

CAMPUS PLASTIC

*College students cope with
unsecured debt*

BY BETTY JOYCE NASH

while also using credit cards — appear to be growing in number. Additionally, there's evidence that students are using credit cards to cover shortfalls in student loans, including private loans which accrue interest during college. And student debt casts a longer shadow: It determines future jobs, marriage and family timing, and how much students save for retirement, if they save at all. How, for example, could a graduate who borrowed \$50,000 for college afford a required student loan payment of \$613 per month (assuming 8.25 percent interest over 10 years) on a teacher's annual pay of \$28,000 — while maintaining a credit card balance?

Anecdotal evidence like this has prompted consumer advocates to question whether credit card companies are unfairly targeting students, who may be financially naïve. But there is a fairly solid consensus among mainstream economists that reports of out-of-control student debt have been overblown. Isolated anecdotes don't always portray widespread social ills, and unsecured credit is convenient. It spaces out purchasing patterns for students as it does for other people. Students may not be any more likely than anyone else in society to suffer credit woes.

Survey Says

There's no definitive data set on student credit card use. Moreover, the

When Megan Gillespie was a freshman at West Virginia University (WVU), she signed up for a credit card. A campus fraternity got paid for each application. "If you filled out a credit application, you got a free T-shirt," she says. "I put 'zero' for income and filled out all my information, and they sent me a credit card with a \$3,000 limit."

She used it for summer school and found out about interest rates, fees, and fine print the hard way. "It was even hard to cancel," she recalls. "I kept calling to cancel and they kept saying it was part of the terms and that [canceling] would ruin my credit. My mother finally got on the phone and threatened legal action."

Gillespie is a senior this year. WVU has nixed the hard sell accompanied by freebies, says Tom Sloane, senior associate dean of students at WVU. State law now requires community, technical, and state colleges to establish marketing rules. But many colleges and universities continue lucrative partnerships with card issuers that allow campus solicitations.

Students like Gillespie — who are taking out loans to pay for tuition



extent of student credit card debt is hard to quantify because it's not tracked by official statistics. The Federal Reserve Board's Survey of Consumer Finances doesn't capture data from this age group. Nor does it sample individuals in group quarters such as college dorms. But other surveys provide some evidence.

The American Council on Education analyzed 2003 to 2004 data from the National Postsecondary Student Aid Study and concluded that more than half of all college students (56 percent) have at least one credit card in their name, with the median reported balance at \$1,000. About 25 percent of student credit card holders said they used the cards to pay tuition.

Widely quoted data from lender SLM Corp., better known as Sallie Mae, found similar results. Its subsidiary Nellie Mae, which administers government and private loans, takes data from applicants' credit reports. The survey started in 1998 when concern arose over students' growing credit use.

Student card use fell, according to the 2004 report. Financial education and the media spotlight, along with some state laws like West Virginia's, may have slowed card use. The average balance was \$2,169, the lowest since 1998; median debt was \$946, down from \$1,222 in 1998. While there's no broad data set that represents students, the Fed's 2004 Survey of Consumer Finances noted that 46.2 percent of families carry credit card debt, with a median balance of \$2,200, a 10 percent increase over 2001.

What all these survey results show is that student credit card use is widespread, but not necessarily more so than in the population at large. Moreover, student credit card use itself isn't that big a deal, but it's part of the bigger story of overall student loan debt, says economist Angela Lyons of the University of Illinois.

"What's happening is the financial aid packages aren't keeping pace with the rising costs of college," she says. "Students are having to turn to other alternatives, one of which has been

credit cards." For example, more students now take out private loans, and those payments aren't deferred until after graduation. (Interest rates for government loans recently went from about 5 percent to between 7.14 percent and 7.94 percent, depending on the loan.)

Lyons' big worry about credit cards is the effect on students' future access to credit. If the students foul up their credit, they'll pay higher interest rates on mortgages and cars. They may also damage their chances to find a job among employers who use credit reports when evaluating applicants.

Gillespie, who is from Beaver County, Pa., works 15 to 20 hours a week in a variety of jobs related to her field, broadcast journalism. She earns about \$200 a week, and she uses credit cards to tide her over when needed. She estimates her student loan debt at \$65,000 upon graduation. While she has no card debt — for that she credits her parents' attitudes toward consumer debt — some of her friends are dodging collection notices. "Probably about 15 of my friends are in trouble with their credit cards," she says.

Overblown?

