

# The First Credit Card

**Ben Rogers**

*Driver, CU Tomorrow  
Filene Research Institute*



## About Us

Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs, the Institute examines issues vital to the future of credit unions.

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

CU Tomorrow is a Filene Research Institute clearinghouse for credit union young adult strategies. The project publishes research and open-source business plans to help credit unions attract younger members, promising young professionals, and younger volunteers. Initiatives include:

- **Business briefs**—open-source, young adult business plans for credit unions.
- **30 Under 30**—entrepreneurial SWAT team of young credit union professionals.
- **Community**—CU Tomorrow and Filene Web sites for publication and idea sharing.
- **Leagues**—statewide collaboration to implement CU Tomorrow programs.
- **Recruiting**—talented interns and new hires from high-profile universities.
- **Research**—academic research, focus groups, online surveys, and interviews.

Visit [www.cutomorrow.org](http://www.cutomorrow.org) for more details.



## About the Author



### Ben Rogers

The author, Ben Rogers, is driver of the Filene Research Institute's CU Tomorrow project and director of the Institute's 30 Under 30 group. Ben is a former editor of The CEO Report and chairman of the National Directors' Convention. Ben holds a master's degree in journalism from Northwestern University and graduated cum laude from Brigham Young University with degrees in English and philosophy.

## Acknowledgments

The Filene Research Institute would like to thank PSCU Financial Services, the nation's largest credit union service organization, for its generous financial support of past, present, and future studies of the under-30 population and the potential that young adults represent for the continued success of the credit union system. We also gratefully acknowledge the Credit Union Executives Society (CUES), Fiserv, and the Corporate Credit Union Network for their financial and intellectual support of research and projects focused on credit union growth.



## The Challenge

American youth are awash in plastic. One in three high school seniors carries a credit card.<sup>1</sup> Undergraduates report freshman year as the most popular time for getting credit cards, with 56% reporting having obtained their first card at age 18.<sup>2</sup> A young adult's first credit card is a rite of passage, a gateway to a solid credit record, and often a financial (and social) necessity.

Young adults, responsible or not, are very likely to get at least one credit card during the transition period after high school. Credit unions that decline to offer or to market their own cards to young adults miss the chance to build a relationship and a responsible credit user during that key transition phase.

Credit unions sometimes argue that issuing credit cards to young consumers with no credit history is irresponsible. But national issuers already sponsor events on high school campuses, mail offers directly to teenagers, and offer credit cards with limits as high as \$1,000 to 16-year-olds.<sup>3</sup> Two-thirds of college students have at least one credit card, and fully 91% of graduating seniors have one, according to Curtis Arnold, founder of CardRatings.com.<sup>4</sup>

Credit unions that want to deepen relationships with young adults have to offer an attractive competing product. Those that don't will miss the chance to capture an active borrowing relationship that lasts, on average, 15 years for credit cards.<sup>5</sup>

*“Banks have a strategy to seek out customers who have never had a card. College students are among the most prominent targets for this marketing. They are young and understand that they need credit to get ahead in the world. Some need credit because of the rising cost of a college education. Finally, most of them are clumped together on campuses that they either commute to or live at. This makes them easy to target.”<sup>6</sup>*

## Make It Yours

“In recent years, credit union membership and loan growth have sputtered. Interest income is sagging and the average member age is up to 47. Although some have recognized the power of Gen Y, few

1 Liz Pulliam Weston, “Teach Your Teen How to Handle Credit Cards,” [moneycentral.msn.com/content/collegeandfamily/raisekids/p40989.asp](http://moneycentral.msn.com/content/collegeandfamily/raisekids/p40989.asp) (retrieved October 17, 2008).

2 Nellie Mae, *Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends*, May 2005.

3 Libby Wells, “Card Issuers Target Teens for Latest Plastic Attacks,” [Bankrate.com](http://Bankrate.com), March 21, 2007.

4 Personal communication with the author.

5 Robert Manning, *Credit Card Nation* (New York: Basic Books, 2000), 167.

6 Edmund Mierzwinski and Christine Lindstrom, *Characteristics of Fair Campus Credit Cards*, U.S. PIRG Education Fund, April 2008, 1.

credit unions have expanded their lending products or policies to serve this demographic. Credit unions are starting to get Gen Y in the door, but many fail to offer starter lending products to meet their needs and lifestyle.”<sup>7</sup>

Citi offers co-branding with MTV. CapitalOne offers a slew of rewards. American Express offers prestige and exciting giveaways. Most credit unions cannot compete with such comprehensive rewards or marketing. Therefore, they should differentiate themselves—to students and to parents who recommend cards to their adult children—by offering a first credit card that is demonstrably better *for the first-time cardholder*.

