Bruce Cundiff
Vice President
bcundiff@visa.com

Business Insight

June 2020

Forbearance and deferrals may influence the debt payment hierarchy

As COVID-19 takes the U.S. economy into uncharted territory, many credit card issuers and other lenders are wondering how consumers' debt behavior might change during the current crisis; however, lenders may not get all of the answers they are looking for right away. As a large portion of consumers' income is interrupted, many are seeking relief on their loans through forbearance or deferrals, meaning that any changes to the debt repayment "hierarchy" will be delayed until consumers start to get back on their feet. While there are many unknowns and virtually everything about this crisis is unprecedented, historical patterns and current trends can provide some clues.

Historically, there was a repayment pattern to the three major forms of consumer debt, with consumers opting to pay back their mortgages first, followed by auto and credit card debt, according to an analysis of loan data from Moody's Analytics. This hierarchy changed during the Great Recession as auto and credit moved ahead of mortgage repayments. Retail credit cards also rose in the hierarchy as many subprime and even near prime consumers lost access to bankcard lines of credit. The hierarchy shifted back to historical norms as credit supply and demand regained their balance during the post-recessionary period. Conditions are very different in this new recession, especially given the passage of the most significant government relief and recovery legislation in the history of the country, which could very well shake things up again in the hierarchy.

Key Points:

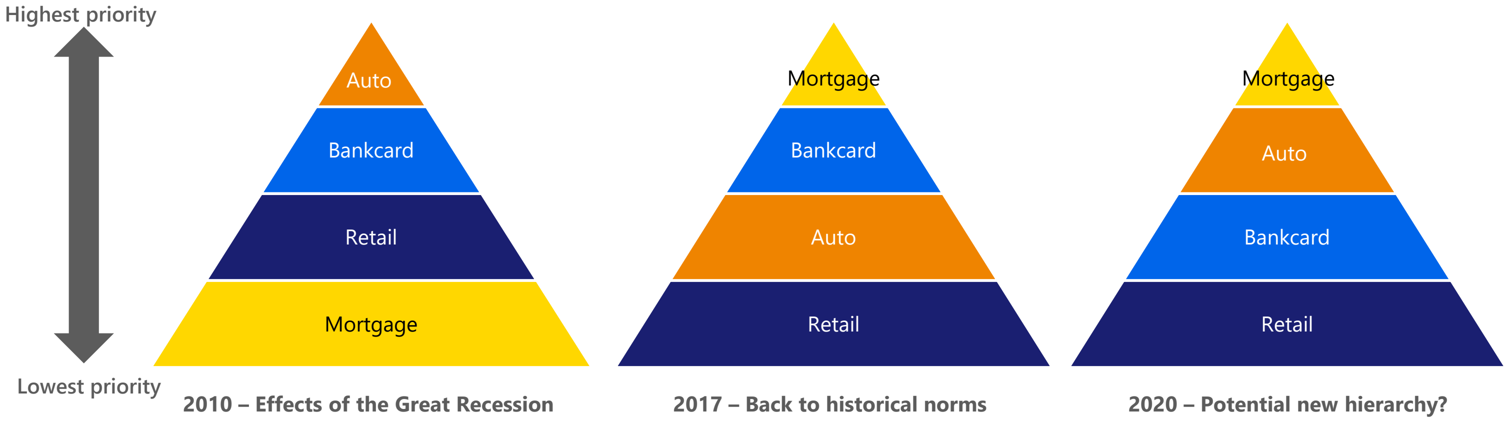
Current pandemic "black swan" event may shift consumer debt repayment patterns

Historical patterns provide clues to consumer debt repayment logic, preferences and "hierarchy"

As deferral expiration dates approach, issuers will be weighing customer needs, hardship and loyalty vs their bottom lines

What is a “normal” payment hierarchy?

Historical changes in payment hierarchy



Sources: Equifax; Moody’s Analytics; Visa Business and Economic Insights

The main reason mortgage payments fell in priority during the last recession was the decline in home prices. A substantial 11.3 million homeowners—24 percent of all homes with mortgages—were “under water” in 2010,[1] owing more on their mortgages than the actual value of their homes. Once their properties defaulted and banks started removal proceedings—which could take more than a year—homeowners no longer had an incentive to prioritize their mortgage payments. Consumers often then placed a higher importance on keeping their car for going to or looking for work, and credit cards for maintaining an open line of credit to buy their basic necessities.

There are no indications that a steep decline in home prices will happen during this recession, or have an affect on the debt payment hierarchy in the current recession. Shelter and housing have taken on an even more important value during this recession, and consumers will likely keep their mortgage payments high in priority. Additionally, as of the third quarter of 2019 roughly 2 million mortgages are under water—just 3.7 percent of mortgaged homes.[2] Auto payments should also remain high in priority as jobs return and individuals need to get to work. Given the potential ongoing reluctance to use public transportation, returning workers will want to ensure that they keep their cars. Bankcard payments have also taken on a different level of importance with the shift to e-commerce. Although alternatives exist, cards are still used in a majority of online transactions.

