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Lenders curtail college student loans

As private loans dry up, students may turn to credit cards



By Jay MacDonald

Hold the pizzas and cancel the beer run: Cash for college just got tighter.

Last summer, America's ongoing credit crisis hit unsuspecting college students where they live -- in the private loans they depend upon to make up the shortfall between what federal student loans and grants can provide and what mom and dad can afford.

According to student lending giant Sallie Mae, 8 percent of all students use private loans, averaging \$7,694.

But a new study, "The Student Market for Credit Cards: Issues and Trends," by Maryland-based consulting firm Kaulkin Ginsberg finds that more than two dozen lenders either stopped or cut back private lending to students last summer.

Dimitri Michaud, Kaulkin Ginsberg consumer finance analyst and author of the report, spotted the trend while analyzing the accounts receivables of the lending institutions.

Those curtailing private student lending ranged from such major institutions as [Citi](#), [Bank of America](#), [JP Morgan Chase](#), Wells Fargo and Wachovia to smaller lenders, including CIT Group, College Loan Corporation, Education Finance Partners, EduCap, Nelnet, NextStudent and Student Loan Corp.

"Not all of them pulled back entirely; the likelihood is that they probably just limited the number of loans they were originating," Michaud says. "If they normally wrote 15,000 loans for the summer, they most probably limited it to 10,000."

Michaud first noticed private student lending drop off in the first quarter of 2008 when the market into which lenders resell their loans started to dry up.

"A spillover from the overall credit crisis caused many investors to become a little gun-shy to invest in private student loans, even though historically they are safe," he says. "The summer of 2008 has been kind of difficult for all pooled securitized debt."

'Perfect storm' of student gloom

The pullback could not have come at a worse time: A slumping student job market, rising education costs and mounting loan debt have combined to create a "perfect storm" of financial rough seas ahead for students to navigate after graduation, Michaud says.

While unemployment remained in the mid-5 percent range among the total labor force, it grew to more than 20 percent among those ages 16-19 last summer, normally the time of year that many students try to work full time. The decline was due in part to an influx of nonstudent workers taking extra jobs due to work cutbacks or an inability to find full-time positions.



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Over the past three years, the average cost of tuition at four-year public and private colleges and universities rose more than 20 percent, from \$21,235 to \$26,833, according to the nonprofit College Board. Because federal loans and grants have failed to keep pace with education costs, the market for private student loans has grown to more than \$17 billion annually.

Studies vary widely on how many student credit cardholders use their plastic to help pay for their college educations. Studies by the American Council on Education and U.S. Public Interest Research Groups (U.S. PIRG) have found that one in four student cardholders already uses credit cards to pay for tuition. An August 2008 [study](#) from Sallie Mae and Gallup found the number far lower, with just 3 percent of students saying they used credit cards to pay for school.

Regardless of the true percentage, with the private loan market tightening, Michaud says, that number may well increase.

"Students are using credit cards as a last resort to pick up the slack when they have difficulty getting loans or jobs to cover their expenses," he says. "With fewer loans and jobs available, you have the makings of an increase in college student credit card debt on top of existing student loan debt."

Unfortunately, there's a simultaneous movement afoot to tighten access to student credit cards, as well as investigate the financial dealings between college administrations and banks eager to issue college students their first credit card.

A hot slice of debt

Issuers of [student credit cards](#) have come under [increased scrutiny](#) for using free pizza and T-shirt giveaways, charitable fundraisers and alma mater affinity products to lure freshman into applying for their first card.

"The industry knows from market research that you build brand loyalty when you're the first product that somebody ever uses," says Christine Lindstrom, higher education program director for U.S. PIRG. "That's why they waive the normal underwriting criteria for students. If you're a student, boom, you get a credit card."

U.S. PIRG, along with other consumer groups and a growing number of state legislatures, argues that carpet-bombing campuses with credit cards is blatantly irresponsible, a small-scale version of the same subprime lending that rocked the U.S. housing market.