Many young consumers don’t understand the fundamentals of interest payments or the financial risks of paying down a card with only the minimum payment. In fact, only 48% of high school seniors in a recent survey correctly said that a credit card holder who pays only the minimum amount on monthly card balances will pay more in annual finance charges than a cardholder who pays his or her balance in full.<sup>8</sup>

But young adults can still be responsible borrowers. A Georgetown University Credit Research Center study found that 88% of undergraduate student credit cards are, on average, paid on time and in good standing. The average for all adults is 91%. The average balance on a student credit card is \$552, about one-fourth the size of the balance of older adults and one-third the size of the balance of a non-student cardholder.<sup>9</sup>

## The Rewards Conundrum

Young adults are no different from older consumers in expecting rewards or incentives to use the card. Rewards cards are a double-edged sword: While they encourage higher use, they often charge higher interest rates, which young adults who carry a balance can ill afford. But cards that carry no rewards may not be as appealing to a “what’s in it for me” consumer.

Major credit card issuers are ramping up their spending on rewards programs, from a total of \$10.2 billion in 2006 to a projected \$18.4 billion in 2010.<sup>10</sup> Young adults are not much different from average

7 Mark Meyer, *COOL Solutions: Build Credit with Y* (Madison, WI: Filene Research Institute, 2006), 4.

8 JumpStart Coalition for Personal Financial Literacy, 2008 survey.

9 Michael Staten and John Barron, *College Student Credit Card Usage*, Credit Research Center, Georgetown University, McDonough School of Business, June 2002.

10 Curtis Arnold, *How You Can Profit from Credit Cards* (Upper Saddle Ridge, NJ: Pearson Education, 2008), 2.

consumers, and when it comes to rewards, American consumers prefer cash. After cash, their interests diverge significantly:

- 56% of Americans prefer cash-back rewards
- 23% prefer air miles
- 12% prefer points
- 9% prefer automatic discounts or rebates<sup>11</sup>

Credit unions should consider a rewards component with merchandise or, if possible, cash. As a responsible alternative for young adults who often struggle to accrue assets, consider cash-back rewards deposited directly to a share or other savings account.

## Characteristics of a Responsible Card

Credit unions' credit cards for first-time users should transcend common industry practices like high late fees, exorbitant interest rates, and other "gotcha" pricing (see "Credit Card Tactics to Avoid" on page 5).

Late fees on all cards have risen much faster than inflation, from an average of \$12.83 in 1995 to \$33.64 in 2005.<sup>12</sup> A responsible credit union card should still include late fees to motivate timely payments, but the fee should be nominal.

Student-oriented credit cards from 33 issuers carry an average APR of 15.26% as of September 2008, according to Arnold.<sup>13</sup> A responsible credit union credit card can be profitable while staying at or below this average.

With a renewed national interest in saving, credit unions can differentiate their credit card programs by offering a savings component, says Arnold. He points to the One Card by American Express, which deposits 1% of purchases into a 2.75% savings account. American Express calls it a "savings accelerator," but Arnold questions the \$35 yearly fee, which negates the first \$3,500 that cardholders spend. Other than that, he says, "I like the forced savings component. As Americans having a negative savings rate, I see this as a way to jump-start savings."<sup>14</sup>

Robert Manning, author of *Credit Card Nation*, has long criticized irresponsible lending and consumers' "cognitive disconnect" of spending all or more than they earn.

11 Ibid., 30.

12 Ibid., 13.

13 Personal communication with the author.

14 Ibid.

“Credit card companies encourage fantasies of easy money because students are so profitable. Teens have financial naiveté, high material expectations and responsiveness to relatively low-cost marketing campaigns, high potential earnings, and future demand for financial services.”<sup>15</sup>

He offers several suggestions for a starter card with credit union values:

- Offer a 1.9% introductory rate that rises steadily and predictably to demonstrate the real cost of carrying a balance.
- Share members’ credit scores with them once per year, along with information about how to improve it.<sup>16</sup>
- Allow up to three free over-limit or late payment fees per year.
- Link a savings or investment account to the credit card and allow members to deposit to it when paying their bill.<sup>17</sup>

Young adults are graduating from college today with much higher student loan balances. The average amount borrowed by undergraduate students increased by 39% to \$11,179 in the 10 years leading up to 2006–2007.<sup>18</sup> Experts forecast an even steeper increase in education expenses as a result of the 2008 credit crisis.<sup>19</sup> With education, living, and travel costs rising, students and non-students alike have increasingly relied on credit cards to make ends meet.

