UNIVERSITY OF CALIFORNIA

Student Loan Law Initiative

The Student Loan Payment Pause: Assessing Financial Distress in California

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About the Student Loan Law Initiative

Led by University of California-Irvine Law Professor Dalié Jiménez and University of California-Berkeley Law Professor Jonathan Glater, the Student Loan Law Initiative (SLLI) is a partnership between the University of California and the Student Borrower Protection Center to build a body of rigorous academic work around the future of student loans.

As the student loan market expanded over the past decade, borrowers have turned to the courts, regulators, and lawmakers to protect and expand their rights and halt student loan industry abuses. However, these efforts often faltered, lacking a solid foundation of rigorous analysis and comprehensive legal research. That's why UCI partnered with the Student Borrower Protection Center to launch SLLI—the nation's first academic project focused on student debt and the law.

SLLI fosters the highest quality academic research, provides grants for research, and builds the capacity of student loan experts to shape the future of this marketplace.

Student Loan
Law Initiative

Introduction

A major policy response to the economic uncertainty created by the COVID-19 pandemic in 2020 was the suspension of federal student loan repayment obligations, a pause in the accrual of interest on these loans, and the temporary cessation of collection efforts against borrowers in default.[1] The Department of Education (ED) indicates that the payment pause has benefitted more than 40 million people.[2] The goal of this policy was to support borrowers coping with the adverse financial conditions created by the global health emergency, the ensuing economic contraction, widespread job loss, and family health and child-care needs, all amid a broad shift for many to remote and online professional operations. The suspension of borrower obligations also has provided an opportunity for researchers to estimate the possible effects on borrowers of the permanent debt cancellation plan that the Biden Administration announced in 2022.

The political importance of student debt is not surprising given the scale of present indebtedness. Borrowers owe more than $1.5 trillion to the federal government, and pre-pandemic studies of this debt burden's effects have found that student loans have hindered investment in homes, family formation, and the achievement of other major life milestones. Restarting the massive and complex federal student loan payment and collection system will affect borrowers in ways that reach far beyond the reimposition of monthly payment obligations.

We find that indicators of financial distress related to federal student loan obligations declined during the payment pause and that borrowers also appear to have improved their financial situation in other respects, including by seeing enhancement in their credit scores.

In this paper, we compare the financial performance of borrowers from different credit score bands before and during the pandemic period using a constructed indicator called the "Financial Distress Index" (FDI) as a proxy. We find that indicators of financial distress related to federal student loan obligations declined during the payment pause and that borrowers also appear to have improved their financial situation in other respects, including by seeing enhancement in their credit scores. These findings align with other studies on the effects of the pause, on the risks accompanying the re-imposition of payment obligations, and on the potential effects that different forms of debt cancellation have on differently situated borrowers.

Methods

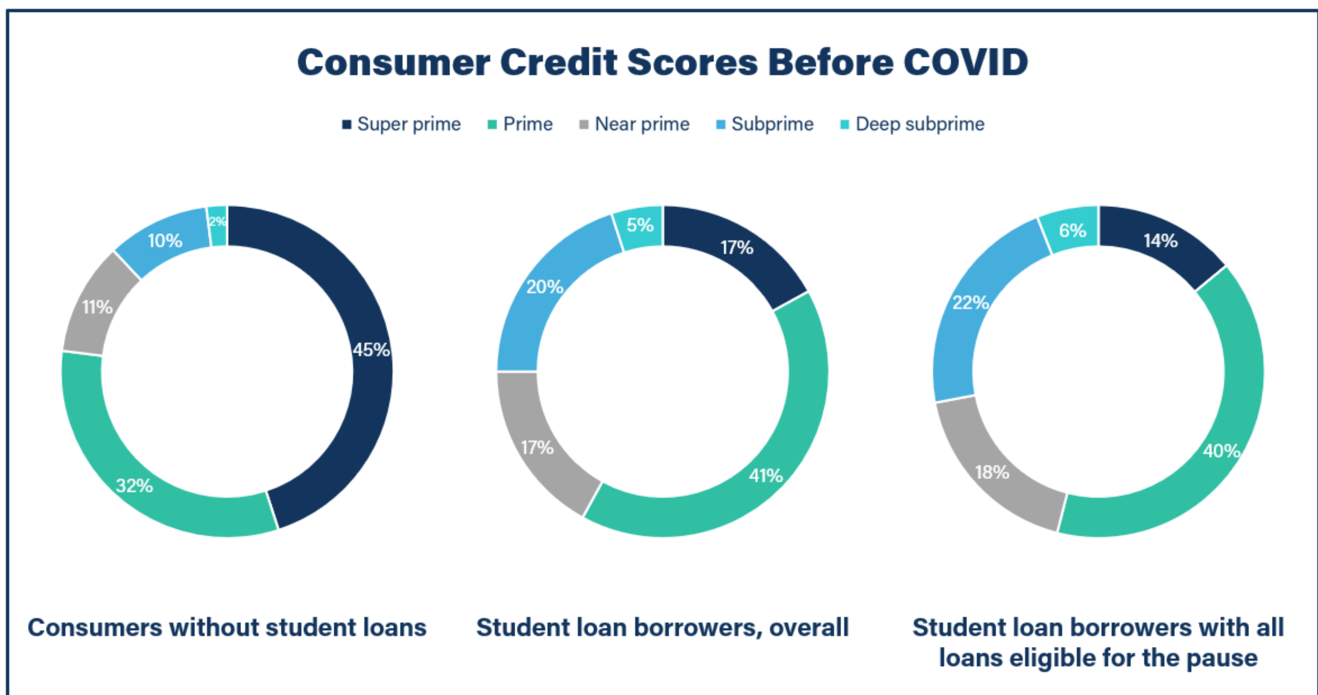
We use data from the University of California Consumer Credit Panel (UCCCP), an anonymized dataset of consumer credit files that includes 100 percent of people with credit histories who live in California. We selected individuals residing in California during the first quarter of 2020 and followed those 19.8 million individuals through the first quarter of 2022.[3] We distinguish between people who do not have student loans reported in their credit files (referred to below as "NSL") and those who do (referred to below as "SL"). Given that financial distress is generally concentrated in lower credit score bands, we focus on the deep subprime (VantageScore of 300 to 500) and subprime (VantageScore 501 to 600) categories.

