TransUnion

MARKET BRIEF

Identifying Third-Party Debt Settlement Risk Before It Surfaces

Insights into consumer behaviors and enrollment patterns that shape lending decisions

Third-party debt settlement is becoming a more significant consideration for lenders evaluating portfolio performance, customer behavior and credit risk strategies. Enrollment volume is rising, with a growing share of consumers entering these programs before becoming seriously delinquent — a notable shift from historical enrollment patterns.

In turn, this creates new visibility and portfolio management challenges for lenders. Third-party debt settlement firms typically negotiate unsecured debt for less than the amount owed, which can alter repayment behavior, account performance and lender recovery expectations. For lenders, the concern is greater than just increasing enrollment. It's that some consumers may exhibit changing credit usage patterns before enrollment — and traditional delinquency-based signals may not fully reveal emerging risk.

The result is a strategic decisioning challenge across portfolio management, account treatment, credit line increase strategies and new credit extension. Addressing it requires earlier visibility into likely enrollment risk — insight that can help identify consumers showing early warning signs, inform credit line and account management decisions, and protect portfolio strategies from exposure that may not be visible through delinquency status alone.

For many consumers, debt settlement programs represent one of several options for addressing financial obligations, alongside other financial management and debt relief approaches. For lenders, the key challenge is understanding how participation may influence credit behavior, account performance and portfolio management decisions.

To help clarify what's changing and where lenders should focus, TransUnion® conducted a study guided by five core questions:

- Why does third-party debt settlement matter now?
- What credit activity occurs after consumers enroll in third-party debt settlement programs?
- How do credit behaviors differ between third-party debt settlement, bankruptcy and control groups?
- Which indicators help identify consumers likely to enroll in third-party debt settlement?
- Does third-party debt settlement lead to a more favorable credit outcome than bankruptcy?

Study overview

TransUnion analyzed selected lenders' consumer-level third-party debt settlement enrollment data from 2023. Because the analysis was based on participating lenders' data, findings should not be interpreted as an industry-level view.

The study compared US consumers enrolled in third-party debt settlement programs with bankruptcy and control cohorts, controlling for risk tier, age and lender distribution. Consumer behavior was observed across a 48-month window: 24 months before and 24 months after the enrollment or event date.

To evaluate credit behavior before and after enrollment, TransUnion appended attributes including **VantageScore®** 4.0, balances, number of trades, credit lines and utilization. The study also assessed post-enrollment performance, including account-level 60+ DPD vintage trends within six months of origination for subprime bankcard accounts.

Together, these inputs provide a practical view of how third-party debt settlement enrollment is changing, how consumers behave before and after enrollment, and which credit attributes may help lenders identify likely participation earlier.

Key trends in third-party debt settlement and credit risk behavior

Four trends stand out from the study.

1. Enrollment is increasing, including among current-status consumers

The study validated lender observations that third-party debt settlement enrollment is increasing. Among lenders included in the analysis, debt settlement consumer enrollments grew 41% over a 12-month period, while average enrollment balances remained relatively stable. The analysis also confirmed a notable shift in enrollment status: 53% of debt settlement enrollees were current at the time of enrollment. This matters because current-status consumers may not trigger the same treatment strategies as consumers already showing serious delinquency.

What it means:

Lenders should not assume third-party debt settlement risk is limited to consumers already in advanced delinquency. The rise in current enrollees creates a potential visibility gap for account management, credit extension and credit line increase strategies. Portfolio strategies should account for consumers whose credit behavior may be deteriorating or changing before traditional delinquency signals appear.

More than half of debt settlement enrollees were current at enrollment, creating a new visibility challenge for lenders.

2. Current-at-enrollment consumers showed early credit usage signals before entering debt settlement

Consumers current on their obligations at the time they enrolled in third-party debt settlement showed meaningful increases in credit card and personal loan usage before enrollment. Among this group, average card balances rose from approximately $7,112 at 24 months before enrollment to roughly $14,547 at enrollment. Card utilization also increased steadily, rising from about 51% at 24 months before enrollment to nearly 78% at enrollment. Credit access and usage expanded as well. Average open card credit lines increased leading up to enrollment, and these current-at-enrollment consumers added cards before entering debt settlement. Personal loan balances also grew materially over the two years before enrollment, rising from about $12,404 at 24 months before enrollment to nearly $19,969 at enrollment.

What it means:

These patterns suggest some consumers may expand unsecured credit usage while still current before entering third-party debt settlement. For lenders, this reinforces the need to **look beyond delinquency status alone** and evaluate changes in balances, utilization, number of trades and personal loan activity. Trended behavior can help identify consumers whose credit usage may warrant closer review before additional credit is extended.

Changes in card and personal loan utilization may help identify consumers who later enroll in debt settlement programs.

