

Credit Scars: Credit Reporting Relief for Defaulted Student Loan Borrowers*

Diego A. Briones[†]

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Abstract

In the United States, more than 1 in 5 student loan borrowers enter default. Entering default can have severe consequences for consumers' financial health, extending well beyond the initial period of financial distress as credit records retain this information for up to seven years. This paper examines the role of indicators of student loan default evident in credit reports on credit access and estimates the causal effect of their removal from consumer credit reports. Using a large panel of administrative credit bureau data, I first show evidence that default records are highly persistent and remain on reports until the seven-year statutory limit for derogatory information set by the Fair Credit Reporting Act (FCRA), indicating that relatively few succeed in using formal relief programs like rehabilitation. As a result, it is the FCRA time limit that generates the removal of default indicators from borrowers' credit records. In a stacked difference-in-differences design, I show that FCRA-mandated removal of a default record discontinuously increases a consumer's credit score by approximately 15 points, on average, relative to a pre-removal mean of 555. This positive credit shock leads to statistically and economically significant increases in borrowing across mortgage, auto, and credit card debt, primarily on the extensive margin. The results indicate that student loan defaults act as binding credit constraints and that their automatic removal provides a substantial boost to credit access. The value that individuals place on this increased access to credit suggests that there may be significant private and social returns to efforts to rehabilitate defaults or access relief programs intended to eliminate default.

Keywords: Student Debt, Delinquency, Default, Credit Access, Consumer Lending

JEL Codes: G51, I22, I23

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[†]University of Virginia, Department of Economics. dab5xq@virginia.edu