Our analysis focuses on the FDI, a measure that we adapt from work by Dobbie et al. to use as a proxy for financial distress.[4] A consumer's FDI consists of the total number of financially distressing events reported in their credit report at a point in time. In particular, the FDI is the sum of the number of accounts that a person has that have a delinquency, have been sent to collection, or have been charged off, as well as the number of foreclosures, repossessions, and bankruptcy filings reported for that person during a given time period. Any distressed credit account that has already been resolved, paid, or closed is not included in an individual's FDI.

Findings

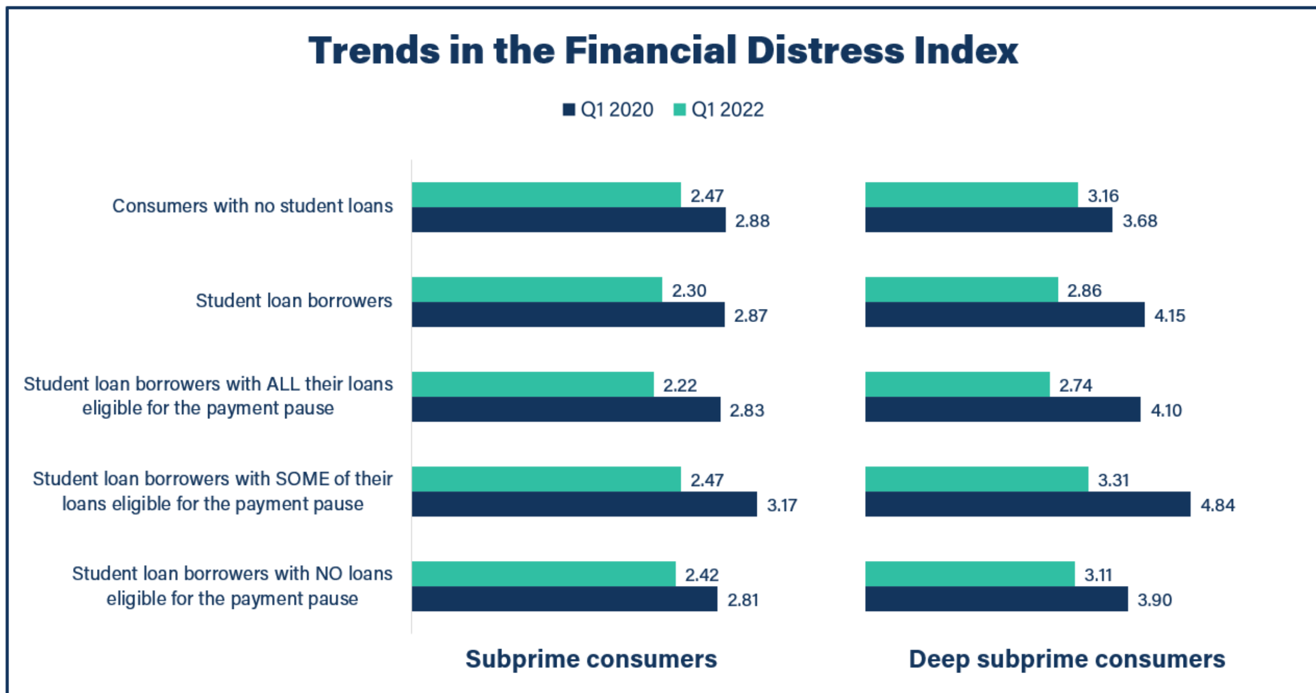
We find that individuals with student loans have worse credit scores than those who do not have student loans. The SL group accounts for 5 percent of people in the deep subprime credit category and 20 percent of those in the subprime category. Borrowers with student loans covered by the federal payment pause account for 6 percent of people in the deep subprime category and 22 percent of those in the subprime category. In contrast, the NSL group includes 2 percent of borrowers in the deep subprime category and 10 percent of those in the subprime category (see Figure 1). In the period prior to the payment pause, student loan borrowers—and more specifically student loan borrowers who were eligible for the payment pause—were disproportionally in the deep subprime and subprime credit categories relative to the non-student loan borrowers.

