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SFA Research Corner

Unsecured Consumer ABS: Delinquencies on the Rise as Weaker Borrowers Struggle With Inflation

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Unsecured Consumer ABS: Delinquencies on the Rise as Weaker Borrowers Struggle With Inflation

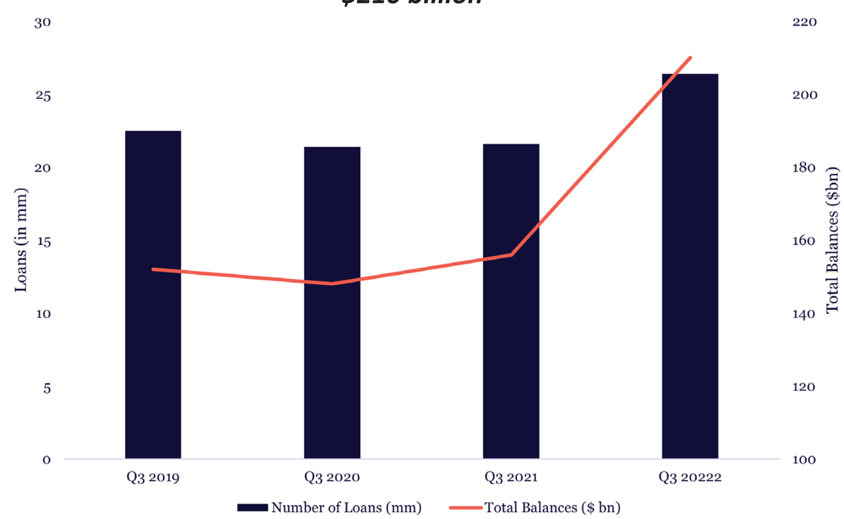
At the end of Q3 2022, $210 billion of unsecured consumer loans were outstanding, a 35% increase from 2021 and a 38% increase over 2020, according to a recent TransUnion Credit Industry Insights Report. TransUnion, a credit-reporting firm, attributes the rise to "significant increases in lending to below prime risk tiers" and the wealth-eroding effect of persistent inflation. Unsecured personal loans are typically closed-end installment loans used primarily to consolidate existing debt, cover unexpected expenses, or make large purchases.

Held by 22 million Americans, their average loan amount is $10,749. According to credit reporting firm VantageScore, the largest increase in loan balances came from lower-income borrowers where average balances for those with annual incomes below $45,000 increased by 28% from one year prior, while balances of borrowers with income greater than $150,000 *decreased* 1.8%.

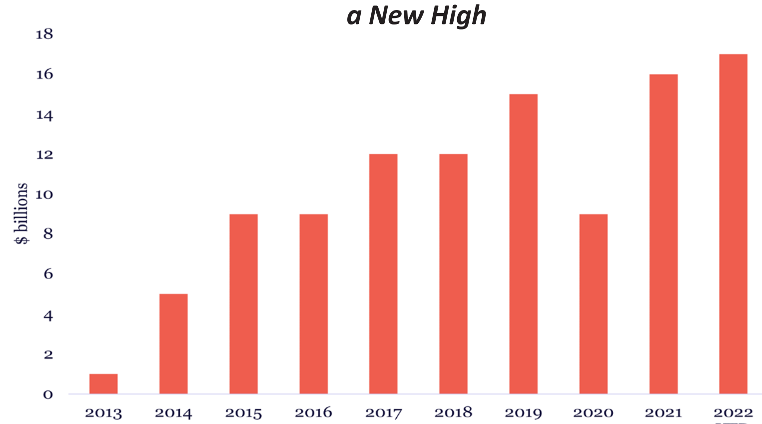
The securitization market has been a steady source of funding for non-bank unsecured consumer loan lenders since 2013. Issuance of ABS backed by unsecured consumer loans has reached $17 billion so far in 2022, a new high for the sector. Industry analysts expect 2023 issuance to be 10-25% lower as investors are expected to shy away from certain ABS backed by below prime collateral as high prices, high interest rates and softer labor markets take their toll on borrowers.

