GUIDE TO STUDENT BANKING AND OVERDRAFTS

There are a lot of misconceptions associated with student bank accounts, overdrafts and debt. This guide breaks down some of these complex issues, and hopefully helps you to make decisions when managing your finances as a student.

What is an overdraft?

An overdraft is a pre-agreed amount that the bank lets you spend on top of the money you actually have in your account. Many Student bank accounts offer an “interest-free”, or 0% overdraft, i.e. there are no interest charges on the overdraft. When you go into your overdraft, it will show on your bank statement as a negative number. Think of it as emergency funding you can dip into if necessary, but that you will need to pay back eventually as it's not technically yours.

There are two main types of overdraft:

1. An arranged overdraft – This is the amount pre-arranged with your bank that you're allowed to borrow in your current account, and it is sometimes referred to as a 'planned', 'authorised' or 'agreed' overdraft.
2. Unarranged overdraft – This is when you exceed the pre-agreed amount you've arranged with your bank. This is sometimes referred to as an 'unplanned' or 'unauthorised' overdraft, and the bank tends to charge you fees when this happens.

Why is having an overdraft useful?

- The main benefit is because it is an extra source of money you can dip into when you need it. As a student you are likely to experience ‘peaks’ and ‘troughs’ - especially as most students will receive their student finance across three instalments to cover the full academic year. This overdraft can be useful to help you with additional funds when you need and also manage cash-flow between loan instalments.
- This is also handy as usually the overdraft facilities on student bank accounts come with 0% interest (depending on your credit score - make sure you check this!). If you’re likely to be spending a significant amount of time in your overdraft, this feature is useful in order to avoid accumulating extra charges on what you spend.

What are the downsides of overdrafts?

- An overdraft is essentially a loan, so you'll have to pay it back. So the less you borrow, the less you'll have to repay later. Therefore, while an overdraft is a good backup to have in case you require emergency funds, you don't have to use it just because it's there.
- If you exceed your overdraft limit, you'll have entered into an unauthorised overdraft – at which point you'll either face a penalty fee or your payment will bounce.
- The student overdraft is not 0% interest for life - once you finish university, if you have not paid off your student overdraft, make sure you switch to a graduate account. This is because some graduate accounts will give you time to pay back the overdraft interest free over time, but please check your terms and conditions of this with your bank.

Which bank account/overdraft should I choose?
We cannot recommend a specific bank account to choose as financial advice is a regulated area. However both [Save the Student]() and [Money Saving Expert]() websites list some of the most popular student bank accounts. Please read your bank's terms and conditions carefully before deciding to take out an overdraft.

What is the impact of an overdraft on my credit score?
A credit score is a tool used by lenders to help determine whether you qualify for a particular credit card, loan, mortgage or service. Students are often reluctant to get a student bank account because they believe an overdraft may affect this credit rating.

However, an arranged overdraft is unlikely to have a major impact on your credit score as long as you don't go beyond your overdraft limit or have payments refused. In fact, sensible use of an overdraft by regularly paying it off could actually improve your credit rating. Lenders will be able to see that you have an overdraft, what your limit is and how much of your overdraft you are using. If lenders can see that you stay within your agreed limit and regularly clear your overdraft, then it shows them you are a reliable borrower. This means you are more likely to be approved if you apply for another form of credit such as a credit card or mortgage.

However, it should be noted that your overdraft will adversely affect your credit score if you aren't careful with it. If you regularly go above your overdraft limit it will damage your credit rating. Lenders will be able to see that you do not stay within your agreed limit, and this may mean you would be less likely to be approved for another form of credit such as a credit card or mortgage.

Good Vs Bad Debt
There are different kinds of debt, some of which are worse than others.

A good debt is one that could be considered a sensible investment in your financial future, as it may help you in the long-term and should not have a negative impact on your overall financial position. You will have a clear reason for taking it out, and a repayment plan that allows you to clear the debt in a realistic and manageable way through affordable payments. This includes a mortgage, or more commonly for students, this may include student loans for maintenance and tuition fees, and interest free bank overdrafts. These debts are often not seen as 'bad' debt, and with careful management you can use these funds without finding yourself with unmanageable repayments during your studies or after graduation.

There are other forms of debt that you should try to avoid. Bad debts are those that are not affordable and are also likely to have no realistic repayment plans.This includes large credit card debt because of its high interest rates and low minimum payments, as well as using any unauthorised overdrafts as these too are likely to carry a high interest rate for borrowing.

There are some types of debt that you should try to avoid no matter what. Seek advice if you are considering payday loans or using doorstep lenders to enable you to meet your costs. The interest rates are often well over 1000% and the repayment terms can be very difficult to manage.

This website contains more information on good debt vs bad debt, and for more information on dealing with debt, see the following University webpage.