

College Students and Credit Cards

Testimony Given by:

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Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Hearing on “The Importance of Financial Literacy among College Students”

September 5, 2002

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Introduction

Good morning Mr. Chairman and members of the Committee. My name is Michael Staten. I am Professor of Management and Director of the Credit Research Center at the McDonough School of Business at Georgetown University. The Center is a non-partisan, academic research center devoted to studying the economics of consumer and mortgage credit markets. Over its 28-year history the Credit Research Center has generated over 100 research studies and papers, most of which examine the impact of public policy on credit markets. Throughout its history, the Center’s research program has been supported by a mix of grants from the public sector (e.g., National Science Foundation, Federal Trade Commission) and unrestricted private sector grants from foundations and corporations made to its host University on behalf of the Center. I have served as the Center’s director since 1990.

As students head back to college campuses this fall, a perennial debate will resume over the problems some of them have in handling their credit cards. Marketing research surveys indicate that about 57% of all full-time undergraduates own a general-

purpose credit card (Visa, MasterCard, Discover, American Express) in their own name.¹ From the sad anecdotes portrayed in the news media, one could get the impression that students are awash in debt, victims of relentless marketing by big credit card companies and incapable of controlling their urge to charge.

Along with my co-author, Prof. John Barron (Purdue University), I recently completed a study for the Credit Research Center at Georgetown University that offers new evidence on student card usage, evidence that paints quite a different picture.² The report provides benchmark measures of college student credit card usage. The analysis utilizes a pooled sample of over 300,000 credit card accounts randomly selected from the portfolios of five of the top 15 general-purpose credit card issuers in the U.S.

Discussions of college student card usage in both the policy arena and the popular press have been based mostly on anecdotes and self-reported survey evidence. To our knowledge the Georgetown study marks the first time account-level information has been pooled across major issuers to create a statistically reliable database for examining the actual usage and performance of credit cards marketed to college students. Consequently, the results should be helpful in grounding subsequent discussion on facts rather than anecdotes.

In the remainder of my testimony, I would like to share with you some results from our study. There is much evidence that college students are as responsible as the rest of us when it comes to their card usage behavior, and are more sensible in some respects. Whether or not they use credit cards wisely is a subjective question that depends upon your own views of how credit and credit cards should be used. But a dramatic lack

¹ *Financial Services*, Student Monitor, Ridgewood, NJ Spring, 2001.

² *College Student Credit Card Usage*, Working Paper #65, Credit Research Center, McDonough School of Business, Georgetown University, June 2002 (available online at www.msb.edu/prog/crc).

of sophistication among students in handling this powerful payment tool is not apparent in the data.

COLLEGE STUDENTS AND CREDIT CARD USAGE

The analysis compares behavior across three types of accounts: Those opened through college student card marketing programs; those opened by young adults aged 18–24 through normal marketing channels (i.e., *not* through dedicated student marketing programs); and those opened by older adults through normal marketing channels. All accounts analyzed in this study were opened during the period mid-1998 until early 2000 and were observed over a twelve-month period during 2000-2001.

The analysis follows a study plan that was originally proposed by the U.S. General Accounting Office in response to a request from members of Congress, but was never executed by GAO due to budget constraints. The study is similar to the GAO study plan in the range of cardholder behaviors to be examined and shares its focus on comparing the activity of recently-opened student accounts to the experience of accounts opened recently through conventional (non-student) marketing programs.

One of the first findings of the study was the fact that any random sample of open accounts contains a significant number of accounts that exhibit no activity during a 12-month period. Such dormant or “inactive” accounts may reflect a credit card being held in reserve by the owner for an emergency, or a credit card that has been discarded or destroyed by the owner without the issuer being notified. The incidence of such “emergency/destroyed” cards varied substantially across the five companies in our sample, sufficiently that we could not determine a reliable “average” rate of inactivity

among open accounts. Nevertheless, it is clear that any discussion of student credit card usage that makes projections of student card debt based on the number of credit cards owned (i.e., the number of open accounts) will likely overstate the actual use of credit cards.

