Financial Conduct Authority

MS14/6.2: Annex 5

Market Study

Credit Card Market Study

Interim Report: Annex 5 – Firm business model analysis

November 2015

Introduction

1. This annex summarises issuers' approach to evaluating profitability, as well as a summary of the role of affinity and co-branded providers in the credit card market.

2. The information reported here draws on credit card issuers' responses to the market questionnaire and the responses of 20 co-brand/ affinity partners' (both commercial and charitable partners) to a voluntary market questionnaire that we sent to affinity and co-brand providers in the market.

Issuers approach to modelling profitability

3. Our analysis of the responses of 24 issuer responses to our market questionnaire suggests that:

   - Issuers use a variety of approaches to modelling the profitability of their credit card portfolios. Some model profitability on a risk segment, product, acquisition channel or whole portfolio level or a combination of these.
   - Issuers carry out profitability assessments to understand whether a particular product or acquisition campaign is viable.
   - Issuers tend to forecast profitability by estimating the behaviour and performance of groups of consumers who are assumed to have taken out the same product in the same month (referred to as the consumer 'cohort').
   - In general, we find issuers assess profitability over a five year basis, using some form of discounting model.

4. Below we describe the general approach used by issuers to model profitability, followed by a description of the implications of product type and consumer behaviours on profitability.

Four steps to modelling profitability

5. From our assessment, we find four key steps that issuers tend to use when assessing the profitability of a particular product/ acquisition channel.

   - Step One: Input Assumptions
   - Step Two: Forecasted Base Curves
   - Step Three: NPV Calculations
   - Step Four: NPV Summary Output

6. Taking each in turn.

Step One: Input Assumptions

7. To inform their input assumptions, issuers consider consumer behaviours and revenues from a similar product or acquisition campaign to the one they are considering launching. For example, in assessing the likely average balances over the life of a 'new' product, they will use historical data to assess average balances for

similar products in their credit card portfolio. Information on historical products, is used to build 'base curves', which are explained in more detail below.

Step Two: Forecasted Base Curves

8. This section provides a description of:

- **'base curves'** and how they inform profitability modelling
- **types of 'base curves'** used to identify key drivers of revenue and costs

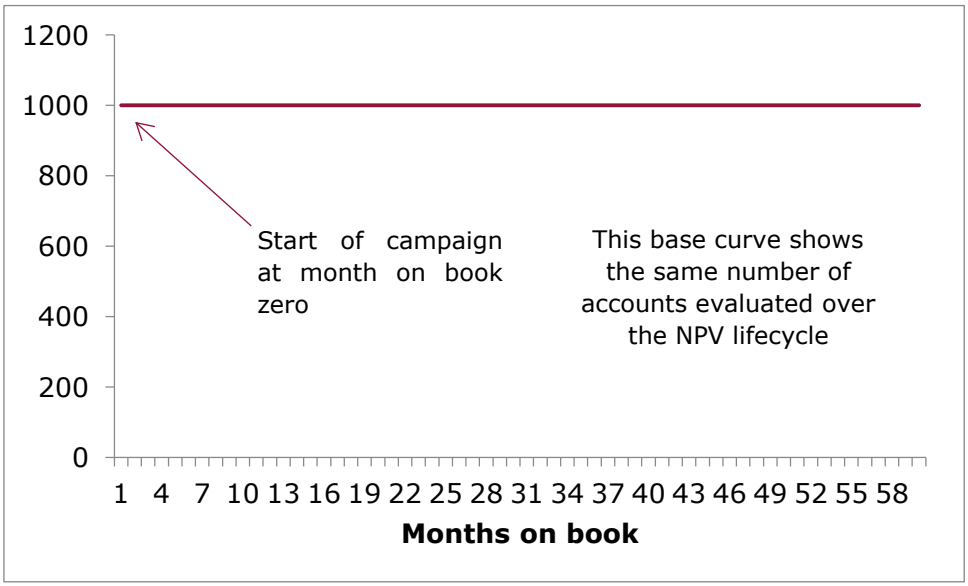
Base curves

9. Base curves are used by issuers across the market to understand the key profit drivers of credit card products or acquisition campaigns. They help firms assess the likely implications for profitability of different product designs (such as combinations of credit limit, purchase interest rates, promotion rates, balance transfer options, cash advance options, rewards, etc.) and consumer behaviours (for example, consumers that tend to transact).

10. Base curves are a forecasting tool used by issuers to show the behaviour of the average consumer in a particular cohort, for example, how balance or revolve rates for the average consumer change on a monthly basis (referred to as consumer months on book) over a five year lifecycle (60 months). These forecasts are based on previous trends and issuers monitor these curves and update them with actual performance.

11. The below graph is an illustrative example of a base curve. It shows the number of accounts evaluated over a five year lifecycle for an acquisition campaign. This shows that the number of accounts does not vary, i.e. it is always the same cohort of consumers being modelled.

Figure 1: Illustrative example of a 'base curve' looking at the number of accounts in a cohort



Types of base curves

12. As mentioned above, base curves help assess the key drivers of revenues and costs. They eventually feed into the NPV calculations. The eight key types of curves that are typically considered by issuers for each product in their portfolio are described below.