3. Comparing credit performance outcomes for debt settlement and bankruptcy participants

The study evaluated whether completing a third-party debt settlement program leads to a more favorable credit outcome than filing for bankruptcy. The study did not observe a consistently stronger credit recovery outcome for debt settlement participants during the observation period. Current debt settlement consumers experienced the most significant VantageScore decline after enrollment and showed the slowest recovery 24 months later. Their median score declined from 645 six months before enrollment to 549 six months after enrollment — a 96-point drop. By comparison, bankruptcy consumers median score declined from 582 six months before filing to 562 six months after — a 20-point drop.

The study also found about half of credit cards were closed for both current and delinquent debt settlement consumers within six months of settlement enrollment. Cards closed by debt settlement consumers had higher utilization, suggesting balances were maximized on higher-line cards before closure.

What it means:

The findings suggest credit recovery trajectories varied across populations and should be evaluated within the context of each consumer's broader financial circumstances. This reinforces the need for lenders to assess settlement-related exposure at the consumer level, particularly for consumers who were current at enrollment and later experienced sharp score declines. These insights can help inform account treatment, credit line management and future credit eligibility decisions.

Consumer-level analysis can help lenders better understand how debt settlement relates to future credit performance.

4. Predictive indicators can help identify consumers likely to enroll

Among enrollees who were current at enrollment, a bankruptcy-related risk score and total unsecured personal loan balance were the two most influential model features, together representing more than half of the model's predictive power. Adding trended credit attributes improved the model's ability to identify likely enrollees in top scoring bands, suggesting lenders can benefit from combining risk scores with behavioral credit signals.

What it means:

Lenders can improve debt settlement risk identification by combining bankruptcy-related risk signals with trended credit attributes before enrollment occurs. These predictive indicators can help **identify consumers more likely to enter third-party debt settlement before risk becomes visible** through traditional outcomes, supporting more targeted account management, credit offer and credit line increase strategies.

Strategies for managing debt settlement risk in lending portfolios

Taken together, the findings point to a more nuanced third-party debt settlement environment. Lenders aren't simply managing consumers already in distress. They're also facing risk from consumers who may be current, expanding unsecured credit usage and approaching a decision to enter a debt settlement program. The response cannot rely only on delinquency status or static credit views. It requires lenders to modernize portfolio, segmentation and account management strategies together.

The following actions can help lenders identify potential enrollment indicators earlier.

1. Identify likely debt settlement enrollment earlier

Lenders should **assess whether current risk monitoring captures behaviors associated with future third-party debt settlement enrollment**, including rising balances, increasing utilization, unsecured personal loan growth and changes in trade activity.

Applying these signals across portfolio review, account management and credit line increase populations can help lenders identify consumers showing a higher likelihood of future debt settlement enrollment. From there, lenders can make more precise decisions about credit extension, line management and targeted treatment strategies before risk becomes visible through delinquency or performance deterioration.

2. Use predictive indicators to refine credit extension and line management decisions

Because more than half of debt settlement enrollees were current at enrollment, delinquency status alone may not provide enough visibility into emerging risk. Lenders should evaluate trended credit behaviors, including changes in card balances, utilization, number of open trades, unsecured personal loan exposure and recent credit growth.

Bankruptcy-related risk signals and trended credit attributes were especially useful in improving early identification of consumers more likely to enroll in third-party debt settlement. Incorporating these indicators into portfolio review, credit line increase, prescreen and account management strategies can help lenders distinguish stable current-status consumers from exhibiting credit behaviors linked to later debt settlement enrollment, enabling more precise decisioning before risk becomes visible through traditional performance outcomes.

3. Improve visibility into debt settlement enrollment

Credit bureaus currently lack direct visibility into third-party debt settlement enrollment. Capturing additional information on consumers engaged in these programs could enhance analytics and support more effective lender strategies.

Improved reporting, data sharing and analytic models related to debt settlement enrollment can help lenders better distinguish general financial stress from behaviors associated with likely program participation. Greater visibility would support earlier risk identification, more precise account treatment and stronger portfolio strategy development.

Better visibility into debt settlement enrollment indicators can help lenders support more informed portfolio management and account treatment strategies.

The importance of identifying debt settlement risk before delinquency

Third-party debt settlement enrollment is rising among the lenders studied, with meaningful participation from consumers who were current at enrollment. Responding effectively requires looking beyond delinquency status and evaluating trended behaviors, unsecured debt growth and predictive indicators that may signal future enrollment.

Lenders that better understand behaviors associated with debt settlement enrollment can make more informed decisions about portfolio management, credit extension and customer engagement strategies before those trends become visible through traditional performance outcomes.

TransUnion helps lenders better understand credit behaviors that may signal third-party debt settlement enrollment – from rising unsecured balances to trended utilization and bankruptcy-related risk indicators. By translating these patterns into actionable insights, lenders can identify emerging exposure earlier, refine credit extension and line management strategies, and make smarter, more confident portfolio decisions.

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