Assessing consumer mindset leads to a potential new hierarchy (shown above) emerging in 2020. There are logical reasons for consumers to prioritize each type of debt payment, but not all debt repayment is equal. The differences depend on the breaks that consumers can receive—either from acts of Congress or the lenders themselves—resulting in forbearance or deferrals on specific types of debt payments. The repayment period for each, and whether the deferrals are mandated or stem from an agreement between the lender and borrower, will play a role in the consumer payment hierarchy moving forward.

When consumers’ paychecks are suspended, how do they pay their bills?

The ability to revolve on their loan payments may play a role in which bills consumers pay, or pay first. Unlike credit cards, mortgage and auto payments are non-revolving debt at a set amount per month. Since consumers will likely need access to credit throughout the recession, they may prioritize not only keeping their credit cards current, but also making only the minimum payments as needed. Another factor is consumers’ ability to seek forbearance on mortgages or federal student loan payments for up to six months, mandated by the CARES Act (with a possible extension of an additional 180 days on mortgages for those still under financial strain), or voluntary deferrals agreed upon with lenders for auto, credit card, or personal loan payments.

What might influence payment hierarchy in the COVID-19 recession?

Forbearance or deferrals for debt payments in 2020

Type of debt	Eligible for forbearance or deferral	Time	Part of CARES Act?	Lenders open to deferrals?
Mortgage	Forbearance	180 days (potential for an additional 180 days)	Yes	N/A
Auto loan	Deferral: depends on lender	30-90 days	No	Yes
Bankcard	Deferral: depends on lender	30-90 days	No	Yes
Student loan	Federal: forbearance Private: depends on lender	3/13 - 9/30	Yes (federal only)	Yes
Personal loan	Deferral: depends on lender	30-60 days	No	Yes

Source: CARES Act; Visa Business and Economic Insights

These forbearances and deferrals may delay any changes to the repayment hierarchy. Consumers will not prioritize payments that they do not need to make. With mortgage forbearance built into governmental programs, consumers will not have to make these payments for the next several months. The table above is an early take on how these debt types could be subject to gaps in payment.

Understanding how forbearance affects consumer payment hierarchy will come in fits and starts, and may take some time to get to a new normal. Reporting criteria have changed under the CARES Act, with mortgages that would normally get a delinquent status now marked current if they were current at the start of forbearance. In their deferral plans, many credit card issuers are distinguishing between mortgage holders and renters. Deferral plans for mortgage holders may be less lenient given the lenience they already receive on their mortgage payments: forbearance may be in place for up to a year. Issuers are therefore requiring mortgage holders to at least keep their cards current and make payments. Renters, on the other hand, may receive deferrals more easily on credit cards for at least three months. Currently, financial institutions have agreed to deferrals on an estimated 2.5 percent of credit card accounts.[3] It is unclear when the deferral period will end, and whether the job market will have recovered sufficiently by then to provide cardholders with the income needed to once again make payments on their debt. But thus far deferrals are not pervasive

Although the debt payment hierarchy is uncertain in the current crisis, it will become more clear as the full scope of the recession unfolds, and when both the pandemic and the economy move into a recovery phase. Certain job sectors or geographic areas may recover more quickly, restoring income and consumers' ability to pay down debt. Credit card issuers and other lenders are already proactively engaging with cardholders and borrowers to better understand their specific situations and offer both deferrals and plans to return loans to good standing after the deferral period ends. Historically, agreements and payment plans have a better track record of minimizing losses and maintaining customer relationships. Depending on the length of the recession, and especially if it is protracted, lenders that proactively engage with customers now and maintain their loyalty may have a competitive advantage once the recovery gets underway.

---

[1] CoreLogic®, a property data and analytics company

[2] CoreLogic®, a property data and analytics company

[3] Equifax

Disclaimer

Studies, survey results, research, recommendations, opportunity assessments, claims, etc. (the 'Statements') should be considered directional only. The Statements should not be relied upon for marketing, legal, regulatory or other advice. The Statements should be independently evaluated in light of your specific business needs and any applicable laws and regulations. Visa is not responsible for your use of the Statements, including errors of any kind, or any assumptions or conclusions you might draw from their use.

Visa Business and Economic Insights

Wayne Best, Chief Economist

Bruce Cundiff, Vice President, Insights

Michael Brown, Principal U.S. Economist

Adolfo Laurenti, Principal European Economist

Richard Lung, Principal Global Economist

Glenn Maguire, Principal Asia Pacific Economist

Michael Marx, Sr. Director, Consumer Insights

Mohamed Bardastani, CEMEA Economist

Jennifer Doettling, Director, Content and Editorial

Jeffrey Roach, Senior U.S. Economist

Dulguun Batbold, Global Economist

Weiwen Ng, Asia Pacific Economist

Angelina Pascual, European Economist

Travis Clark, Associate U.S. Economist

Mariamawit Tadesse, Associate Global Economist

Juliana Tang, Executive Assistant

For more information, please visit us at
Visa.com/Economicinsights or **Visa.com/Travelinsights**.