(i) Credit card balances

13. A forecasted curve of the average credit card balance over the 60 month lifecycle of a product. The balance curves are used in conjunction with the active rates and revolving rate. There are variations in how balances are modelled depending on the product type. Balances can be modelled at a total level, or broken down by balance type, for example the balance transfer balance and purchase balance.

(ii) Credit card purchases or spend

14. A forecasted curve of the average credit card spend over the 60 month lifecycle of a product. The purchase curves are used to model the amount of revenue generated from the interchange fee.

(iii) Cash advance

15. A forecasted curve of the average value of cash transactions over the 60 month lifecycle of a product. The cash curves can be used to model the interest from cash, and value of fees from cash transactions.

(iv) Balance Transfer fee

16. This is the fee charged for transferring balances on balance transfer products. This is not a typical curve as fees only apply on balances transferred within the first 90 days/three months of opening a balance transfer product. Therefore balance transfer fees will only typically be applied across the first three months, but can be a significant proportion of income.

(v) Revolve rates

17. A forecasted curve of the revolve rates are used to understand the proportion of balances bearing interest. The way revolve rates are modelled can vary depending on the NPV model design; it is generally modelled as the percentage balance that revolve, but may also be combined into an effective interest rate.

(vi) Active rates

18. A forecasted curve of the percentage of open accounts that are active and using their credit card in any given month. This is used to determine how many open accounts are contributing to revenues.

(vii) Fees

19. There are a number of different types of fees that can be modelled. These are typically fees, such as late fees, over limit fees, but can also include foreign exchange fees and other contributing fees.

(viii) Consumer account attrition

20. This is the forecasted amount of closures each month over the 60 month period. The attrition combined with the active rate, determines how many accounts are contributing to revenues.

21. From the base curves, drivers of revenues for a particular product type can be established.

22. In terms of costs, there are four key costs that tend to be included in issuers' NPV calculations. Capital costs can sit outside of the NPV calculations and are used when calculating the full economic value of a particular acquisition campaign or product.

(i) Risk costs

23. Risk costs are the losses from consumers charging off and going into repayment plans. The modelling of these curves can differ. Typically charge off rate (percentage of accounts that have charged off), charge off balance (value of the balance charged off) and recovery rate (percentage of balance that is likely to be recovered) are used to model the monthly risk costs.

(ii) Acquisition cost

24. This is an upfront cost of acquiring an account and will vary depending on the acquiring channel.

(iii) Operating costs

25. Firms vary how they include operating costs; these can be marginal or fixed.

(iv) Funding costs

26. The cost of funding credit card lending. These can be transfer pricing from the issuer's treasury function.

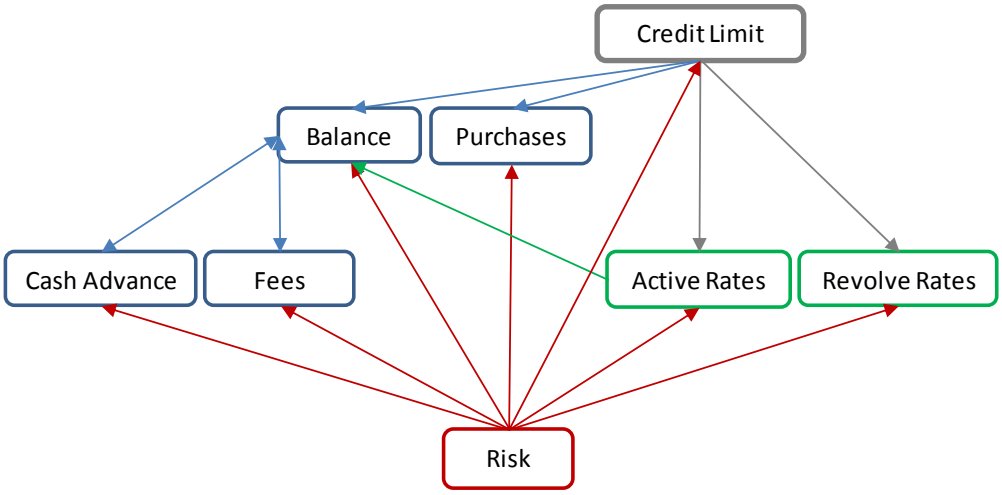
Step Three: NPV Calculations

27. The forecast of each cost and revenue driver is estimated, keeping in mind how the forecasts are interlinked. It also takes into account the impact the product features have on consumer behaviour. As illustrated in the diagram below, the level of balances can affect cash advance balances and fees and vice versa. In addition active rates and revolve rates can affect balances. Clearly as purchases are a proportion of the balance, any changes in purchase values, will affect the credit card balance.

28. There are other influences on consumer behaviour and these will affect the base curves and hence the estimated profitability of a product or acquisition campaign.

29. For example, the credit limit set for a particular product. Although the credit limit is not directly included in NPV calculations, it will impact many of the base curves. Credit limits are usually set by issuers, taking into account the expected risk of the cohort of consumers. Where consumers are assessed as high risk, they will receive lower credit limits in order to reduce the issuers' exposure to the risk of default.

