US banks

Credit card providers count cost of customer freebies

With losses on the rise, the end of the ‘rewards war’ is on the horizon

Extensive perks, including cashback offers, Uber credits, air miles and preferential hotel rates could be scaled back by credit card companies © FT montage; Bloomberg

AUGUST 17, 2017 by: Alistair Gray in New York

“Jason, you’ve had a rewarding year,” read the pamphlet. “A year of colourful memories. A year of perfect views.”

The recipient could hardly disagree. After a year of holidays and eating out on his credit card, the Manhattan millennial has racked up almost $2,500 worth of points he can use towards hotels, airfares and other expenses. The issuer, Chase, wrote to him last week, reminding him of the perks on offer if he keeps the wafer of shiny dark metal in his wallet.

Jason is one of millions of Americans enjoying the spoils of a credit card rewards war. But whether such deals will prove so rewarding for card issuers is less clear. With losses from soured loans on the rise, executives are facing questions from investors about how they can justify the splurge.

Jeff Morris, head of US equities at Standard Life, says: "From an investor standpoint, it is still to be determined how attractive some of these reward programmes are going to be."

Brian Riley, a director with the payments consultants Mercator Advisory Group, adds: "You can bring customers in, but at what cost? These rewards become very hard to justify. You have decreasing profitability with this arms race going on."

Credit card debt hits record high

US revolving consumer credit ($tn)

Source: Federal Reserve
© FT

Card issuers will produce a return on assets (ROA) from US credit cards of 3.5 per cent next year, down from almost 5 per cent in 2014, forecasts Mercator.

Even so, for now at least the business remains among the best performing corners of the retail banking industry. The ROA of 4 per cent last year was about three times higher than that of the wider sector, whose profitability has been hurt by low interest rates.

Issuers have several ways to make money. About a quarter of cards carry annual charges, according to CreditCards.com. Jason's Chase card, the Sapphire Reserve, has a levy of $450 per year.

Providers charge a raft of other fees, including a typical cash advance levy of $10 or 5 per cent, whichever is greater. More than half of cards carry foreign transaction fees, typically about 3 per cent.

More importantly, customers who fall behind on monthly payments and borrow on their cards — known in the industry as "revolvers" — are whacked with interest charges. These often run to more than 15 per cent, considerably higher than other types of loan.

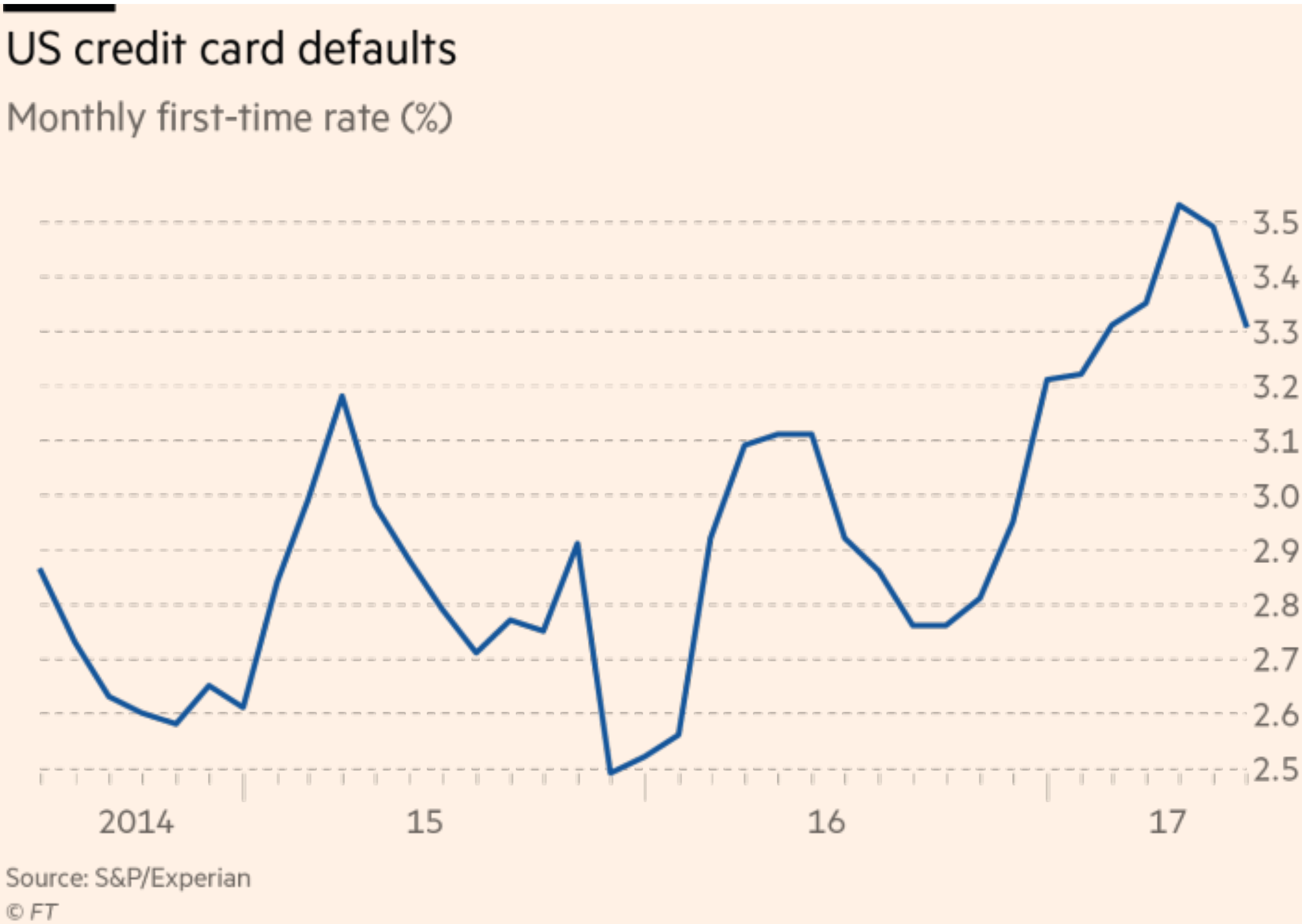
"It's not that hard to make money when you're charging those APRs [interest rates]," says Michael Taiano, director at Fitch's financial institutions group.