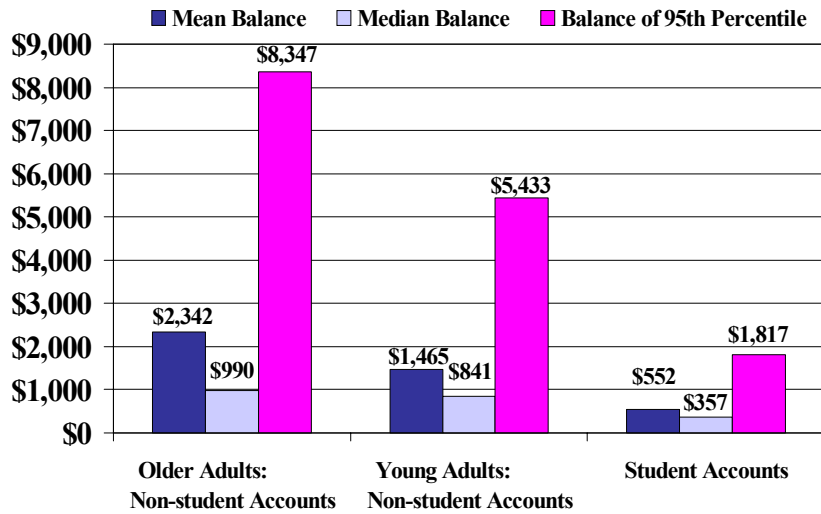
The analysis in the report is restricted to a sample of more than 300,000 *active* accounts, each of which was followed for a twelve-month period during 2000-2001. Active accounts are defined as accounts with charge activity, payment, positive balance, or some other posting of activity at any point during the observation period. Given this large sample size, the random sampling approach adopted by the participating companies, the market share and national scope of the companies providing the data, and the use of weights to reflect the relative number of cards issued across the various groups by each company, *the findings reported below can be considered representative of accounts opened at major credit card issuers during the period from mid-1998 through early 2000 that were active during the 2000-2001 period.*

Results

Credit Balances, Credit Limits, and Utilization Rates

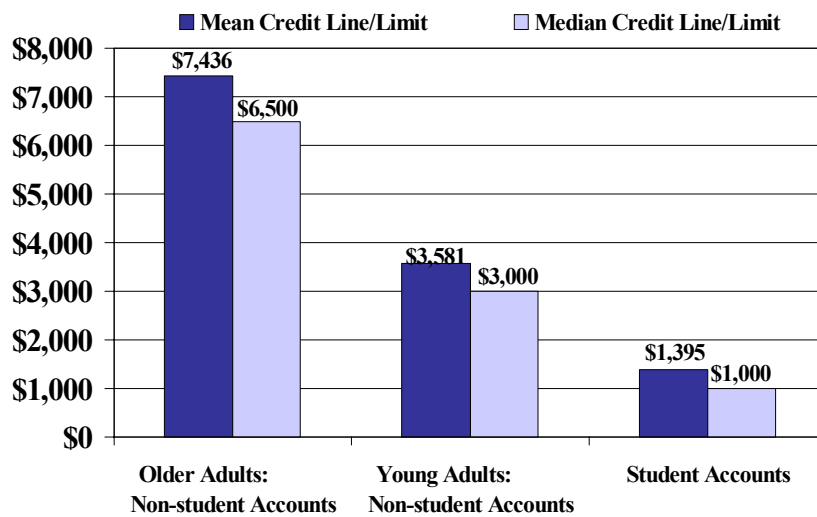
- The average balance of an active student credit card account (\$552) is approximately one-third the size of the average balance of an active non-student account of a young adult (\$1,465), and one-fourth the size of the average balance of an active older adult account (\$2,342).

Balances by Type of Account



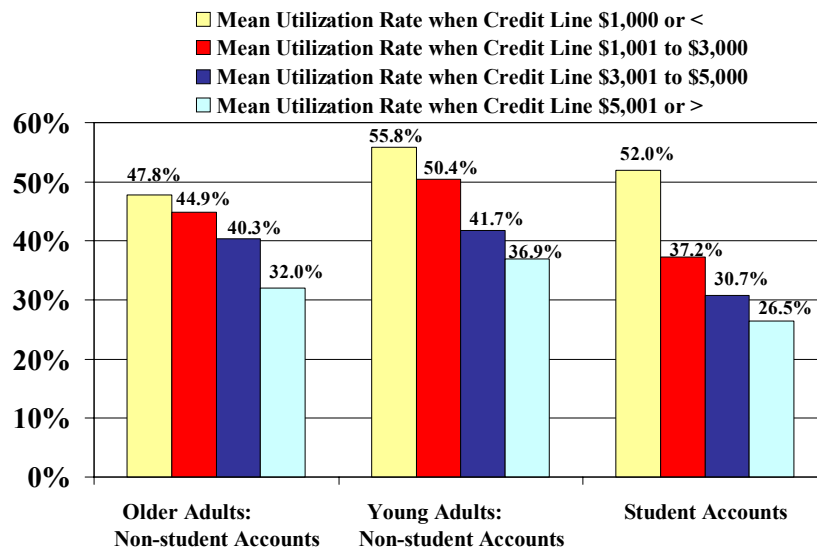
- The mean credit limit for student accounts (\$1,395) is less than 40% of the mean for non-student accounts of young adults (\$3,581) and less than 20% that of adult accounts (\$7,436).