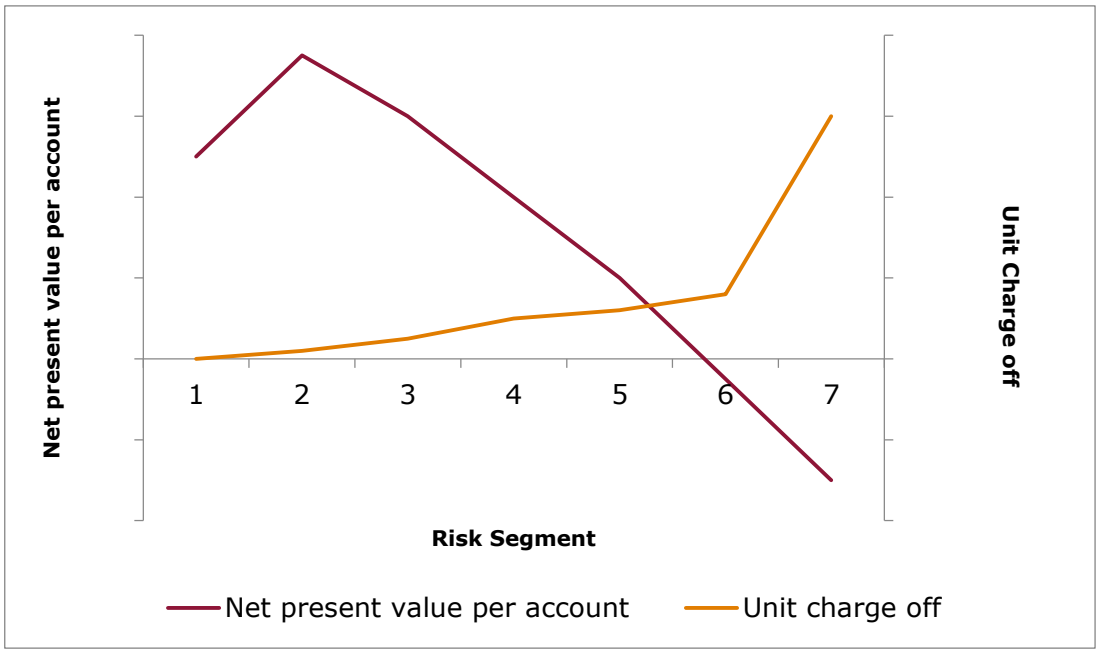
Figure 2: Interlinkages between factors that influence NPV calculations



30. Another example of influences on consumer behaviour is the risk profile of the consumer. As seen in the illustrative diagram above, risk can affect all other factors in the NPV model. The risk will affect the value of cash advances and fees, as higher risk consumers are more likely to take cash advances and incur higher penalty fees. This in turn will affect the balance. Higher risk consumers tend to have higher active rates and revolve rates. Higher risk consumers will typically have lower credit limits, although higher utilisation rates. This can also affect balances as well active rates.

31. As mentioned above, issuers model profitability either at the product level or risk segment per product. They can also measure profitability by acquisition channel. This is done as consumer behaviours and costs and revenues can vary by channel. The example below shows the modelled NPV by risk segment. In this example, risk increases with increasing score, as shown by the unit charge off rate. The segments 6 and 7 have a negative NPV, and therefore will not be accepted based on a segmented NPV approach to modelling.

Figure 3: Illustrative example of NPV, split by risk segment



Step Four: NPV Summary Output

32. The key output of the NPV models are assessed against the hurdle rates. These will be specific to the issuer and can be produced at an overall campaign level, product level or per account level. These inform issuers' decision making.

33. The outputs are used to, for example:

- Inform the various price features: for example, the level the credit limit is set, the APR that applies, the length of a balance transfer promotional period etc.
- Define credit risk score cut-offs at the point of application i.e. the amount of risk the issuer is willing to accept. Credit risk scores also determine the point at which down-selling is necessary, for example, by offering higher APRs or lower credit limits than advertised, higher risk accounts can still be in expectation profitable.
- Inform decisions on whether to change prices, credit limits and/ or amend promotional periods over the life of an account.
- Decide whether to expand their business.

Typical base curves by product type

34. There are five main product types in the credit card market. The key drivers of revenue will be dependent on the product features, and as a result specific curves will be more or less important in the profitability modelling.

35. Below we describe the base curves used in modelling profits for different product types and the various shapes these base curves take. As described above, the consumer behaviour and subsequent revenue drivers will change depending on the product. For example, the shape of balance base curves for 0% balance transfer offer products are very different to those with no balance transfer offer (a standard product).

36. There are five main products types described below:

Product Type	Description	Key differences (based in our illustrative base curves that follow)
Standard Product	A simple flat rate with no promotional periods.	All base curves increase over the first three or so months and then plateau for the remaining life cycle of the account.
Long term balance transfers	Low or 0% interest on balances transferred within a specified time period. Usually the balance is subject to a balance transfer fee which is a proportion of the amount transferred.	Balances and active rates increase in around the first three months, and then start to decline until around month 30, and then plateaus for the remaining lifecycle of the account. Revolve rates steadily grow up until month 27 and then sharply increases and peaks at month 30. This is followed by a sharp decline until month 35 when revolve rates plateau. Profit spikes in around month 3, loss making over month 5 to around month 30 and then plateaus with a positive profit for the remaining life of the account.
Combined products	Have both 0% purchase promotions and 0% balance transfer promotions. The purchase promotion may be longer (purchase led card); or the balance transfer promotion could be longer (balance transfer led card) or balance transfer and purchase promotion are of the same length (dual card).	Similar to above.
Higher risk	Similar to the standard credit card, but targeted at higher risk consumers and often used by consumers to build their credit profile.	Balances gradually increase over the life of the account. Active rates, revolve rates increase significantly in first three or so months, and then plateau for the remaining life of the account. Profit base curve shows loss making in the first number of months, profit position improves over the life of the card, breaking even at around 7 months and increases gradually and then plateaus near the end of the life of the account.
Rewards	Similar to the standard product, except it offers a rewards element that aims to drive spending on the card.	Similar to the standard.