To be sure, savvy consumers avoid such charges. And annual levies on the best cards are typically dwarfed by the rewards. Tie-ups that providers have with retailers and other companies make the points go even further. Jason's sign up bonus alone covered a first class flight from Frankfurt to New York.

Despite such costs, banks are especially eager to woo big spenders since, as well as charging fees to cardholders, they also take a slice of every payment.

Regulation places tight restrictions on those merchant fees on payments made by US debit cards, but not credit cards. Visa and MasterCard cards carry average merchant fees of more than 2 per cent, according to the Nilson Report. The haul came to $47bn last year, split between card networks and issuers.

All told, says Mr Morris of Standard Life, credit cards "remain attractive from a yield and return standpoint".



Banks continue to pile in. Citigroup recently put US credit cards at the forefront of its turnround strategy. Citi, which last year added about $11bn worth of Costco credit card assets, is sweetening some consumer offers. Last month it unveiled enhanced benefits for its Prestige card.

Yet there are signs providers are starting to rein in the most aggressive deals. David Nelms, chairman and chief executive of the credit card group Discover, says the level of rewards competition for creditworthy borrowers has “reached a plateau”.

Chase earlier this year halved the sign-up offer on the Sapphire Reserve. Brian Kelly, founder and CEO of The Points Guy website, describes the initial bonus of 100,000 points as “psychotically good”. “People thought it was crazy,” he says.

Pamela Codispoti, president of Chase Branded Cards, says she is delighted with the response from consumers. “We spent zero dollars on marketing and we invested instead in a large sign on bonus. The engagement with the product was like nothing we’ve ever seen before.”

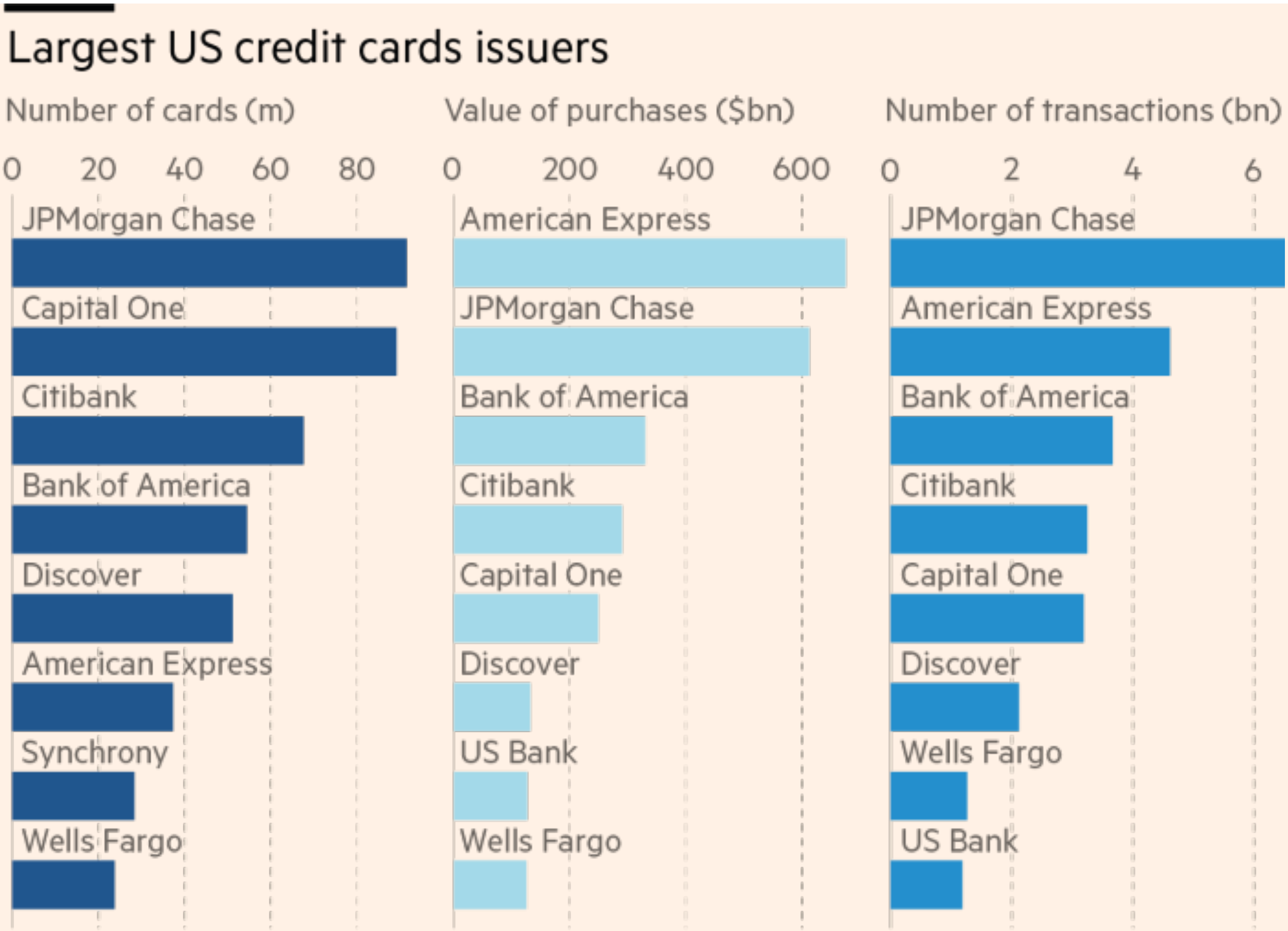
And she adds: “The reason we’re interested in these customers is because they’re valuable. These are the customers that everyone wants. We’ve now acquired them.”