Richard Todd, an economist at the Minneapolis Fed, is not convinced by such stories that student credit card debt is a widespread problem worthy of policy intervention. Monthly balances grow as students close in on graduation, he notes, reflecting card issuer behavior as well as student behavior, as firms probably increase limits on older students. The pattern is consistent with the idea that as students approach graduation, they begin to draw from their future salaries. In this way, students are behaving much as economic theory says they should. "I think there is evidence, at least on the surface, of a simple story that says as people become more confident they're going to finish and have a decent draw, they're going to draw on that income," Todd says.

He points out that while some students get into trouble, the rate is probably higher for other groups of

adults in the same age range, for example, young military recruits (see sidebar).

"If you look at young working-class adults going into a low-paying job, I suspect their financial problems are bigger, and we don't have a lot of data on them either," he says. "The reports of the massive social problems of massive credit card use have been greatly exaggerated."

Lyons agrees that "on the whole, students are probably doing a pretty good job." In 2003 she surveyed 150,000 students in the Midwest about credit card use. The response, about 20 percent, was consistent with other surveys. "I haven't seen anything jump out at me that says this is really out of whack and students are mismanaging their cards." That said, Lyons observes that certain groups struggle with credit: the poor, minorities, and women, groups that in the past had a hard time obtaining credit. "Now there's great concern ... about whether it's good for groups traditionally constrained to be taking on this credit."

Student Market

The reason card issuers market to students is loyalty, says Peter Burns, who directs the Payment Cards Center for the Philadelphia Fed. "If they can get a customer at that early age, and if they are going to college, it is more likely that they'll have a job that will allow them to become an even better card customer in the future." Students are typically held to low credit limits. One study, funded by the credit card industry for the Credit Research Center at Georgetown University, found the mean credit limit for student accounts to be \$1,395 compared to \$3,581 for nonstudent, young-adult accounts in 2002.

Data processing and communications technology have created risk-based pricing. In selling cards to students, issuers can use expected income to determine creditworthiness. At the same time, credit card earnings have been consistently higher than returns on all commercial

bank activities, leading consumer advocates to say issuers profit from fees, charges, and high interest rates by marketing credit to a group who might not have enough money now to keep debt from escalating. Consumer groups would like to see additional disclosure rules, along with a ban on retroactive interest rate charges, among other changes.

The Center for Responsible Lending, which is asking the Federal Reserve to review its entire 1968 Truth in Lending regulations along with its current review of open-end credit rules, says card issuers sometimes “opaque and complex accounting methods ... distort cost information and competition.”

For example, paying only the minimum can sink the financially

un-savvy, including students. Historically, issuers required minimum payments of about 5 percent. But that fell to about 2 percent in the late 1990s, according to a GAO report in 2006. Extremely low payments left customers with balances that, along with finance charges and fees, extended “repayment periods well beyond reasonable time frames,” according to the 2003 regulatory guidance issued by the Federal Reserve Board that attempted to address the problem. Nowadays, minimums are rising.

While risk-based pricing allocates credit efficiently, it has “come at a cost in the form of a complex and customized product whose pricing is difficult to summarize,” according to a 2003 paper by economist Mark Furletti of the Philadelphia Fed.

Disclosures can be difficult, Burns agrees, and frustrate consumers and companies alike. The best solution is education. Who would want to return to the days when all interest rates and fees were the same? Under that scenario, “some significant percentage of the population won’t qualify because their risk will be too high,” he says.

Robert Manning, author of *Credit Card Nation* and a professor of consumer finance at the Rochester Institute of Technology, has criticized the lack of statistics on youth card debt as well as failure to enact the College Student Credit Card Protection Act. He argues that deregulation, beginning in 1978 with the Supreme Court decision permitting banks move headquarters to states with high interest rate ceilings, allows people to get credit because it’s profitable for the issuer, not because they have demonstrated creditworthiness.

In a study of college students at George Mason University in 2002, Manning found that some 60 percent of undergraduates had “maxed out” their credit cards and 58 percent had used credit cards to pay down other credit cards. And 73 percent had used student loans to pay down credit cards. Default rates among students, he notes, would be larger if students did not have access to student loans, other credit cards, and parents.

Credit Counseling

These findings may be troublesome to some. But to many economists, they don’t suggest the need for regulatory actions like the type Manning prescribes. Yes, using credit takes practice, like driving a car, but restrictions on its flow aren’t the solution, says Lyons, because students generally use credit responsibly. She’s seen seniors who ran out of money one semester shy of graduation. “They charged it on their credit cards; they got their degree, and they got out.”

Early lessons in personal finance, including separating needs from wants, can teach students how to behave financially, says Dottie Bagwell, who teaches personal

Basic Training: Financial Education

College students are not the only segment of the young-adult population who are sometimes inexperienced when it comes to personal finance. So, too, are those who enter the job market or the military after high school.