Credit performance has begun to weaken as borrowers navigate new economic challenges, namely the end of fiscal stimulus and lender accommodation programs, which were helpful in assisting borrowers through pandemic-driven unemployment, and the crippling effects of extended inflation. VantageScore's CreditGauge reported that the delinquency rates across all delinquency categories (30-59 days, 60-89 days and 90-119 days delinquent) increased in

Unsecured Consumer Loans Outstanding has Increased to $210 billion



Unsecured Consumer Loan ABS Issuance Has Reached $17 billion, a New High



Source: TransUnion

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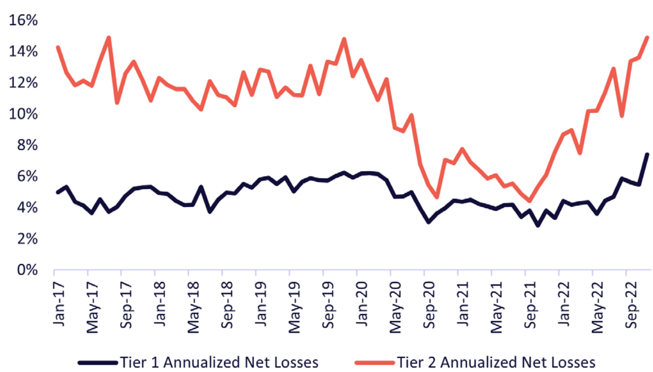
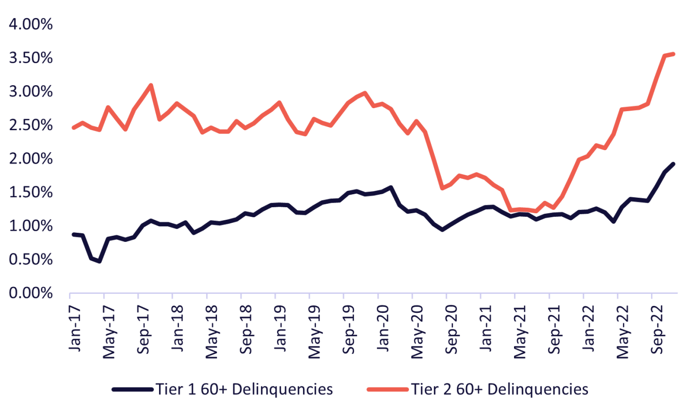
October year-over-year. When compared to auto, credit card and mortgage loans, unsecured consumer loans exhibited the highest rate of delinquent loans for the 90-119 days category. ABS trusts have also reflected a deterioration in performance. Annualized net losses for lenders in the Tier 1 index increased 359 bp year-over-year in November, according to KBRA's Marketplace Consumer Loan Indices for November 2022. The same metric jumped by 879 bp for lenders in the Tier 2 index. The Tier 1 index shows performance for SoFi, Marlette, and LendingClub-Super Prime securitization platforms and generally have a weighted average FICO score of 710 and 760. The Tier 2 index includes performance for LendingClub-Prime, Prosper, Upgrade, Upstart, Freedom Financial, LendingPoint, Pagaya, and Theorem – the weighted average FICO score for these pools are between 660 and 710. Increases in 60+ delinquencies also indicate that more deterioration is forthcoming in the near-term.

Annualized Net Losses Jump Higher for Unsecured Consumer Loan ABS



Source: KBRA Marketplace Consumer Loan Indices November 2022

Late-stage Delinquencies Move HigherIndicating More Deterioration in Near-Term



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Consumer Credit Meets BNPL

Buy Now, Pay Later (BNPL) loans, first developed by Klarna in Sweden in 2005, are a form of fixed-rate short-term micro-lending ($30-$1000) usually repaid in 4 payments over 6 weeks. Reaching the US in 2012 with Affirm—the BNPL leader partnered with Amazon, Walmart and Target—other US BNPL lenders include Afterpay, Klarna, Sezzle, Zip, PayPal and, most recently, Apple Pay Later, a launch which could soon have enormous impact on the BNPL market.

BNPL's meteoric rise owes much to the Covid-19 pandemic's online shoppers and is now almost universally embedded in what marketers call a frictionless online purchasing process. BNPL is favored by consumers aged 18-40, 61% of BNPL's users according to a TransUnion study, who prefer payment platforms like Apple Pay and Square over credit cards. From the merchants' perspective, BNPL increases conversions, clicks on their website that lead to purchases, by 31% as well as increasing the amount that each consumer spends by as much as 40%, Klarna claims.

Affirm has been the largest US ABS issuer so far, funding nearly one-third of its loan portfolio through securitizations. In 2022, Affirm raised $1.5 billion of funding through the securitization market. According to DBRS MorningStar, the sole rating agency on the Affirm offerings, Affirm originates its loans through three state-chartered banks, and all loans are non-revolving, unsecured, fully amortizing fixed rate products with terms of 30 days to 60 months. The 2022-B transaction was backed by 1.2 million loans with an average balance of $563. The weighted average FICO score of the pool was 674 and over 2,000 did not have a FICO score. Over 45% of the loans funded general merchandise.