Figure 1: Student loan borrowers had generally worse credit scores than non-student loan borrowers before the COVID-19 pandemic.



In general, borrowers in the subprime and deep subprime groups demonstrated more financial distress. During the study period, student loan borrowers eligible for the payment pause had a higher FDI than the NSL consumers (see Figure 2).

Figure 2: Financial distress declined for all categories of consumers, but it declined more for student loan borrowers.



During the payment pause, we find a declining trend in FDI for both NSL and SL borrowers, though borrowers eligible for the payment pause experienced greater relief than NSL borrowers (see Table 1). During the payment pause, 7.3 percent of student loan borrowers were able to get rid of financial distress entirely by achieving a zero FDI score. On the other hand, only 3.7 percent of NSL consumers were able to achieve a zero-level FDI. Student loan borrowers who only had student loans that were eligible for the payment pause (as opposed to those who had at least some student loans that were not eligible) had the best improvement, with 8.4 percent of these borrowers were achieving a zero FDI during the study period. Surprisingly, both NSL and SL consumers in the prime and super prime categories ultimately had a higher distress index during the payment pause after a temporary

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Table 1: Mean FDI dropped more for student loan borrowers, and the greatest benefits went to the most financially distressed consumers.

	CHANGE IN MEAN FDI FOR BORROWERS WITH A FINANCIAL DISTRESS IDEX ABOVE ZERO, Q1 2020 TO Q1 2022				
CREDIT SCORE BAND	CONSUMERS WITH NO STUDENT LOANS	CONSUMERS WITH STUDENT LOANS	SL BORROWERS, ALL LOANS ELIGIBLE FOR THE PAUSE	SL BORROWERS, SOME LOANS ELIGIBLE FOR THE PAUSE	SL BORROWERS, NO LOANS ELIGIBLE FOR THE PAUSE
Deep subprime	-14.0%	-31.1%	-33.3%	-31.7%	-20.4%
Subprime	-14.2%	-19.9%	-21.3%	-22.1%	-14.0%
Near Prime	0.7%	2.5%	2.3%	3.8%	2.0%
Prime	21.5%	21.6%	21.5%	29.5%	18.0%
Super Prime	21.8%	16.8%	30.9%	16.8%	11.3%

Table 2: Credit scores improved most for the most financially distressed consumers.

	CHANGE IN MEAN CREDIT SCORE FOR BORROWERS WITH A FINANCIAL DISTRESS IDEX ABOVE ZERO, Q1 2020 TO Q1 2022				
CREDIT SCORE BAND	CONSUMERS WITH NO STUDENT LOANS	CONSUMERS WITH STUDENT LOANS	SL BORROWERS, ALL LOANS ELIGIBLE FOR THE PAUSE	SL BORROWERS, SOME LOANS ELIGIBLE FOR THE PAUSE	SL BORROWERS, NO LOANS ELIGIBLE FOR THE PAUSE
Deep subprime	17.2%	15.8%	15.9%	15.9%	15.2%
Subprime	5.1%	5.0%	4.8%	5.7%	5.3%
Near Prime	-0.6%	-0.4%	-0.9%	0.1%	0.3%
Prime	-5.5%	-4.9%	-5.5%	-5.1%	-3.8%
Super Prime	-13.5%	-12.3%	-14.6%	-14.7%	-10.7%

