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MARKETS

Shoppers Love Rewards Credit Cards. Retailers Hate Them.

Merchants want the right to reject some rewards credit cards, citing high interchange fees



Target Corp. is one of the merchants pushing for the right to reject some rewards credit cards.

PHOTO: LM OTERO/ASSOCIATED PRESS

By *AnnaMaria Andriotis*

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Consumers have become addicted to credit cards with generous rewards programs. Retailers are trying to cut them off.

Large merchants including Amazon.com Inc., Target Corp. and Home Depot Inc. are pushing for the right to reject some rewards credit cards, which typically carry higher fees for merchants. They are likely to opt out of a roughly \$6.2 billion settlement Visa Inc., Mastercard Inc. [MA 0.35% ▲](#) and several large banks recently reached with merchants and continue to make their case in court, according to people familiar with the matter.

The retailers are trying to end the card networks' "honor all cards" rule, which requires merchants that accept Visa- or Mastercard-branded credit cards to take all of them. If merchants could pick and choose among Visa or Mastercard credit cards, those with the highest merchant fees—and most generous rewards—likely would be on the chopping block.

Ultimately, though, the retailers are looking for bargaining power that could help them lower fees across the board.

The stakes are high all around. Rewards credit cards such as JPMorgan Chase & Co. 's Sapphire Reserve, Capital One Financial Corp. 's Venture and Citigroup Inc. 's Double Cash are wildly popular among consumers for

their perks like cash back, airfare and hotel stays. Some 92% of all U.S. credit-card purchase volume is currently charged on rewards credit cards, up from 86% in 2013 and 67% in 2008, according to estimates from Mercator Advisory Group Inc., a payments research and consulting firm.

Yet merchants say the most generous rewards credit cards with the highest fees are cutting into their profits. When shoppers pay with Visa or Mastercard credit cards, merchants are charged interchange fees that are set by the card networks and funneled to the banks that issued those cards. These “swipe” fees vary widely, but are higher on rewards credit cards—sometimes around 3% of the cardholder’s purchase price.

Banks have come to rely heavily on the fees they earn from credit cards. All told, merchants paid credit-card issuers \$43.4 billion in Visa and Mastercard credit-card interchange fees in 2017, up 68% from 2012, according to the Nilson Report.

Rewards credit cards and a broader consumer shift to cards from cash have fueled big gains for Visa and Mastercard in recent years. Shares of Visa and Mastercard have soared 31% and 46%, respectively, so far this year.

An upending of the fee structure could lessen the incentive for small banks to issue credit cards, said Brian Riley, director of credit advisory services at Mercator, cutting into the fees the card companies collect and leaving them with a customer base more heavily made up of big banks that have more clout to negotiate directly with merchants.

“The long-term risk to Mastercard and Visa still centers on interchange more than anything else,” said Mr. Riley. “In the next three years, there’s going to be a shakeout.”

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Card networks say preventing merchants from picking and choosing among credit cards creates a frictionless experience for consumers. They argue their rule also creates an even playing field by making sure credit cards issued by banks large and small are accepted.

“If a merchant agrees to accept Mastercard, there cannot be any discrimination between different issuers’

cards or between different types of cards issued by one financial institution,” a Mastercard spokesman said.

“Visa believes consumers should always have a choice in how they pay, including being allowed to use their Visa credit card regardless of the card type or issuer. When consumer choice is limited, nobody wins,” said a Visa spokeswoman.

The lead lawyer for a group of merchants suing Visa and Mastercard to end the “honor all cards” rule said merchants aren’t trying to take away consumer choice. “What merchants want is the right to negotiate the terms of acceptance like they do with vendors in every other aspect of their business and partner with banks directly,” said Jeffrey Shinder, a managing partner at Constantine Cannon LLP.

Retailers have been battling for years to lower interchange fees and relax the rules governing credit-card agreements. A class-action lawsuit filed in 2005 alleged that the policies are anticompetitive.

While that lawsuit is closer to a resolution with the \$6.2 billion settlement, Visa and Mastercard are likely to continue battling with Amazon and other retailers that previously filed separate lawsuits challenging the “honor all cards” rule.

A recent court ruling may bode well for the card companies. The Supreme Court earlier this year ruled in favor of an American Express Co. policy that prevents merchants that accept AmEx from offering customers discounts and other incentives to pay with cheaper credit cards.



JPMorgan Chase’s Sapphire Reserve was so popular among consumers, the company temporarily ran out of metal used to manufacture the cards. PHOTO: JPMORGAN CHASE/ASSOCIATED PRESS

Banks began rolling out more generous rewards credit cards about six years ago in an effort to challenge AmEx, which dominated the market for wealthy consumers. Citigroup ramped up the rewards-card race in 2013 with its Prestige card. JPMorgan rolled out its Sapphire Reserve card three years later, and U.S. Bancorp introduced the Altitude Reserve card in 2017.

The credit cards have annual fees of around \$400 or higher, large sign-up bonuses in exchange for sizable spending in the first few months of usage, and travel benefits that range from airport lounge access to travel expense reimbursement. Sapphire Reserve was so popular, JPMorgan temporarily ran out of the metal used to manufacture the cards.

As more cards were launched with higher swipe fees, they became harder for retailers to avoid. For years, some merchants had opted not to accept costlier AmEx cards, but rejecting Visa and Mastercard could result in a steep decline in sales. (Unlike Visa and Mastercard, AmEx both operates the card network and issues its cards. An AmEx spokesman says that on average

the current cost of accepting AmEx is about the same as Visa and Mastercard.)

Visa and Mastercard premium credit cards charge some of the highest interchange fees, often north of 2.1% of the purchase amount, compared with roughly 1.2% to 1.7% on nonpremium credit cards.

Interchange fees are often comprised of a flat fee plus a percentage of the dollar amount of a cardholder's purchase. The fees vary based on several factors, including merchant type and fraud rates, and they aren't fixed. Large merchants try to negotiate those fees. Amazon, for example, has been working to negotiate lower interchange fees with Visa and Mastercard for years on the grounds that it has lower fraud rates than many online merchants, according to a person familiar with the matter.

Amazon and many other large merchants also have their own credit cards, typically in partnership with a bank and a card network, that are designed to boost shopping at their stores. Merchants rarely pay interchange fees on those cards when they're used at their stores.

For some merchants with lower margins, like grocers, the fees can have a big impact. Kroger Co. unit Foods Co Supermarkets stopped accepting Visa credit cards in August after the two companies failed to reach an agreement on swipe fees.

Kroger Chief Information Officer Chris Hjelm said in an interview at the time that the growing use of rewards credit cards factored into the decision.

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