Testimony of Kenneth J. Clayton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the Committee on Financial Services

United States House of Representatives

AMERICAN
BANKERS
ASSOCIATION ®

Testimony of Kenneth J. Clayton

On Behalf of the American Bankers Association

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

June 26, 2008

Chairwoman Maloney and members of the Subcommittee, my name is Kenneth J. Clayton, senior vice president and general counsel of the American Bankers Association (ABA) Card Policy Council, the group within the ABA that deals with card issues. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

We appreciate, Madame Chairwoman, the opportunity to appear today to discuss college students' rights as adults to obtain and use credit cards. We certainly acknowledge at the outset that not all students will manage debt in a responsible way, just as not all adults in general will manage debt without experiencing problems. Dealing with debt problems at any age can be very stressful and our card companies do their best to deal with each individual situation quickly to help resolve the problem. However, anecdotes of student problems in the card area fail to paint the real picture that students, as a broader group, are in fact managing their credit obligations well. Importantly, we fear that policy decisions made on the basis of anecdotes will end up hurting the vast majority of young adults who have shown they are capable of managing their finances responsibly. As such, they will be denied the full benefits of a very valuable payment and credit instrument.

It is also important to note that despite their relative inexperience, ***college-age individuals are adults***. They have the right to contract, work, marry, serve in the armed forces, and vote. They have the right – and responsibility – to exercise independent judgment in these areas, aided by the educational tools that we in society can provide. We hope policymakers will be mindful to not create artificial barriers to the exercise of these independent choices, recognizing that in creating such barriers, you may be limiting the significant benefits that credit products have to offer for the vast majority of young adults.

In my statement today, I would like to focus on four major themes:

- Credit cards provide an invaluable service to students;
- Students have shown they use credit responsibly;
- Barriers to access will impose hardships on the vast majority of students who have demonstrated they can manage credit card use responsibly; and
- Financial education for young adults is critical to financial success.

I. Credit Cards Provide an Invaluable Service to Students

Credit cards have become an integral, convenient and important part of student life. They are an instant means of payment for purchases; they are safer than cash, accepted more places than checks, and can be used almost anywhere. They provide a flexible and convenient way for students to buy books and other essentials, as well as purchase airline tickets or rent cars. The Government Accountability Office (GAO) in the most recent, comprehensive government study undertaken on student card use found that some 77 percent of students used their cards for routine personal expenses, 57 percent for books and supplies, and 12 percent to pay tuition and fees (though over half of the last category paid their charges in full right away).[1] Clearly, cards have become an invaluable tool for students' everyday needs.

Moreover, credit cards provide a particularly important safety net for emergencies. In that same GAO study, researchers found that 67 percent of students reported that they used their credit cards for occasional and emergency expenses, illustrating the importance of having access to such cards for unexpected circumstances. "Credit cards provided convenience and security and were

---

1 *College Students and Credit Cards*. U.S. Government Accountability Office, June 2001. (GAO-01-773)

especially useful in emergencies, allowing students to pay for unplanned medical expenses or purchase airplane tickets home."[2]

For many consumers, and particularly for students, credit cards are also the point of entry into the world of credit. Credit card use establishes credit histories, which help people to obtain jobs, rent and buy homes, or purchase cars and other big-ticket items. In fact, according to a 2008 study by Student Monitor, 53 percent of college students of who obtained a credit card did so to establish a credit history.[3] Credit histories permit individuals to demonstrate their creditworthiness, and therefore have dramatically expanded access to credit to all members of society in the most efficient, non-discriminatory way possible.

Banks recognize that applying for a credit card may be a college student's first independent experience with the bank and want it to be the start of a positive, life-long customer relationship. As such, banks have a vested interest in responsible underwriting, so as to ensure ongoing customer satisfaction. They establish low credit limits and lower fees, they constantly monitor student accounts, and have instituted significant financial literacy programs. Students also receive a wide range of disclosures on the terms of agreement both in the account-opening procedures and on an ongoing basis. All of these efforts are focused on creating a successful relationship with young adults new to this financial tool.

Banks are also cautious about marketing efforts, generally focusing on depository accounts rather than credit accounts. In fact, checking accounts are typically the lead product for marketing efforts to students, and credit cards are offered as a supplement to this. As a result, the vast majority of credit cards obtained by students come from students visiting the bank branch to begin a broader account relationship. Recent information from one member bank suggests 65 percent of student credit card accounts were opened through banking centers, allowing for important education on financial literacy as a part of interaction with bank staff. The remaining card accounts are opened by students over the Internet, in response to direct mail solicitations, or through telemarketing initiatives. A Student Monitor survey indicated that only 2 percent of students obtained their cards by filling out an application at a display on campus.[4] This reflects the reality that student card accounts are opened through various distribution channels, many of which are not targeted to

---

2 Ibid. p. 3

3 *Annual Financial Services Study*. Student Monitor, 2008.

4 Ibid.

students at all but members of the general population that share a common characteristic, (e.g., those that open checking accounts or other accounts within the institution). This is not to say that various institutions are not interested in the student market, just that criticism directed at specific marketing techniques tends to overstate the real world experience.

II. Students Have Shown They Use Credit Responsibly

It is perhaps because of banks' focus on a lasting relationship that students have shown that they can use credit more responsibly than the general population. Recent studies have found that student accounts generally have lower balances and lower credit limits, and that students use them less than the general population. And although seventy percent of undergraduates and post-graduates have outstanding debt, the bulk of this debt is from student loans.