Credit Limits by Type of Account



- At 45%, the mean utilization rate across all student accounts (percent of credit line tapped) is higher than the utilization rate for older adult accounts (36%) and about the same as the utilization rate for non-student accounts held by young adults (46%), despite much higher credit limits for these other groups. Among cardholders in all three groups who have credit limits above \$1,000, student accounts have significantly lower utilization rates.

Utilization by Size of Credit Line and Type of Account



Card Usage: Cash Advances, Paying the Full Balance, and Finance Charges

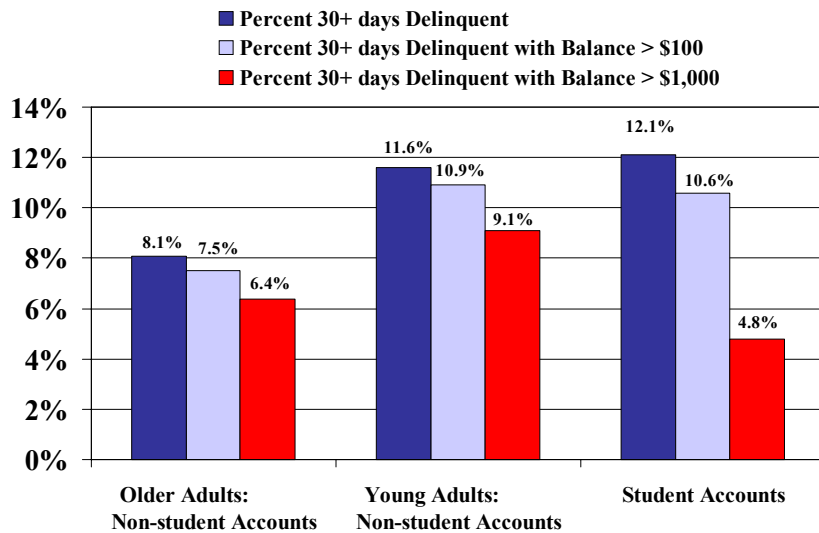
- Student accounts are substantially less likely to use the credit cards for cash advances.
- Among accounts with positive balances, student accounts are somewhat more likely in any given month to pay the prior balance in full.

- A student account is less likely to incur finance charges in a given month, but more likely to incur fees, either for being late or for being over the credit limit. The average finance charge incurred on student accounts in a given month is \$7. Only 5% of student accounts incur a finance charge greater than \$26 in a given month.

Delinquency Rates and Charge-offs

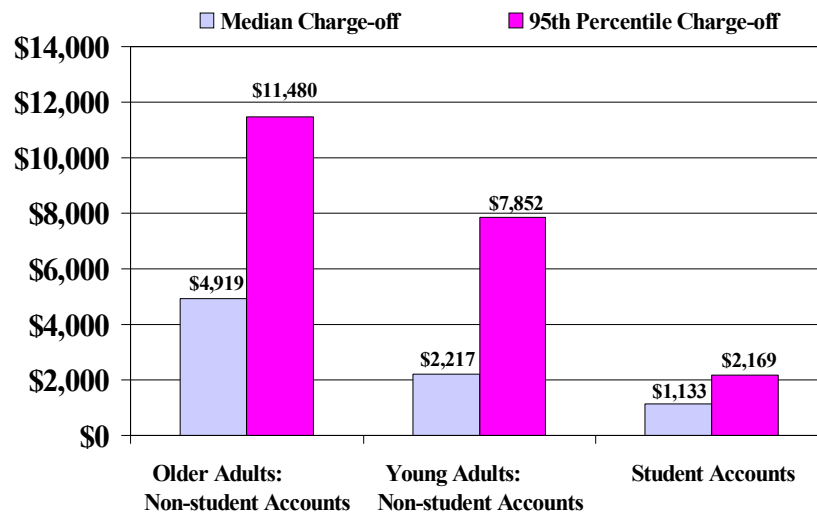
- Delinquency rates on both student accounts and young adult, non-student accounts are higher than for older adult account holders. In a given month, 12% of active student accounts are past due, versus about 11% for other young adults under age 25 and 8% for adults 25 and older. However, among student accounts that have large balances (e.g., accounts with an outstanding balance greater than \$1,000) student account delinquency rates are substantially lower than for similar accounts held by other young adults under age 25.

