CONSUMER FINANCE PODCAST - REWARDS PROGRAMS AND THE CO-BRAND RELATIONSHIPS BETWEEN CREDIT CARD ISSUERS AND MERCHANTS
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Chris Willis (00:05):

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the Co-Leader of Troutman Pepper's Consumer Financial Services regulatory practice, and I'd like to welcome you to today's episode, which is going to be all about credit card co-brand programs. But before we jump into that topic, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, where you'll find daily updates about everything going on in the Consumer Financial Services world. And don't forget to check out our other podcast, we have lots of them. We have our credit reporting podcast, *FCRA Focus*, we have one focused on crypto, *The Crypto Exchange*, and our privacy and data security podcast called *Unauthorized Access*, all of which are available on all popular podcast platforms. And if you like this podcast, let us know, leave us a review on your podcast platform of choice.

Now, as I said today, we're going to be talking about all things related to credit card co-brand arrangements and agreements between credit card issuers and merchants. And I have the perfect person on the show today to talk about, and that's my partner, Glen Trudel. Glen occupies a special hybrid role because, not only is he very experienced in the regulatory issues surrounding credit cards in general and credit card rewards programs and co-brand relationships, in particular, but he also has a massive amount of experience in drafting and negotiating agreements and deals between issuers and merchants for co-brand credit cards. This has been something Glen's been doing for decades, and so he's a real expert on it.

So, Glen, thanks a lot for being on the podcast today.

Glen Trudel (01:32):

Thanks, Chris. Very glad to be here.

Chris Willis (01:34):

So, Glen, in the world of rewards and loyalty programs, co-brand credit card pairing between an issuer and a merchant is often viewed as a key or even critical part of the offering by both parties. Why are they viewed as so important by both the issuers and by the merchants?

Glen Trudel (01:50):

For both the issuer and the merchant they've long discovered that these co-brand programs further both of their goals. From the merchant perspective, it is a great way of increasing sales, building customer engagement, brand loyalty, and as it relates to their relationship with the financial institution, the card issuer gives them access perhaps to more and different data on consumers, which again, feeds into their ability to market to those consumers.

From the perspective of the bank, obviously, it's no secret they've learned that customers will often choose credit cards almost based solely on the sort of rewards that are available to those customers under those card programs. And this means increased usage, which means increased interchange income, finance charges, that sort of thing. So, it's been long touted as sort of a win-win.

And this is true, regardless of whether, for example, the rewards program is a card-specific rewards program, which is where the membership in the rewards program is limited only to cardholders, which is the strongest back benefit based on the popularity of the rewards, or in a more general or what we would refer to as tender neutral, it's a multi tender program where membership is open to any customer. You think of your airline frequent flyer programs or your hotel programs or where there are multiple ways that a customer can earn points, not just through use of a credit card, and indeed, they may be payment method agnostic. In those cases, a bank can still gain additional benefit by making additional benefits available to the cardholders, whether they're point accelerators or signup bonuses, that sort of thing, or things that are not specifically related to loyalty currency.

And you think of, for example, in an airline program, the first check bag for free, lounge access, status tiers, that sort of thing, and there are many other types. But, ultimately, it's about both parties advancing the goals of their organization through the use of this pairing and customers love it.

Chris Willis (03:50):

Glen, what I love about talking to you is I always get such a great insight, and it's not just the legal issues that we're talking about, but also the business concerns that motivate the deals in the first place. I just wanted to say that. But having gotten that out of the way and thanking you for that, let's look at these co-brand rewards relationships, both from the standpoint of the merchant and the retailer and then from the issuer. So, from the merchant to retailer standpoint, what are some of the issues or concerns or risk that that party needs to deal with or anticipate in participating in a co-brand rewards program with an issuer?

Glen Trudel (04:23):

There are a couple of things that I can bring up, for example, on the merchant or retailer side. Probably the biggest single issue for them is managing and controlling the costs. This isn't always the case, but typically in these programs and particularly in the larger programs, the merchant is bringing the rewards program to the card relationship. And so, there is that aspect of controlling costs. Now, a lot of those costs may be put on to the bank, which may be acquiring the points that the customers are using or paying for the redemptions, but there is this tug of being able to supply the various, whether it's for points or rewards or items or what have you, to the extent that it's giving the customer what the merchant would otherwise sell to the customer, there's forgone revenue that can arise from that, whether it's an airline ticket or a hotel room or merchandise or what have you.