For example, nearly half of enlisted military are under 25. And for them, the stakes of financial mismanagement are particularly high. If they get into financial trouble, they can lose security clearances and be pulled off deployment. “When you’re looking at maintaining security, it [financial maturity] speaks to responsibility and accountability. It’s paramount to holding certain levels of security,” says Lt. Col. Jeremy Martin, a spokesman for the Department of Defense (DOD). “Not being able to manage your finances could be an indicator. Training in personal finance varies, but nearly always includes budgeting basics, among other skills,” he says.

Federal Reserve Board is gathering data from ongoing surveys of enlisted military personnel, says Jeanne Hogarth. She manages the consumer education and research section of the Board’s Division of Consumer and Community affairs. The study tracks groups of enlistees, one with formal financial education, the other

without. The first five months of data are being crunched now. The groups average 22 years of age. The groups will be surveyed every six months over three years. Hogarth hopes to publish first results from this ongoing survey in 2007.

“That will buy us an ongoing rollout of information,” she says. “By 2009, we would have a robust analysis of long-term trends and patterns we see in these young men and women.”

Financial education among recruits is essential in part because of lending practices that target military personnel, according to an August DOD report to Congress on predatory lending and the military. The DOD is ramping up efforts to educate members about such practices as well as overall financial management. The department also is seeking protections such as a federal ceiling on the cost of credit to military borrowers, “capping the [annualized percentage rate] to prevent any lenders from imposing usurious rates,” according to the report. While that would limit credit to certain servicemen, the report states: “Limiting high-cost options assists the Department in making the point clear to Service members and their families that high cost loans are not fiscally prudent.”

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financial planning at Texas Tech University. She noticed card debt problems among her students and started a financial education program called “Red to Black,” in which she requires students to keep a spending diary.

“A cell phone is a ‘need’ now,” she notes. (In fact, some dorms do not have telephones.) And iPods now appear on those need lists occasionally. Students’ total indebtedness often includes auto loans. “I walk through the parking lot and see really nice cars.”

Bagwell and co-authors So-Hyun Joo and John Grable in 2003 looked at student credit card use, behavior, and attitudes using a sample of 242 undergraduates and graduates via survey. The survey included questions about ethnic/racial background, academic level, and parents’ credit card use, among other factors. Students’ attitudes toward credit, the study found, are influenced by many factors, including exposure to credit use by parents, leading the authors to suggest that educational programs be targeted at student populations unlikely to have received financial education at home.

While credit card debt may mire a student, one hopes that would be temporary — and an experience that will serve them well, as long as the debt isn’t crushing, says Marsha Cole, the executive director of the University of South Carolina’s Alumni

Association. “The students who show up to get it [the card] are the ones who aren’t in trouble yet,” she says. “It almost seems to me that getting into debt is a kind of a rite of passage.” She says students arrive with an average of 1.5 credit cards, according to information she gathered about three years ago.

“It’s not like they are getting their first credit card,” she says. “I can’t even imagine being an adult and not having a credit card. And they are not children, they are adults.” Credit card issuer JPMorgan Chase solicits on campus, with incentives, with university approval of locations and times.

But with a foot in the adolescent and adult worlds, the student population is vulnerable. Elizabeth Schiltz, who teaches banking law at the University of St. Thomas School of Law in St. Paul, Minn., says the 18- to 21-year-old population has been treated paternalistically in some cases, with their best interest in mind. Smoking and drinking are examples.

“This [credit cards] could be one of the areas society decides needs protection as well,” Schiltz says. “Anybody selling to this segment knows it has a heavy debt load already.” Shiltz says regulators already possess tools to make sure lenders understand they have special responsibilities toward this population. “The frustration on the part of consumer advocates is that

they don’t perceive regulators as sending strong messages to banks,” she says. Voluntary agreements could play a role, she suggests. It’s in the issuers’ interest to keep students financially healthy and educated about credit. That’s long term, though, not short term.

The Responsible Credit Partnership (RCP) of Chicago teamed up with credit card issuers in 2004 to test the effectiveness and cost of financial education strategies. Completion of online courses corresponded with but didn’t necessarily cause more responsible credit card use. It’s not clear whether students learned something from the course or if they were just predisposed to be responsible debtors.

Most card firms offer financial education of one kind or another, even if it’s just a brochure in a credit card offer. Capital One’s annual back-to-school survey found that 18 percent of parents discussed back-to-school budgets, a decline from the 24 percent who did so last year.

Too bad, because parents turn out to be the best teachers, says Lyons, who has researched financial socialization of young adults. “Why are some better managers than others?” Turns out these kids had been taught to set aside Grandma’s birthday money and decide whether they really could afford to buy the hot new computer game. **RF**

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