Parents can be your best partner in promoting a responsible first credit card to young adults for two reasons. First, parents are likely to trust their own credit union over a national card issuer as a place for their teenage or young adult children to receive their first credit card. Second, undergraduates (and probably non-students as well) report their parents as the second most common source for selecting a credit card vendor. The first is direct-mail solicitation. Consider pairing a direct-mail solicitation that explains to the parent why a credit union credit card is a responsible choice with a solicitation to the young adult.

Consider this advice from credit-card expert Arnold when crafting your communication with parents:

- Get a card with a low limit and no annual fees.
- Discuss the details of the card with your teen, including the interest rate on purchases and cash advances, fees, due dates, and grace periods. Review all transactions every month and discuss them with your teen.

15 Manning, *Credit Card Nation*, 169.

16 Filene i<sup>3</sup> hatched a product with a similar goal. Smart Score helps members understand the relevance and importance of their credit score. See [filene.org/home/innovation/i3ideas](http://filene.org/home/innovation/i3ideas) to get more information.

17 Robert Manning, personal communication with the author.

18 *Trends in Student Aid* (Washington, DC: The College Board, 2007).

19 Craig Karmin and John Hechinger, “Crisis Shakes the Foundations of the Ivory Tower,” *Wall Street Journal*, October 17, 2008, A9.

- Show your teen what finance charges will apply if the balance is not paid in full and on time. This includes any interest and fees.
- Realize that when teens reach a college campus, they'll be inundated with card offers and will be able to get a credit card, even if you are their sole financial support or are unaware of it.
- Be a good role model for your children. Show your teens your credit report and a credit card bill. If you have high credit card debt, explain how it happened and what you're doing to get out of it. You don't have to be perfect to set a good example.
- Discuss how everyone needs to limit card use. Explain that you'll be setting limits before your teens head off for school, and explain what will happen if they run up bills they can't pay. Will you be able—or willing—to bail them out, or will they be on their own? Lay out the consequences. It's much better that they know in advance.<sup>20</sup>

20 Arnold, *How You Can Profit*, 165.

#### CREDIT CARD TACTICS TO AVOID\*

Many financial institutions include clauses in the fine print of credit card contracts that allow them to change terms or charge unexpected fees. Here is a list of tactics to avoid to make your credit card the responsible choice:

- Capricious rule changes—Many issuers include clauses that reserve the right to change terms at any time or for any reason. Tell first-time credit card holders that you will never change terms on them without telling them why, in plain English.
- Exorbitant rates—Borrowers with no credit history deserve cautious underwriting, but research shows that first-time borrowers, especially students, can be good credit risks. They often can draw on family support. Offer a fair market rate to first-time borrowers and explain that their rate may improve and their limits may rise after responsible repayment.
- Variable due dates—Young members and their parents will appreciate a consistent monthly due date.
- Over-the-limit fees—Some issuers generate fee income by honoring a payment that exceeds the card's credit limit and then charging for the convenience. A responsible first-time credit card holder holds the line at the stated credit limit. Consider notifying cardholders who approach their limit that they may be eligible for a credit limit increase, but only if they have a history of responsible card management.

\* Summarized from Mierzwinski and Lindstrom, *Characteristics of Fair Campus Credit Cards*.

With concerns about responsible lending, it is increasingly likely that Congress will impose stronger restrictions on credit card underwriting and practices.<sup>21</sup> And at least one large issuer is seeing the light. Kenneth Chenault, CEO of American Express, recently told a gathering of policy experts, “I don’t believe a company has much of a future if it earns the majority of its revenues when customers make a mistake or don’t conform to a rule. ‘Gotcha’ pricing is not the way to build a sustainable business model.”<sup>22</sup>

21 Connie Prater, “Senate Banking Chairman: Credit Card Reforms on Tap,” [www.creditcards.com](http://www.creditcards.com), October 15, 2008.

22 [filene.org/blog/post/three-big-payment-ideas](http://filene.org/blog/post/three-big-payment-ideas).