And there may be increased cost of delivering benefits, especially when you get past things that you can throw in a bag and ship and becomes more like experiences or first pitch or this kind of thing. The cost can go up. And particularly if they're receiving a static revenue on a pro point basis, then there could be a disconnect there, and that's certainly a concern.

The other aspect is sometimes these are very successful from the merchant's standpoint and the rewards program begins to become seen more as a profit center than as a way of increasing customer flow. They make as much, or in some cases, perhaps more than they might make from that customer otherwise through things like breakage, the concept that people are earning points and not using them. The merchant may have gotten paid for those points so there is a breakage there and they can recognize revenue over time as a result of that.

And they begin to get a tug of war where there's an increased dependence on that revenue. From the merchant perspective, they're playing more not to lose as opposed to win and that can be at odds with what the bank wants, which is to increase cardholder usage and so forth. And so those are some of the issues that they have as well as to the extent that the bank has the ability to wield its terms and conditions for issues like application acceptance and those acceptance rates and dealing with the bank, those are some of the issues and concerns that a merchant may have in connection with these programs.

Chris Willis (06:30):

And I assume all those become subjects of negotiation in the arrangement between the issuer and the merchant and retailer, and both parties need to be aware of that and the motivations behind them in order to successfully reach a deal, I assume, is that right?

Glen Trudel (06:45):

Oh, that's absolutely correct, that is part of it. And the example that I gave where your rewards or the points are being purchased at a certain set rate, once that's agreed at the agreement upfront, the merchant is kind of living over with the results of that. And so, as part of these discussions, there's always this tug of war over who controls what basically in the rewards program and some of the levers of that, whether it's merchandise or experience selection, the ability to change them, and that sort of thing. And in fact, there's typically a lot of discussion in that regard.

Chris Willis (07:16):

Well, let's look at the other side participating in this tug of war, which is, of course, the issuer, the bank that's going to be issuing the credit card. Give me a rundown and give the audience a rundown, if you would, of what are the concerns and issues that the issuer is going to have when it participates in a co-brand rewards program.

Glen Trudel (07:33):

As I mentioned earlier, often these points are being purchased by the bank, from the merchant in the course of redemption, what have you, and those might be at a fixed amount. The concern is that if there's a lot of control by the merchant in the ability to assess value to those points that you could have a dilution and point value where more points are required to redeem for the same flight or hotel or merchandise or what have you, and that affects the value that their cardholder customers are actually getting versus what the bank may have actually paid for those points. There again is a dichotomy. And so, in the agreements, and as part of the discussion of the rewards program relationship, the bank will be looking for some protections, whereas a merchant may be more reticent about what they can promise both in terms of valuation and in terms of supply of what these merchandiser experiences or the stuff of the rewards program might be. And this becomes a big issue in discussion in these sorts of relationships.

Another concern is around maintaining meaningful rewards. Customers looking in the marketplace and seeing what else is out there, do they really motivate customers to use the card? The merchant may have other motivations from making something part of a rewards program that may or may not directly be appealing to somebody trying to decide whether to use their card versus some other method of obtaining points. And that becomes an issue, particularly in the tender neutral sorts of programs that I alluded to earlier.

It's keeping the rewards fresh if you will. And who decides? And part of the agreement is deciding who decides what rewards are offered and how much they may be valued at from a points perspective. You're looking for creative rewards just beyond merchandise discounts. When we get into perks like experiences or services and things like that, there may be increased costs and then there may be differences of opinion as to what their value is, and then the other issue is who gets to pay for all those increased costs? That can be part of, certainly, of the discussion as well.

Another concern for banks is keeping card usage as the best or most efficient way to earn points. You see this problem in tender neutral programs, where you've set up a co-brand program, but that's not the only way that the customer can earn points, if those other methods of earning points the customers perceive is a more efficient way of gaining rewards, think again air miles programs and that sort of thing, the card program may be sort of left in the dust. There the bank is not getting the benefit they were bargaining for, that becomes an issue as well. So, in those sorts of programs, in the agreements, there may be promises by the part of the merchant to make sure to preserve the card as the best method of gaining points on the part of the cardholder and that sort of thing, or at least that's certainly the attempt that the banks might be looking for.