Standard Product

37. Standard products have a simple flat interest rate with no promotion periods. As such the base curves used in modelling tend to be fairly flat and consistent over the 60 month period.

38. All products are sensitive to changes in funding and risk costs, but the simplicity of standard products makes changes in these areas particularly important. The

sensitivity to risk costs tends to be due to low utilisation on good balances, and high utilisation on bad balances. The standard products tend to offer a low rate and are difficult to maintain profitability and demand. In order to achieve a profitable product, good balance utilisation and high revolve rates are needed to counteract the low APR, since this increases interchange and net interest income revenue.

Figure 4a: Illustrative monthly profit before tax for a standard product

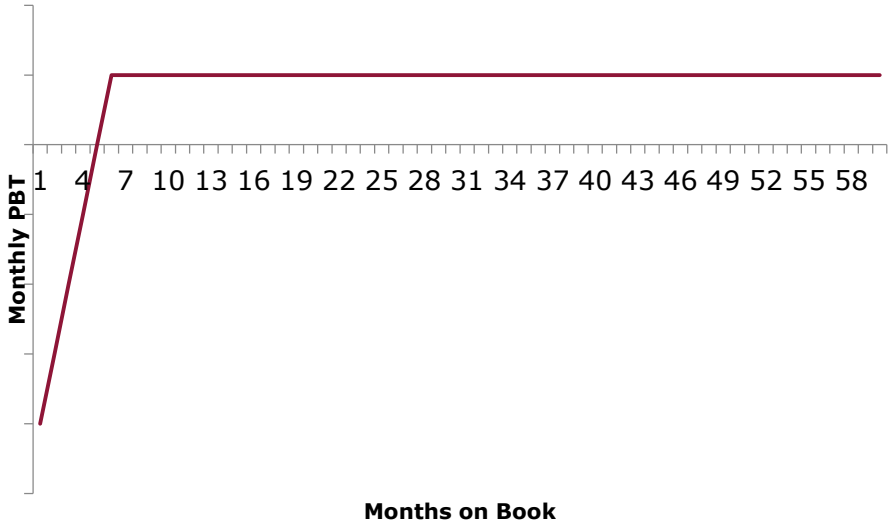


Figure 4b: Illustrative monthly balance for a simple product

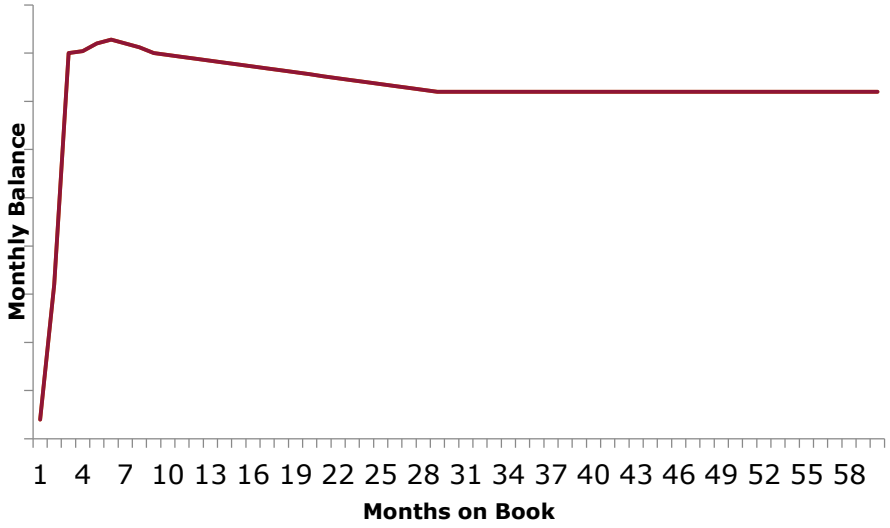


Figure 4c: Illustrative active rate for a standard product

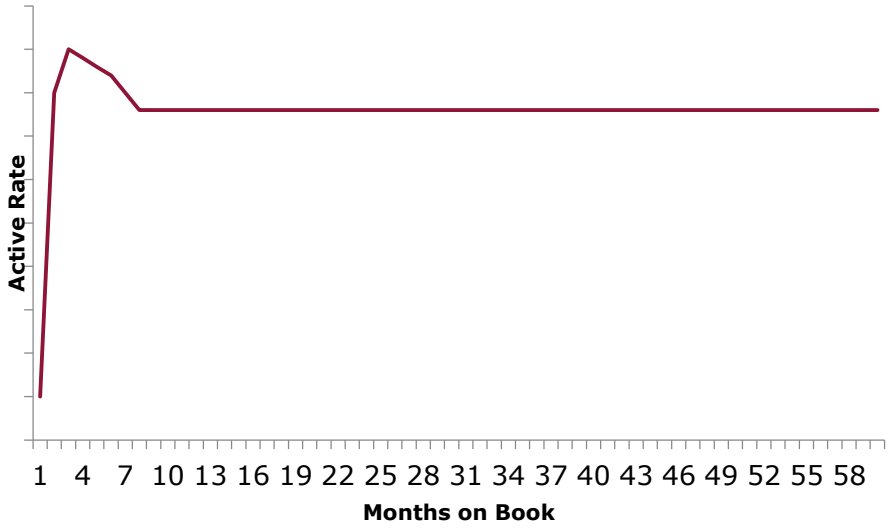
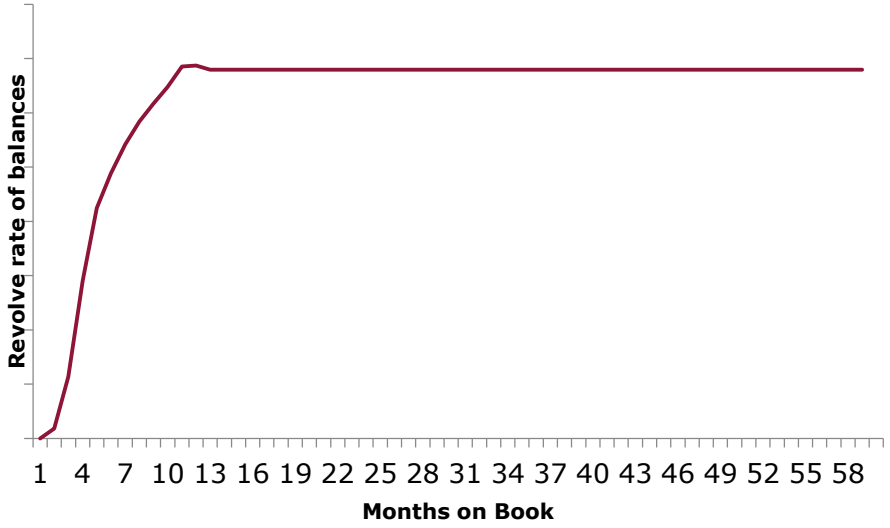


Figure 4d: Illustrative revolve rate for a standard product