Delinquency Rates by Size of Balance and Type of Account



- About 3.6% of student accounts charge-off annually, compared to 2.8% of young adult, non-student accounts and 1.6% of older adult accounts. The median dollar amount charged off on student accounts is \$1,133, vs. \$2,217 for young adult, non-student accounts and \$4,919 for older adult accounts. Large-dollar charge-offs are not common among student accounts given their substantially lower average balances. Considering only charge-offs that exceed \$5,000, student account losses are rare. For every 10,000 accounts of each type, the dataset indicates there would be 77 adult accounts with charge-offs exceeding \$5,000 over a one-year period, 58 such charge-offs for non-student accounts of young adults, but only 2 such charge-offs for student accounts.

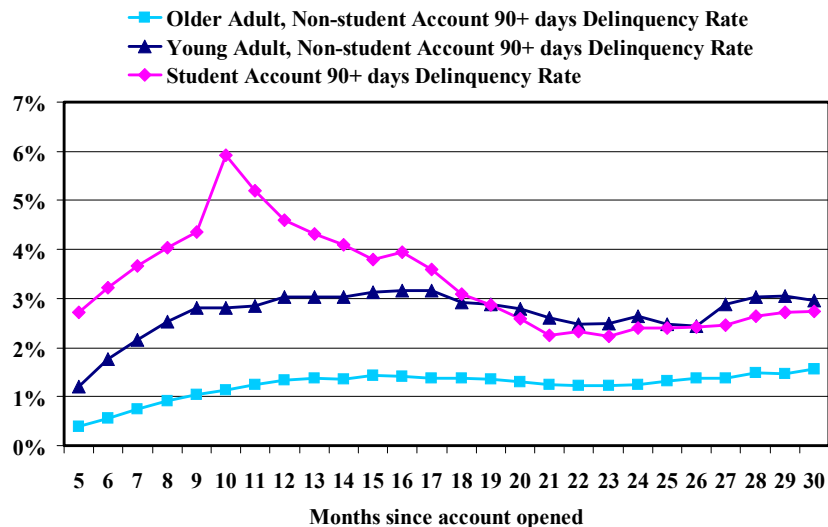
Size of Charge-offs by Type of Account



- Over time, student accounts mature and performance converges to that of young adult, non-student accounts. More specifically, within about 18 months of the account opening date, student accounts exhibit a frequency of serious delinquency

(90+ days) and a likelihood of charge-off nearly identical to that of non-student accounts held by cardholders under the age of 25.

Delinquency Rates (90+ days) on Active Accounts by Number of Months Since the Account Opened



Summary

The data indicate that, on average, accounts marketed to college students have lower credit limits and smaller balances than accounts of similar age that were opened by young adults through issuers’ conventional (non-student) marketing programs. Compared to accounts recently opened by older adults (age 25 and older), student balances and limits are substantially lower.

About 88% of student accounts are current (i.e., pay their accounts as agreed) in a given month, compared to about 88% of young adult, non-student accounts and 92% of older adult accounts. Although recently opened student accounts have a higher likelihood of charging-off compared to other groups, the dollar amounts at risk on

delinquent accounts and the actual losses on charged-off accounts are substantially lower.

Further, the delinquency and charge-off experience for student accounts becomes similar to non-student accounts of young adults for accounts open more than one and one-half years. These findings are consistent with issuers' statements that they establish student accounts with relatively low credit limits with the expectation that the large majority of new, young cardholders will learn how to manage a credit card, establish a credit history and become longer-term customers.³

Conclusions and Recommendations

I understand that this committee is interested in the financial literacy of young people. As you know, national coalitions of industry, government, and non-profit organizations have committed substantial resources to such efforts in recent years. They have already created a tremendous range of educational materials and programs on personal finances for both children and adults, with the promise of more to come. I believe these efforts are essential to the long-term goal of improving the money management skills of most Americans who are faced with an increasingly sophisticated array of financial service products.

Clearly, there are some college students who build up large balances that could well lead to payment problems, but that is true of any cardholder population. I certainly see no evidence from the Georgetown study that students are misusing cards so frequently as to warrant singling them out as a group for special protections from marketing solicitations.