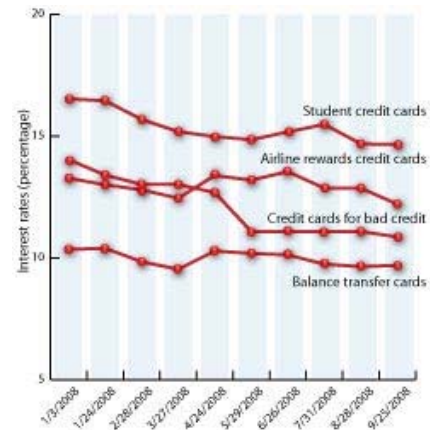
"Our stance is not that young people should have no access to credit cards," Lindstrom says. "But all this aggressive, in-your-face, steaming hot slice of pizza to get you to apply and then we're going to sock you with terrible terms and conditions after we've given you a credit limit that you can't really afford stuff is just plain wrong."

Of the nine credit card categories tracked by CreditCards.com, student credit cards consistently have the highest average interest rates.

Because the credit card industry has effectively insulated their credit card terms and conditions from state and local regulation through federal legislation, angry parents and taxpayers have opted to fight aggressive student credit card marketing by restricting access to campus and student databases.

State legislatures and/or attorneys general in Arizona, California, Missouri, New York, Ohio, Tennessee, Washington state and elsewhere have already proposed or passed legislation to block or limit credit card marketing on campus.

Early next year, Illinois State Treasurer Alexi Giannoulias plans to introduce legislation that would



ban giveaways on campus and prohibit state colleges and universities, their foundations and alumni associations from selling or transferring student names and personal information to credit card lenders.

New Jersey lawmakers have proposed a bill that would require credit card lenders to register annually with state colleges and provide an education program on the responsible use of credit that student applicants would have to complete to receive a card.

U.S. PIRG has set its sights on the [Credit Cardholder's Bill of Rights](#), currently winding its way through Congress.

"We are working to get an amendment placed into the bill that would basically force the industry to treat students the same way they treat everybody else, which means they would have to use the same underwriting standards," she says. "That would solve part of the problem right there because, if you have limited or no credit history, your options would be to get a co-signer for your card or you might be able to get one of those starter cards."

Beware the debit/ID

Perhaps more troubling are the often-murky [contract arrangements](#) between budget-strapped school administrations and credit card lenders that may be rife with privacy violations and kickbacks for exclusivity. In addition, once-simple [student IDs have evolved into full fledged payment systems](#) at many schools. Some campuses even allow financial institutions to issue debit cards as official student IDs.

"ID cards cost a fairly substantial amount of money, so to the school it's a great thing to have an outside source come in and pay for that," says Lindstrom. "But if you're not giving students the option to have an ID without the debit card or have it with another bank, then you're forcing students into a financially vulnerable situation."

Lindstrom says private student loans and student credit cards have one thing in common: miserable terms.

"These private lending products were created more with investors in mind than they were for students, so the terms and conditions are pretty draconian. It's the same type of mindset that got all these bankers and intermediaries into thinking that it makes sense to give a mortgage to somebody without them actually having to demonstrate their income. So when you pile up some federal loans on this kid and then pile up a private loan that has terrible terms and conditions, what you're doing is just plunging this kid into a really deep hole."

Michaud says the pullback in private student lending will likely bring changes to how students juggle their methods of payment.

"Any sort of shortfall in their tuition they're going to have to make up either by borrowing from their parents or using their credit card as a bridge loan," he says. "I think the biggest pain will probably be in nondirect educational expenses; you might see students struggling with their room and board or how best to pay for their meal plans or books and supplies."

If there is a silver lining to fewer private loans, it could force some students into paying more as they go rather than accumulating a mountain of post-grad debt.

"If they opted to take a part- or full-time job last summer to save up some additional funds, it might in the end turn out to be a positive thing in terms of being able to manage their debt. Maybe it will affect the way people perceive things like their student loans and credit cards and work toward fulfilling those obligations a little quicker or avoiding unnecessary expenses."

In other words, hold the pizza -- at least for now.

See related: [Compare student credit cards](#), [Student ID 2.0: College cards have evolved into full fledged payment systems](#), [How America pays for college: lots of borrowing](#)

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