Consider the following statistics[5]:

- 41 percent of college students have a credit card.[6]
- Of the students with cards, about 65 percent pay their bills in full every month, which is ***higher than the general adult population***.
- Among the 35 percent that do not pay their balances in full every month, the average balance is $452. This is down 19 percent from 2007. Moreover, this balance is approximately one-third the size of the average balance for active non-student young adult accounts and one-fourth the size of active accounts for older adults.[7]
- 74 percent of monthly college spending is with cash and debit cards. Only 7 percent is with credit cards.

Certainly, there are examples of students who took on more debt than they were ultimately able to manage. But in the vast majority of cases, students are acting responsibly and meeting their obligations. This fact is borne out when examining portfolios of student credit card accounts at banks. These portfolios are considered low-risk, and their performance is better than the general population.

---

5 Ibid.

6 Previous numbers have been higher. New lower numbers likely reflect the increased use of debit cards and stored value cards.

III. Barriers to Access will Impose Hardships on the Vast Majority of Students Who Have Demonstrated They can Manage Credit Card Use Responsibly

As previously noted, credit cards provide a flexible and convenient way to manage student spending. Students buy books and other student essentials, purchase airline tickets, rent cars and pay for medical and other emergencies with their credit cards. Thus, credit cards represent an important tool for managing both day-to-day needs and unexpected events. Restricting access to this form of credit would result in great financial hardship for most college students ***and their families***.

Notwithstanding that fact, Congress and several state legislatures have introduced legislation that would have the effect of limiting or preventing categories of college students from obtaining a credit card. Some proposals have taken the form of arbitrary limits on available credit. Others have limited the amount of credit available on a single card, or would limit the amount of cards a student may have. Still others would impose liability on lenders who, with the benefit of hindsight, did not make correct judgments regarding the creditworthiness of a student borrower. Such barriers to credit access can create real hardships for students, the vast majority of which have demonstrated their ability to manage their credit cards responsibly.

It is also important to remember that "college students" are hardly a homogenous group. A popular misconception is that the typical college student lives on campus and attends a four-year institution. The fact is that ***only 16 percent of students are full-time undergraduates residing on campus*** – fewer than three million of the more than 17 million students enrolled today.[8] Today's students don't fit the traditional mold: 40 percent study part-time, 40 percent attend two-year institutions, 40 percent are older than 25, and 58 percent are older than 22.[9] While going to school, these "non-traditional" adult college students often work full or part time and many have families. Thus, efforts to regulate access to credit may impose different hardships on different

7 Barron, John (Purdue University)and Staten, Michael (Georgetown University), *Usage of Credit Cards Received Through College Student-Marketing Programs*, NASFAA Journal of Student Financial Aid, 2004.

8 Stokes, Peter J., *Hidden in Plain Sight Adult Learners Forge a New Tradition in Higher Education*, Issue paper for the Secretary of Education's Commission on the Future of Higher Education. 2005.

9 Ibid.

categories of "students" based on their life situations, and will clearly result in consequences unanticipated to policymakers.

These examples show the difficulty in imposing artificial restraints on the dissemination of credit to a particular category of adult borrower. They also reflect a failure to acknowledge that the vast majority of adult students handle their credit responsibly, making such restrictions unnecessary.

IV. Financial Education for Young Adults is Critical to Financial Success

As has often been noted, the key to responsible card use lies in improvements in financial literacy. Financial education is the key that allows students of all types to unlock their financial future and use many financial tools wisely – credit being just one of these tools. Understanding financial matters is a critical part of success in life, and this work begins in the home and in early school experiences.

Most banks that issue credit cards are engaged in a wide variety of financial literacy and school education efforts, often in partnership with consumer groups, and many of these programs include training for young people using credit for the first time. The U.S. Department of the Treasury is also actively engaged in a nationwide, coordinated effort on financial literacy through the National Literacy and Education Commission. That Commission, created by Congress in 2003 as part of the "Financial Literacy and Education Improvement Act" (Title V of the Fair and Accurate Credit Transactions Act of 2003 [FACT Act]), among other things, encourages government and private sector efforts to promote financial literacy as well as develop a national strategy on the subject. Significant Congressional efforts to promote financial literacy have also been undertaken, the most recent example involving the efforts by the Financial and Economic Literacy Caucus, co-chaired by Representatives Ruben Hinojosa (D-TX) and Subcommittee Ranking Member Judy Biggert (R-IL). In addition, the ABA has also been involved in various financial literacy efforts through our ABA Education Foundation, which sponsors the annual "Get Smart About Credit Day" in October to educate young adults about the proper use of credit. ABA has catalogued many of the efforts of our member institutions to provide financial education to consumers. Go to http://www.aba.com/abaef/gsac.htm for more information. We have also included various learning tools on the site itself in multiple languages, as well as links to related sites with useful information.

The answer then is to train students – and all adults – in the responsible management of credit and, indeed, the wise use of all financial tools. Banks, schools, and policy-makers have been working to accomplish this goal, while at the same time enabling adults to access the products they need in order to carry out daily activities, manage surprise expenses, and establish a credit history that will allow them to purchase an automobile or a home when they graduate. Credit cards are one product that enables students to do this, even though the amount of debt students carry on cards is small compared to their total debt load. Restricting access to this form of credit would result in great financial hardship for most card-holding college students and their families.