Conclusions

Overall, during the payment pause we observe (1) that financial distress decreased for everyone below the prime credit score band and (2) that student loan borrowers started off in worse financial condition than people without student loans prior to the payment pause, but that (3) student loan borrowers saw a greater decrease in financial distress during the payment pause (as measured by a lower FDI) than NSL consumers at the same credit score bands did over the same. As we approach the scheduled end of the payment pause, this trend is worth keeping in mind, as the resumption of payment obligations will have a huge effect on borrowers' lives. In the absence of other policy steps to support student loan borrowers whose financial condition was more precarious before the onset of the pandemic and the launch of the payment pause, we expect the resumption of payments to cause indicators of personal economic distress to worsen due to rising delinquencies, defaults, and other negative financial developments.

Technical Notes

Sample

UCCCP is a quarterly (March, June, September, and December) report of consumer credit information of anonymized borrowers. It consists of a 2 percent national sample and a 100 percent population of California. For this paper, we use the California extract for the years 2020, 2021, and 2022. The borrowers from the first quarter of 2020 UCCCP data were followed through 2021 and 2022. If any borrower does not have a credit report available for all three observation points, they are not included in the analysis. A borrower with two or fewer tradelines in 2020 was considered to have a thin file and was excluded. Only borrowers identified as "primary record" are included to avoid double counting in the FDI index. Deceased individuals are also excluded. The payment pause was enacted in March 2020, but credit reports started reflecting the pause beginning only in June 2020. Therefore, we consider the first quarter of 2020 as preceding the payment pause.

Student loan borrowers (SL)

Borrowers who have at least one educational loan. These borrowers may or may not have other types of loans (e.g., auto loan, mortgage, etc.). In our sample, 16 percent borrowers are student loan borrowers.

Student loan borrowers with loans eligible for the payment pause

Payment pause eligibility is granted for some specific types of federal student loans, but not for all education loans in general. The pause is not available for private student loans and certain commercially held federal loans like those made under the Federal Family Education Loan and Perkins programs. The UCCCP does not provide any information that directly identifies eligibility for the payment pause for a given student loan. Therefore, we use a conservative identification approach that would give us a subsample of the actual set of loans eligible for the payment pause. In particular, we identify a student loan as being eligible for the payment pause if it meets the following conditions:

- The account is open (account condition code is A1); and

- The account is a student loan account (account type code is 12); and
- The outstanding balance in the account during the payment pause period (from March 2020 to March 2022) is non-zero; and
- The scheduled payment during the payment pause period is zero; and
- The account is not in deferment (term frequency code is not D); and
- The account does not belong to a cosigner or authorized user (ecoa_cd is 0, 1, 2, 7, A, B, G or H) .

Student borrowers are divided into three subgroups. The first group consists of borrowers who only have student loans that are eligible for the payment pause. The second group consists of borrowers with no student loans eligible for the payment pause. The third group consists of borrowers with both loans that are and that are not eligible for the payment pause. 60 percent of the student loan borrowers belong to the first group.

Borrower category by credit score

Borrowers are categorized into five groups on the basis of their VantageScore (version 4.0) in 2020. Credit scores ranges from 300 to 850. The five groups used here are deep subprime (300-500), subprime (501-600), near prime (601-660), prime (661-780), and super prime (781-850).

Financial Distress Index (FDI)

To calculate FDI, we include all loan types for both student and nonstudent borrowers. The index reflects the reported adverse status for the consumer in terms of delinquency, collections, chargeoffs, bankruptcies, repossessions, and foreclosures at any given time. Incidences of any of these six adverse statuses are summed up to generate a given consumer’s FDI.

Delinquency

Any account is considered delinquent if it is delinquent for at least 60 days. This delineation allows us to separate accidental delinquencies from persistent ones.

Endnotes

[1] Coronavirus Aid, Relief, and Economic Security ("CARES") Act, Pub. L. 116-136 (2020), §3513.

[2] Education Department, PRESS RELEASE: BIDEN-HARRIS ADMINISTRATION EXTENDS STUDENT LOAN PAUSE THROUGH MAY 1, 2022, Dec. 22, 2021, https://www.ed.gov/news/press-releases/biden-harris-administration-extends-student-loan-pause-through-may-1-2022.

[3] To avoid over-representation, we included only the primary records (PR) and dropped associated borrowers and household members. We also dropped records of deceased borrowers.

[4] Dobbie, Will, Paul Goldsmith-Pinkham, and Crystal S. Yang. "Consumer bankruptcy and financial health." Review of Economics and Statistics 99.5 (2017): 853-869.