Long term balance transfers

39. Balance transfer products rely on the initial balance transfer fee (often a percentage of the balance transferred) and a proportion of consumers revolving their balance once the promotion period ends in order to maintain profitability.

40. The key factor affecting the shape of the base curves on a long term balance transfer offer is the promotional period on the balance transferred. The length of the promotional period will affect the rate at which balances are built and paid down. Furthermore, the length of the promotional period will determine when interest will start being charged on balances.+

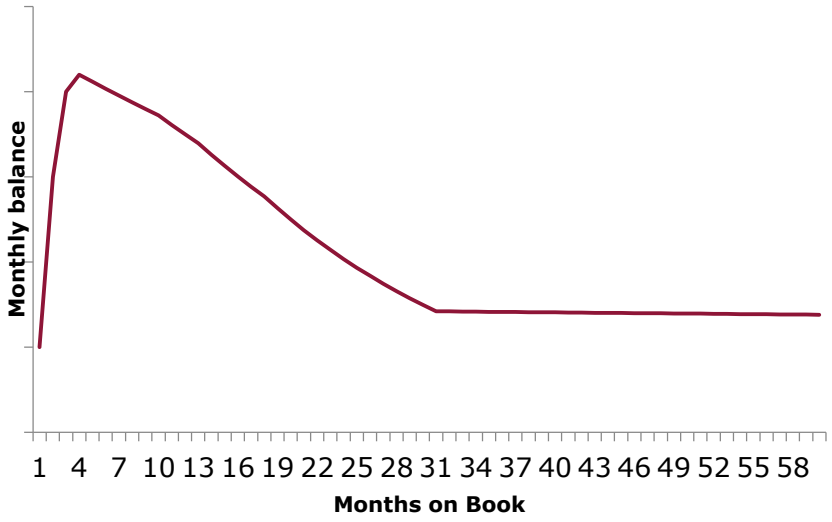
Balance base curves

41. The balance base curve of a 0% balance transfer product is dependent on the length of the promotional period. The peak of balances is generally observed in months 3-4 due to the promotional balance transfer needing to be completed in the first 90 days. The pay down rate will vary depending on the length of the promotional period and

consumer risk segment. Furthermore, the level of balance will vary due to credit limits, with lower risk segments typically having higher credit limits and therefore higher balances.

