College students should be careful with 1st credit cards

July 12, 2013|Carolyn Bigda

If you're heading off to college this fall, you may plan to take out student loans and another type of debt — a credit card.

Freshmen are not the only ones considering a card for the first time. A study last year by student-loan provider Sallie Mae found that 21 percent of first-year students had a credit card in 2012.

Among college seniors, the number tripled, to 60 percent.

Opening a credit card can be a good way to build your credit history, something you will need for your post-graduation financial life. But as with any form of debt, you want to borrow smartly. Here are some tips:

See if you qualify. In years past, almost any college student could open a credit card. But the Credit Card Accountability Responsibility and Disclosure Act of 2009 made it more difficult for those younger than 21 to qualify.
To be issued a card now, young consumers need a co-signer 21 or older, or show that they earn sufficient income.

For some students, neither may be a good option.

A co-signer needs to have good credit and be willing to repay your debts if you can't, since he or she is equally responsible for the bill. As a result, Mom and Dad may not be eager to sign up.

"Co-signing is not the best way," said Linda Sherry, director of national priorities at Consumer Action, a consumer advocacy group. "I've heard young people are getting friends who are over 21 to co-sign for them to get a card. This sounds crazy to me."

The law is not specific about the amount of income a young applicant needs.

Some issuers will consider student loans as earnings or approve you for a card if you have a part-time job.

But using student loans to pay your credit card "makes no sense financially," Sherry said.

"Student loans should be used for books and tuition."

If you really need a card, Sherry suggests an alternative: become an authorized user on a parent's account. With this option you receive a credit card to make purchases and build your credit history.

But if your spending gets out of control, the parent can shut down your card.

Keep the balance low. Once you do get a credit card, you should strive as much as possible to pay off the balance in full every month.
"Don't feel you need to carry a balance in order to establish credit," said Greg McBride, senior financial analyst at Bankrate.com, which keeps tabs on the banking industry. "This is simply not true."

Rather, you want to charge only as much as you can afford to pay off every month. Otherwise, you will owe the balance, plus interest and any fees if you pay late.

Those extra costs can be unforgiving.

"In general, what we've seen since the passage of the CARD Act is that rates for borrowers with limited or spotty credit — including but not limited to students — have tended to move somewhat higher," McBride said. "Not universally higher, but when they've moved, it's been up, not down."

Find the right card. There is more than one student credit card to choose from, so shop around. Look for cards with no annual fee or application fee, McBride says. Also, make sure the issuer reports to the main credit bureaus, which is crucial to establishing a credit history.

Curtis Arnold, founder of CardRatings.com, which lists credit card offers, says freshmen and sophomores should generally stay away from rewards cards.

"These cards are designed with one purpose in mind: to get you to spend more money," he said. "Prove to yourself and to your parents that you can use a plain, vanilla student card for a year or two before you take the plunge."

One exception: cards that reward you for responsible credit behavior. Capital One's Journey Student Rewards card, for example, pays students 1 percent cash back on purchases with a bonus 0.25 percent cash back each month the bill is paid on time.

E-mail Carolyn Bigda at yourmoney@tribune.com

What Parents of Soon-to-Be College Students Need to Know About Credit Cards

Students will likely have college debt after graduation, but should they have both credit card and student loan debt? I interviewed Beverly Harzog, author of *Confessions of a Credit Junkie*, about all things college students and credit cards.

Did legislation really stop college students from getting credit cards?

It did put some needed restrictions on offering credit cards to students. For young adults under the age of 21, they have to show sufficient income before they can be approved unless they have a cosigner. The CARD Act also banned gift giving to entice college students to sign up for credit cards. No more free T-shirts to sign up for a credit card. And the CARD Act also prevents card issuers from sending pre-approved offers to anyone under 21 without the individual's consent.

A 2013 survey by the Consumer Financial Protection Bureau showed that credit card agreements with college has decreased since 2009, the year the CARD Act was signed into law. Most of the provisions became effective in 2010.

Is using a credit card an alternative way to student loans to paying for college in part or in whole?
I do not recommend using credit cards to pay for college. It's fine to use them to get rewards, but only if you can pay the bill in full by the due date. Student loan debt is stressful, but at least it's an investment in your future. Credit card debt is "bad debt" and it's a waste of your money. It would be terrible to graduate with student loan debt and with credit card debt. You don't want to start your adult life out that way.