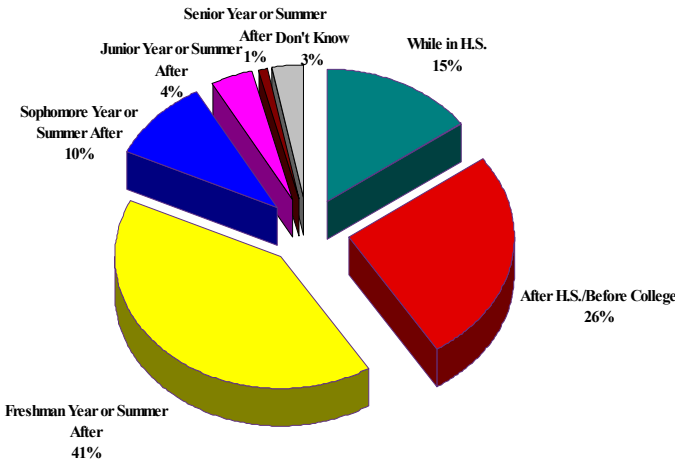
³ *College Students and Credit Cards*, United States General Accounting Office, Report GAO-01-773, June 2001, pp 35-40.

In that regard, I am concerned about some proposals that have been circulating at both the state and federal level which would either limit or ban the marketing of credit cards to college students. Proposals that would ban on-campus marketing of credit cards seem particularly misguided, given the available evidence from annual marketing surveys about how and when students obtain their cards. For students who own a general-purpose credit card in their own name, the largest single source in 2001 was direct mail offers, accounting for nearly 40% of all cards.⁴ Only about 20% of cards were obtained from sources on campus (take-one displays; issuer reps at “tabling” events). The same survey revealed that nearly 40% of undergraduates in 2001 who owned a general-purpose credit card in their own name said they received their first one before they arrived on campus their freshman year.

Consequently, restrictions that would ban on-campus marketing would not stop the majority of students from acquiring cards. Moreover, such restrictions would eliminate probably the only opportunity for any face-to-face contact between a card issuer representative and the cardholder. Present marketing practices may not take full advantage of this opportunity for distributing educational materials and messages, but an outright ban on such marketing eliminates the opportunity.

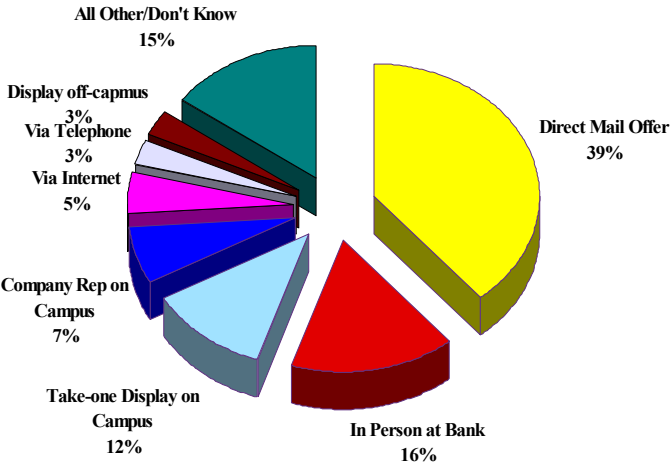
⁴ *Financial Services*, Student Monitor, Ridgewood, NJ Spring 2001.

When First Card in Own Name was Obtained



Source: Student Monitor, Spring 2001 Survey.

Methods of Obtaining General Purpose Cards in Students' Own Name



Source: Student Monitor, Spring 2001 Survey.

Even if card marketing to students could be legislated away, such action does not seem to be in students' best interest. The four years that most undergraduates spend in school are arguably the best time to get acquainted with credit cards. The undergraduate experience gives young adults an opportunity to transition from life at home to life on their own. Most students spend four years with one foot at home and one foot in the real world, learning about one but sheltered by the other. Learning personal financial management is part of that real-world experience.

A general-purpose credit card offered with relatively low limits gives students an introduction to the most powerful and versatile payment device on the planet. Think of it as the "training wheels" approach to learning to use a credit card. Students learn that their wants usually exceed their resources, and that they must manage that tension. They learn that a purchase made with plastic today and forgotten tomorrow can come back to haunt them at the end of the month with the arrival of the credit card statement. They learn that the credit card company doesn't forget you've made the purchase, nor does it forget if you don't pay. For those who choose to revolve, a balance that seems to fall far too slowly month after month kindles a new urge to find gainful employment during the summer, or after graduation.

All of these lessons must be learned eventually. I believe it is better to learn them with the relatively small exposure permitted by the lower limits that are typical of cards obtained through college student marketing programs. Postponing the lesson until after graduation would raise the financial stakes and put young consumers at even greater risk.

It surely can't be too difficult for our best and brightest youth to learn about cards and card marketing while in college. Artificial limits on credit card marketing to this

group will not improve their financial literacy. The wiser course seems to be to facilitate student access to the information they need to make sound decisions about using credit and the importance of maintaining a good credit history.

I thank you for the opportunity to appear today and would be happy to answer questions.