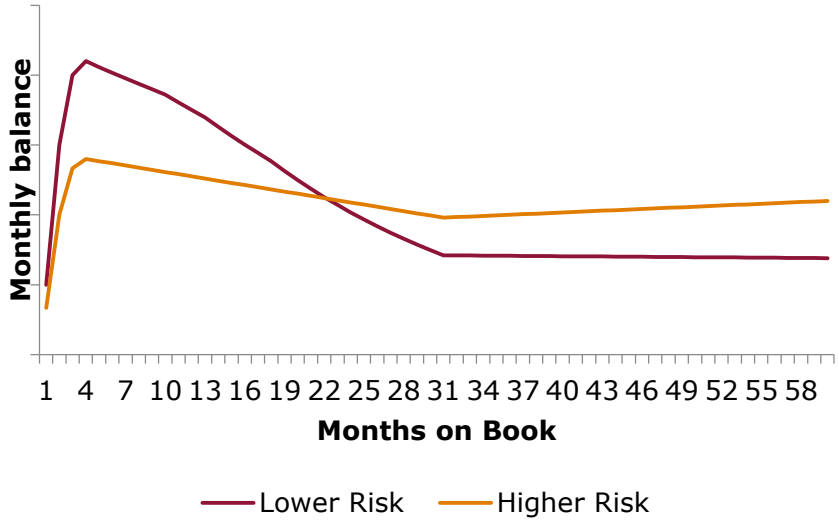
42. Below is an example of a balance transfer product with a 30 month 0% offer. The average balance decreases from months 4 to 30 due to consumers paying down their balance transfer during the promotional period.

Figure 5a: Illustrative monthly balance for a long term balance transfer offer



43. Below is an example comparing a high and low risk segment on the same balance transfer offer. The pay down rate is lower on the high risk segments, but with a lower value of balances.

Figure 5b: Illustrative monthly balance for a long term balance transfer offer



Active rate base curve

44. The active rate for a long term balance transfer product aligns with the balance curves. Additionally, the activity rate will vary by risk segment, with higher risk segments typically having higher active rates post the end of the promotional period.

Figure 6a: Illustrative active rate for a long term balance transfer offer

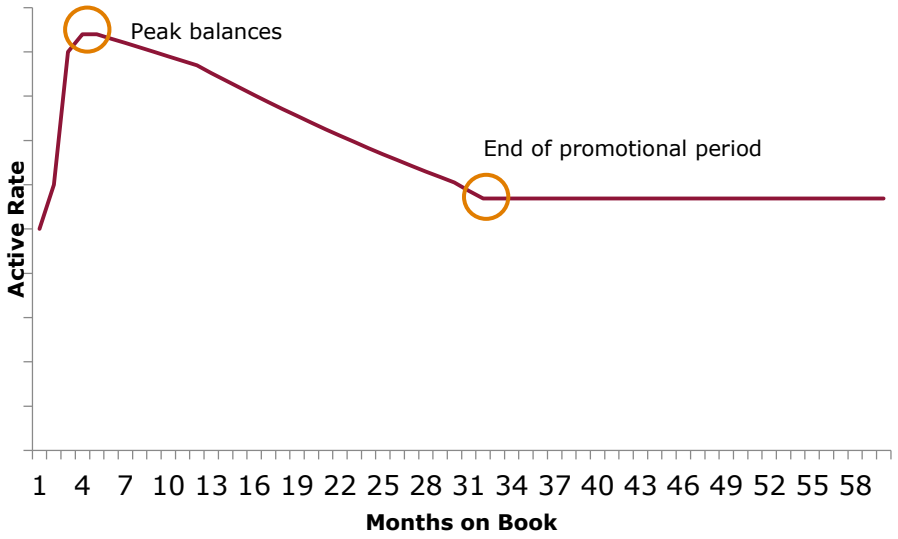
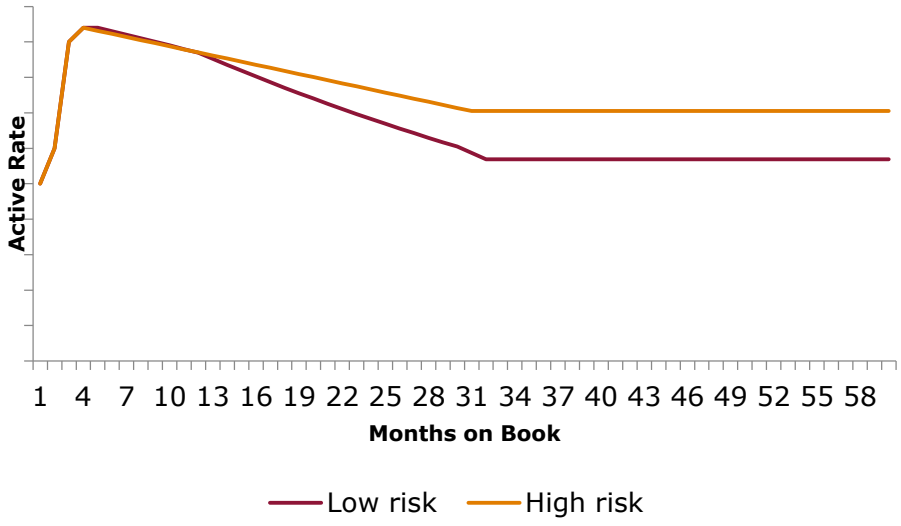


Figure 6b: Illustrative active rate for a long term balance transfer offer



Revolve rate base curve

45. The revolve rate is again linked to the promotional period of the balance transfer offer. Due to balance transfer balances being on 0% APR until the end of promotion, the revolve rate will remain low until the end of the promotional period, and balances are able to be charged an APR.