Chris Willis (10:11):

That's a great summary of the business considerations from the issuer's side in one of these relationships. Can we step back for a minute now and let you tell our audience about some of the trends or issues that you're seeing in the marketplace right now for credit card rewards programs? What's going on out there?

Glen Trudel (10:28):

Sure, Chris. With the pandemic and the emerging societal changes that are happening as a result, a lot of these programs are being revamped and tweaked and modified either to be made more lucrative to consumers in order to stay competitive or other changes are being made, really, all part of an enhanced level of marketplace experimentation. I think we're seeing a real burst of experimentation in these sorts of programs, whether it's by having specific categories of higher earnings, I think we're seeing more variation on that. We're seeing attempts to increase customer choice and their sense of empowerment in these rewards programs, again, in a bid to increase participation, and really leveraging payment technologies and alternative payment structures like buy now, pay later, or the ability to use your phone as your credit card, and all those sorts of things to increase convenience for the customer in using their account in the hopes that they'll use it more frequently and/or to distinguish one card program from another. They're trying to come up with the next new thing, but the next new thing that's going to be perceived by the consumers as a good thing to have or a convenient thing or a useful thing to have or value because that's really what drives customer decision.

Now, these attempts to revamp these programs and to have all of these additional options and these additional choices and that sort of thing, raise issues. This increased complexity in these rewards programs leads to some regulatory issues for a bank and a merchant in that they're increased chance of UDAP issues, which can arise as the disclosures become more complex and the possibility of customer confusion becomes more likely.

Now, there are ways of dealing with this, not only just keeping clear of plain disclosures, obviously, that's the goal, but it's the complexity that's making that more difficult. You want to be able to make sure that your rewards programs, for example, are delivering sensible outcomes, avoiding irrational consumer choices built into the program, such as, for example, having points that are redeemed in one category for an item or an experience be at a different level than if it's redeemed in another, online versus over the phone or what have you, whatever it is, these sort of irrational choices which can lead to be seen as unfair, or not taking advantage of any particularly vulnerable or protected classes in your disclosures or in how they're administered.

And with administration, it's important that you have robust training programs. The last thing you want is for a regulator to take some calls and listen as your reps are struggling through trying to explain these complicated new rewards programs to someone who doesn't understand or has a question, or worse, gets it wrong and misrepresents what the program actually does and what the parameters are. So, training has become even more important in these situations.

And also, they have to keep an eye on developing legislation in this area. Normally I recommended that when you do have a rewards program that is going to be wound down, I've typically said, "You give notice to the customers, you give them 90 days to continue to earn points, and in a concurrent period of up to 180 days to be able to continue to redeem those points," as a rule of thumb for giving customers adequate notice and avoiding charges that they've somehow committed a bait and switch on the customer, telling them it's going to be this great program and then cutting them off or making promises that they're not keeping, et cetera.

And in fact, recently there was a legislation that was passed in New York regarding disclosure periods for customers in the event of a termination of a rewards program, which sets up, I think it was at least a period of about 90 days for earning and redemption of points. And so, banks have to be cognizant of that law, which may be directly applicable or certainly a cautionary tale in terms of dealing with the customers in the event that a rewards program is wound down. But this is an area that the CFPB has looked at and has expressed concern on over the years.

Several years ago, it was 2017 to be exact, the American Bankers Association provided a letter to then-Director Cordray, basically setting out guiding principles of its membership for management of rewards programs. And it's not a terribly long missive, but transparency and disclosure was at the heart of that letter and is something that the banks and merchants alike need to be keenly aware of. That's one issue that's becoming a bigger issue as a result of the brief complexity of these rewards programs.

Chris Willis (14:54):

Glen, that was a terrific rundown on what's going on on the regulatory front, and we definitely need to keep our eye on whether we have more states besides New York passing legislation about credit card rewards programs, which again, that one was just, I think, signed by the governor very recently. So, it's been evident, obviously, throughout this discussion to me, and I'm sure to our audience, just what an encyclopedic resource you are with respect to both the business and the regulatory side of these programs.

Glen, I want to thank you for being on the program today, and of course, thank our listeners for tuning in as well.

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