#### USAGE TIPS FOR FIRST-TIME CARDHOLDERS

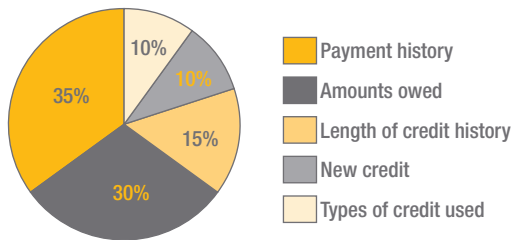
- Consider using a debit card instead of a credit card. A debit card accesses funds on deposit and can be used like a credit card without the potential damage.
- Avoid cards with an annual fee. A majority of credit cards no longer charge an annual fee.
- Read and understand all of the terms of the credit card agreement and be aware of all of the fees. Avoid cards with multiple fees.
- Avoid cards with an APR of 20% or more. There are many credit card offers with more reasonable rates.
- Pay off the balance every month. If you are unable to do so, cut up the card.
- Stay within your credit limit. If this is a problem, consider a credit card with a low limit of \$500.
- Understand that the introductory rate is typically for six months or more, and some card issuers use it as a bait-and-switch technique. The attractive introductory rate is often followed with an excessive rate after the introductory period is completed.
- Keep track of your bills and pay them on time. The Universal Default Clause allows credit card companies to increase your interest rate if you are delinquent on any payment, even if you are up to date on your credit card.
- Call your credit card company after your first late-payment fee. The first late-payment charge will often be forgiven if you have a good history of making timely payments. Pay your credit card bill well in advance of the due date, preferably when you get the statement—waiting until the last minute invites a late-payment fee.
- Remember that a poor credit record can affect your future employment and your ability to get a car loan or mortgage.\*
- If you move, notify your credit card company of your new address as soon as possible.

\* Meyer, *COOL Solutions*.

Another way to be a responsible young adult lender is to educate younger members about credit during their regular interaction with their cards, their bill, or their online account summaries. Consider repurposing or building on the free information about credit and credit scores available from the following:

- Fair Isaac Corporation—myFICO.com.
- AnnualCreditReport.com (not FreeCreditReport.com).
- Federal Trade Commission—[www.ftc.gov/bcp/menus/consumer/credit.shtm](http://www.ftc.gov/bcp/menus/consumer/credit.shtm).

Figure 1: What's in Your Score



Source: [www.myfico.com/CreditEducation/WhatsInYourScore.aspx](http://www.myfico.com/CreditEducation/WhatsInYourScore.aspx).

## The Rewards of Young Adult Lending

A responsible, attractive credit card for young adults is one of the clearest paths to a relationship with young adults. It reaches them at a time when their financial needs are mostly transactional, and it can be a gateway to other loans and, more proximately, deposit accounts.<sup>23</sup> Most consumers select their first financial institution before they are 25, and they remain with this institution for about 15 years.<sup>24</sup> Relationships with card issuers last just as long.

## What to Measure

Tracking the adoption and results of CU Tomorrow business briefs is essential. If you choose to launch a young adult transaction account similar to those outlined in this brief, please do these two things:

1. Record and report:
  - a. The number of young adult credit cards opened.
  - b. The cumulative average age of account holders.
2. Send your contact information and answers to the above questions to Ben Rogers at [benrogers@filene.org](mailto:benrogers@filene.org).

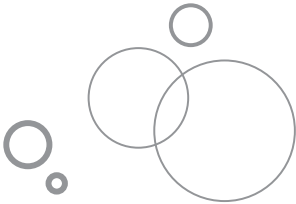
23 Benjamin Rogers, *Young Adult Transaction Accounts* (Madison, WI: Filene Research Institute, 2008).

24 Meyer, *COOL Solutions*.

## Cold Hard Facts

- The average consumer relationship with a credit card lasts 15 years.
- Sixty-nine percent of young adults aged 18 to 34 use credit cards, while only 53% use debit cards.<sup>25</sup>
- Fifty-five percent of students have paid for textbooks with credit cards; 24% have paid for tuition with credit cards.
- Undergraduates reported freshman year as the most popular time for getting credit cards, with 56% reporting having obtained their first card at age 18.
- Eighty-five percent of American households had a rewards card in 2007; 80% of cardholders received some type of reward for their cards.
- Late fees have risen much faster than inflation, from an average of \$12.83 in 1995 to \$33.64 in 2005.

25 Jinkook Lee, *Attracting Young Adults: What Do We Know about Their Use of Financial Institutions and Payment Behaviors?* (Madison, WI: Filene Research Institute, 2008).



**ideas grow here**

PO Box 2998  
Madison, WI 53701-2998  
Phone (608) 231-8550

**[www.filene.org](http://www.filene.org)**

PUBLICATION #176 (12/08)  
ISBN 978-1-932795-55-4

**filene**   
C U T O M O R R O W

READY...  
SET...  
GO