Figure 7a: Illustrative monthly revolve rate for a long term balance transfer offer

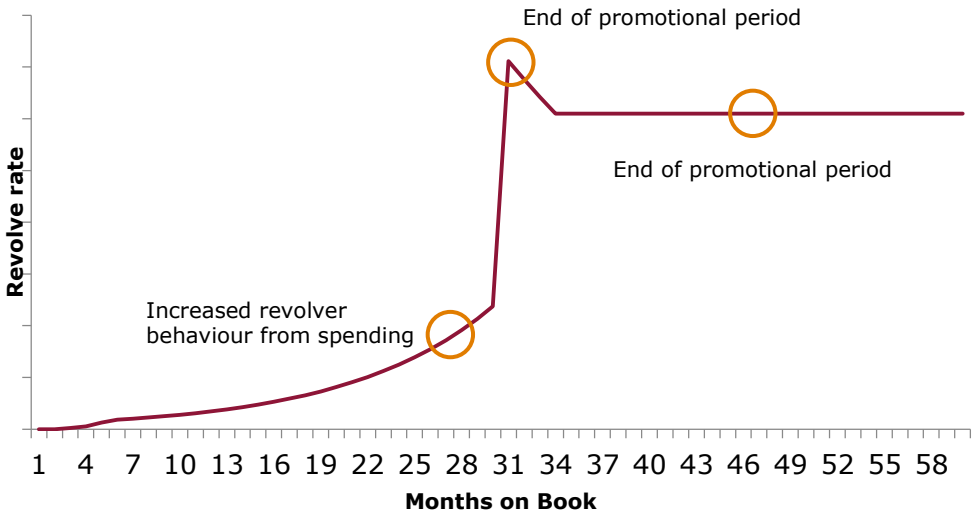
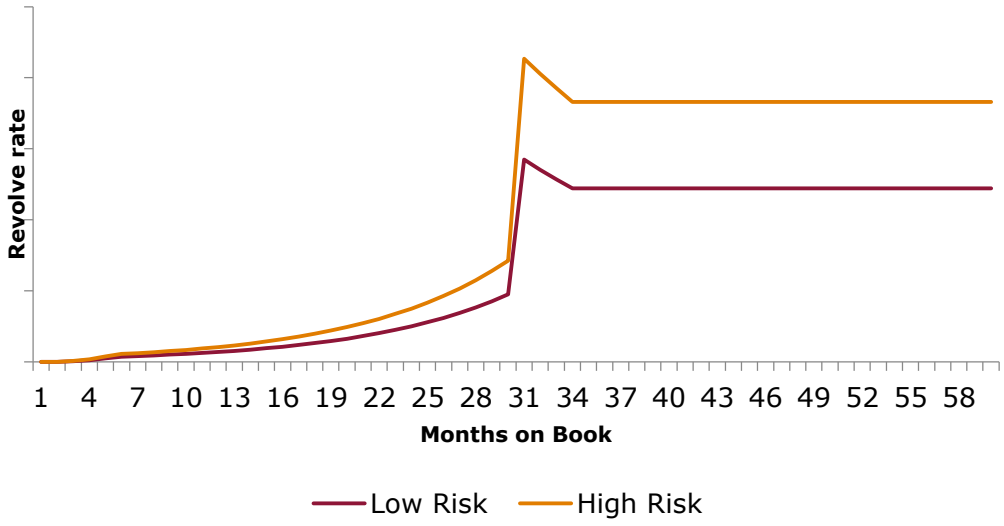


Figure 7b: Illustrative monthly revolve rate for a long term balance transfer offer

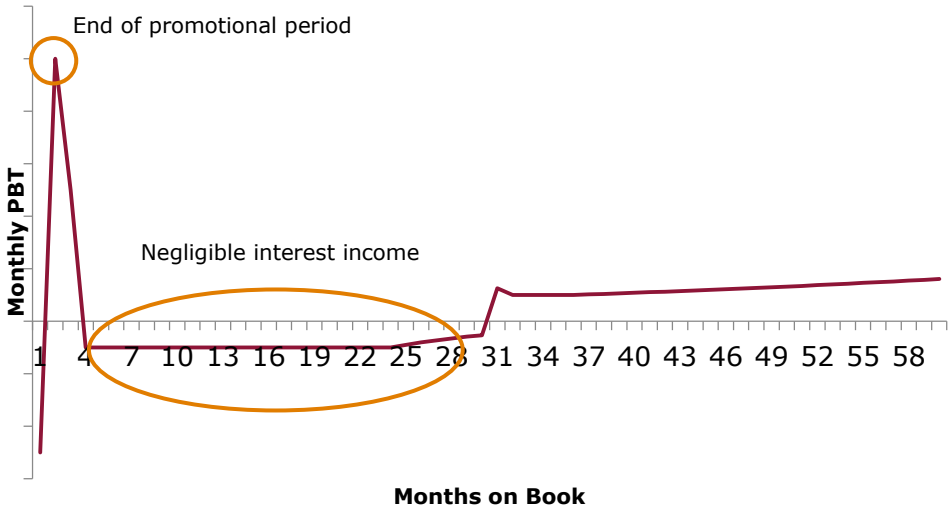


Profit before tax (PBT)

46. The PBT on a balance transfer product is different to other products due to the balance transfer fee. The PBT is positive in the first months due to the balance transfer fee income. The month/months that the income for the balance transfer fee is observed in the PBT depends on how the balance transfer fee is allocated in the NPV model. The fee may be spread across the first 3 months, or for simplicity only applied in the first month on book.

