommodation period with ongoing distress and therefore heightened probability of default. In those cases, there's a heightened need to consider collateral values and income.

Conclusion

While the economy rebounded quickly in 2020 and 2021, many consumers will face significant new challenges in the future. As we continue to navigate the pandemic, financial institutions and other businesses can count on Experian for help understanding multiple facets of their customers.

The conclusions in this report support business objectives, opening opportunities to:

- ✔ Use trended and alternative data, as well as collateral and income verification data, to make better forecasts and to improve your lending and servicing decisions.
- ✔ Improve the customer experience in both the digital and branch environment by making faster and better decisions.
- ✔ Assess the risk in your portfolio.
- ✔ Provide more inclusive lending, particularly in low- and moderate-income (LMI) areas.
- ✔ Plan appropriately for collections volume and losses.
 - » Monitor or update your credit scores and strategies regularly to avoid future problems that may stem from future loan accommodations — particularly mortgage and student loan accommodations.

For more information on improving your lending and portfolio management practices, [contact us today](#).