What are the dangers for parents cosigning credit cards?
When a parent cosigns for a credit card, they take legal responsibility for the debt. So if the student racks up debt and can't pay for it, the parent is responsible. The parent can also suffer damage to their credit score if the student uses the card irresponsibly.

What kind of talk/guidelines should parents have with their students before letting them have a credit card? How crucial is this?
Hopefully, parents have been talking to their kids about money management long before they leave for college. It's very important to talk about credit cards, in particular, because they can be dangerous in the wrong hands. I wrote *Confessions of a Credit Junkie* to show how irresponsible credit card use can wreak havoc on your life. Even if a parent doesn't believe in credit card use, they need to educate their kids so they know how to use credit cards responsibly if they choose to apply for a card. When young adults are out on their own, parents won't be there when they get those offers. So it's essential to arm your kids with information.
Is it a good idea for parents to use the last month of summer to evaluate their child's spending habits before handing them the card?
I recommend starting out with a debit card. When your child has that first job in high school, open a checking account and teach your kid how to monitor their checking account and use a debit card. This teaches them how to budget their money and handle plastic. There's an emotional disconnect when you use plastic because it feels like you're not really spending money.

You can't evaluate a child's spending habits in just one month. Hopefully, you'll spend their senior year watching them handle a debit card. If you do think they're ready for a credit card when they go to college, start by making them an authorized user on one of your accounts or getting your child a secured card.

How are credit cards most often used by college students and their families?

I've seen folks cosign and one of two things usually happen. It's either a success or a disaster! I prefer either the authorized user route, a secured card, or a student card. Your choice depends on the maturity level of your child and how savvy they've been with their money. At the end of the day, the parent is truly the expert when it comes to making decisions about credit cards and their college-student kids.

What the credit card reform law means to you

A primer on how the Credit CARD Act has changed the rules

By Connie Prater

Credit card users are benefiting from the most comprehensive consumer protections on credit terms, interest rates and fees in decades thanks to a federal law that took effect beginning in 2009.

After years of complaints about "gotcha" fine print and confusing terms, the reform law mandated more transparency and easier-to-understand terms -- but it has come at a higher upfront cost.

"The most vulnerable consumers, those who carry a balance, have been protected by the protections of the CARD Act," says Chi Chi Wu, staff attorney for the National Consumer Law Center, a Boston-based consumer advocacy group. "Some of the worst abuses were addressed, including retroactive rate increases. It put the brakes on some of the fees. They are still kind of high, but it kept them from going up."

The new normal

Now that a few years have passed, credit card issuers and credit industry analysts say the credit card reform law has made credit cards somewhat more costly for all users and less accessible for people with low income and bad credit. However, the direst predictions -- that the law would mean the return of routine annual fees and fewer rewards cards -- have not panned out.

President Obama signed the Credit CARD Act of 2009 into law May 22, 2009. (Read the act.) The law directed several federal agencies to work out the fine details of enforcement, and they did so over the two years following the CARD Act's enactment.

In the end, what has the law meant for cardholders? Millions of credit card users are protected from retroactive interest rate increases on existing card balances and have more time to pay their monthly bills, greater advance notice of changes in credit card terms and the right to opt out of significant changes in terms on their accounts. The law gave consumers a bit more time -- 45 days instead of 15 -- to shop around for better deals if they don't like the new terms.

The CARD Act's consumer protections were phased in over 15 months. The first provisions took effect Aug. 20, 2009, and the majority of rules started on Feb. 22, 2010, while the final batch kicked in Aug. 22, 2010.

Here are the highlights of the credit card law:

Limited interest rate hikes: Interest rate hikes on existing balances are allowed only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days' advance notice of the change.

Limited universal default: "Universal default," the practice of raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors), has ended for existing credit card balances. Card issuers are still allowed to use universal default on future credit card balances if they give at least 45 days' notice of the change.

The right to opt out: Consumers have the right to opt out of -- or reject -- certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance.

Limited credit to young adults Credit card issuers are banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt. Credit card companies must stay at least 1,000 feet from college campuses if they are offering free pizza or other gifts to entice students to apply for credit cards.

Credit card reform: What the law has meant

- Limited interest rate hikes
- Limited universal default
- The right to opt out
- Limited credit to young adults
- More time to pay bills
- Clearer due dates and times
- Highest interest paid first
- Limits on over-the-limit fees
- No double-cycle billing
- Making minimum payments
- Subprime card fee limits
- Late fee restrictions
- Gift card expirations limited

More inside Credit Card Help

- 7 credit card basics
- Credit card debt: 8 keys
- 10 things to know about ID theft
- Data breach protection: 10 tips

At a glance: Credit card reform

What the CARD Act says: The law fundamentally changed credit card issuers' practices and consumers' rights. Among the changes: Card issuers can only increase interest rates for a limited number of reasons and can't increase rates at all during the first year of a new card account.