Consumers are certainly lapping up the deals, and spending more on the cards. Total outstanding credit card balances recently hit a new record of more than $1tr, according to the Federal Reserve.

At the same time, losses from bad loans are beginning to tick up. The trend worries David Rosenberg, chief economist at Gluskin Sheff, given that unemployment remains low. “Imagine what happens when the jobless rate does embark on a renewed uptrend,” he says. An economic downturn would make the reward schemes harder to justify.

Other factors could hasten the end of the rewards war. Regulators in other markets, including Europe, have curbed merchant fees and points programmes there are stingier.

US authorities have already cut such fees on debit cards as part of post-crisis financial reforms. While they look unlikely to extend those restrictions to credit cards for the time being, given the Trump administration’s deregulation agenda, Mr Riley reckons they will do so “sooner or later”.



Source: Nilson
© FT

Meanwhile, Wall Street is scrutinising how many of the customers who have been lured recently by lavish sign-up bonuses are prepared to pay renewal fees to keep the cards.

"The challenge you have with higher upfront bonuses is you attract people for the bonus and then they leave," says Ravi Acharya, head of consumer lending and innovation at Santander. "The industry has gotten a little exuberant . . . There's a rationalisation of where those rewards are going to go."

Banks are now trying to strengthen relationships with the customers they have acquired. This summer, Chase is offering 100,000 points — worth about $1,500 — for its credit card users who take out a mortgage. "You'll see more of these types of these opportunities to deepen these relationships," Ms Codispoti adds.

Next month, rival Bank of America is launching its "Premium Rewards" card. The rewards are generous — but mainly for customers who have at least $20,000 in balances with its bank or investment accounts.

Those consumers who want the best deals may be well advised to pounce while they still can.

Zero rate deals: the UK name of the game

"Points mean prizes" was the catchphrase of the British game show *Play Your Cards Right*. But this ethos does not apply to the UK credit card market, **writes the FT's Claer Barrett.**

Zero rate deals, rather than loyalty points, are the name of the game for credit-hungry British shoppers. As UK interest rates have fallen, the number of interest-free months offered by major UK credit card lenders has been steadily increasing.

This year, several UK lenders launched credit cards with a record-breaking 43-months of 0 per cent interest. Customers who transferred a balance could theoretically pay nothing to borrow thousands of pounds for more than three and a half years, although some lenders are now tempering the length of these deals.

While the inducements appear tempting, says Lindsay Cook, founder of the UK consumer finance website Money Fight Club, they are "just the credit card industry's way of hooking you in".

"For years, people with sizeable credit card debts have been able to 'rate surf' by moving their debt from one card provider's 0 per cent deal to another's," she says.

This is not without cost — usually, she says, consumers will pay a percentage fee (typically 1 to 3 per cent) of the value of the debt they are transferring.

Another way the card companies make money is by offering 0 per cent interest on new purchases for a fixed period — potentially a year or longer.

"When these zero rate periods end, the card company will dramatically hike the level of interest being charged on those purchases and this can catch people out," Ms Cook says. "Unless borrowers have been sensible and paid down their debts, they will have to pay to switch again and access another cheap deal. Clearly, this cannot go on forever."

UK credit card debt has already surpassed pre-crisis levels, and the Bank of England has been among those to express concern.

The BoE's figures show that consumer credit — borrowing via credit cards, personal loans and car finance — grew at an annual rate of 10 per cent in the year to June, increasing pressure on policymakers to increase interest rates.