Why it's important: The federal credit card law tilted the playing field toward consumers by limiting what used to be some of the credit card industry's most profitable and punitive practices. Consumer advocates favor it. Card issuers point out it has driven rates for all and limited the availability of credit cards to people with bad credit.

Other resources: See: A comprehensive guide to the Credit CARD Act of 2009 andCredit card reform time line. Read the act.

More time to pay monthly bills: Issuers have to give card account holders "a reasonable amount of time" to pay on monthly bills. That means payments are due at least 21 days after they are mailed or delivered. Before the law was enacted, consumers complained about due dates that changed without notice or were moved up, giving them less time to pay their bills and increasing the likelihood of late fees.

Clearer due dates and times: Credit card issuers are no longer able to set early morning or other arbitrary deadlines for payments. Cutoff times set before 5 p.m. on the payment due dates are illegal. Payments due at those times or on weekends, holidays or when the card issuer is closed for business are not subject to late fees. Due dates must be the same each month.

Highest interest balances paid first: When consumers have accounts that carry different interest rates for different types of purchases (i.e., cash advances, regular purchases, balance transfers or ATM withdrawals), payments in excess of the minimum amount due must go to balances with higher interest rates first. A common practice in the industry had been to apply all amounts over the minimum monthly payments to the lowest-interest balances first -- thus extending the time it takes to pay off higher-interest rate balances.

Limits on over-limit fees: Consumers must "opt in" to over-limit fees. Those who opt out will have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees cannot exceed the amount of overspending. For example, going $20 over the limit cannot have a fee of more than $20.

No more double-cycle billing: Finance charges on outstanding credit card balances must now be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. So-called two-cycle or double-cycle billing hurts consumers who pay off their balances, because they are hit with finance charges from the previous cycle even though they have paid the bill in full.

Subprime credit cards for people with bad credit: People who get subprime credit cards and are charged account-opening fees that eat up their available balances get some relief under the new credit card law. These upfront fees cannot exceed 25 percent of the available credit limit in the first year of the card. Instead of charging high upfront fees, some issuers are charging high interest rates on these high credit risk accounts. After a subprime credit card issuer filed suit in federal court challenging the fee cap, the Consumer Financial Protection Bureau (CFPB) announced plans to allow unlimited fees before accounts are opened.

Minimum payments: Credit card issuers must disclose to cardholders the consequences of making only minimum payments each month, namely how long it would take to pay off the entire balance if users only made the minimum monthly payment. Issuers must also provide information on how much users must pay each month if they want to pay off their balances in 36 months, including the amount of interest.

Late fee restrictions: Late fees are capped at $25 for occasional late payments; however, the fees can be higher if cardholders are late more than once in a six-month period.

Gift cards: Gift cards cannot expire sooner than five years after they are issued. Dormancy fees can only be charged if the card is unused for 12 months or more. Issuers can charge only one fee per month, but there is no limit on the amount of the fee.

Law doesn't cover everything

Although the reforms were dramatic, they do not protect card users from everything. Issuers can still raise interest rates on future card purchases and there is no cap on how high interest rates can go. Business and corporate credit cards also are not covered by the protections in the CARD Act. If credit card accounts are based on variable APRs (as the vast majority now are), interest rates can increase as the prime rate goes up. Credit card companies can also continue to close accounts and slash credit limits abruptly, without giving cardholders advance warning. Many banks are finding ways around the law and launching new fees not specifically banned by the credit card reform law.

Not everyone has been aided by the new law. Stay-at-home parents found that they were penalized by a provision that requires issuers to assess the rule ability of the card applicant to repay their debt before opening a new account. A Federal Reserve rule required issuers to consider only individual rather than household income. Parents who don't work complained to lawmakers that this was unfair. The CFPB is reviewing the rule.

Updated: June 13, 2012

See related: Winners and losers 3 years after Credit CARD Act, Final Credit CARD Act changes take effect Aug. 22, 2010, Credit card reform and you, Interactive timeline: The road to credit card reform and future effective dates of the law, What the new credit card rules don't cover, Interactive look at what new monthly credit card statements would disclose,New credit card rules don't cover business, corporate credit cards,Fed caps credit card late fees at $25