47. After the initial positive PBT, the PBT becomes negative. This is due to reduced interest income in the months where there is the 0% promotional offer, and limited spending on the product.

Figure 8: Illustrative monthly profit before tax for a long term balance transfer offer



Combined products

48. Combined products have both 0% purchase promotions and 0% balance transfer promotions, and have been combined into one product to satisfy consumer demand. The combined products can be:
    - Purchase led; long 0% promotional purchase period and shorter 0% balance transfer promotion period.
    - Dual; similar purchase and balance transfer 0% promotion periods, with both being shorter than on a purchase or balance transfer led product.
    - Balance transfer led, long balance transfer and shorter purchase promotional periods.

49. Balance transfer offers have been added to purchase products to attract consumers with existing debt. Purchase offers have been added to balance transfer products to encourage spending and long term affinity with the product. The curves will be driven by the type of combined offer, and particularly the lead offer, which will typically be the offer with the longer promotion period. For example, a long term balance transfer card with a shorter purchase offer period would typically observe the behaviour of a balance transfer card, but if a firm produced a product with a long purchase offer and a shorter balance transfer, they would expect this to attract primarily a purchase consumer.

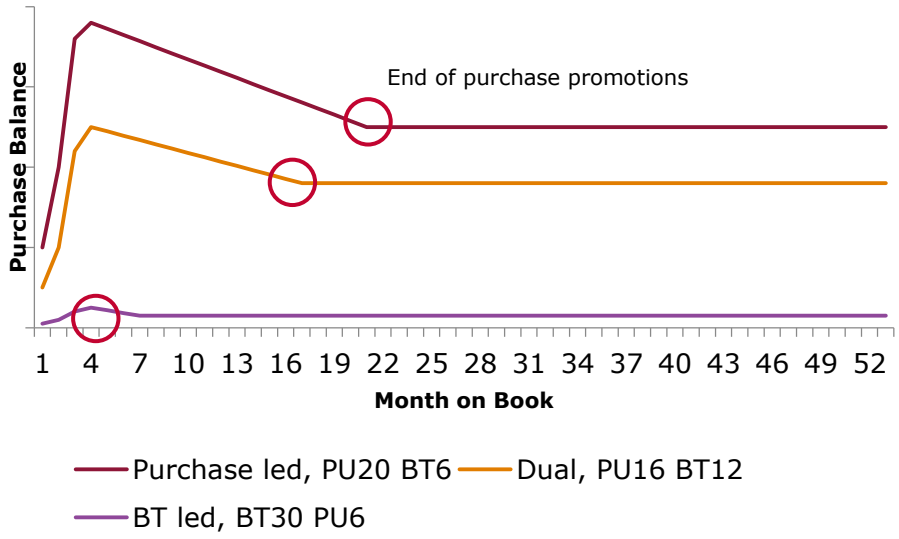
Balance base curve

50. In dual products, understanding the breakdown between purchase balance and balance transfers is helpful to calculate interest income. Curves are built based on what each company sees as their primary target consumer for each product.

51. In the example below,
    - Purchase led products will typically have a lower balance transfer balance and higher purchase balance, as consumers will primarily be purchase consumers.
    - Balances on the dual product will be similar across both purchase and balance transfer, but lower than the balance transfer or purchase led product.

- BT led products will typically have a higher balance transfer balance and lower purchase balance, as consumers will primarily be balance transfer consumers.

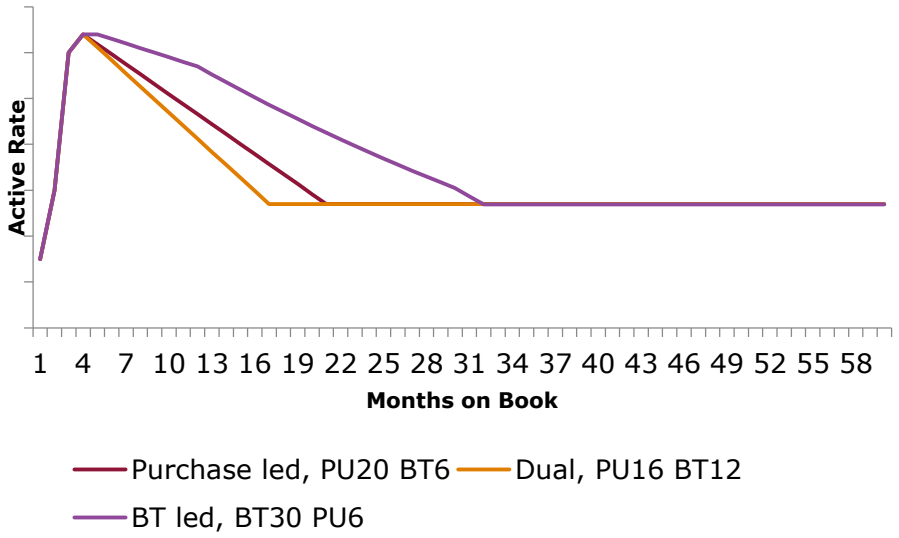
Figure 9: Illustrative purchase balances by product type



Active rate base curve

52. The active rate curve will typically be driven by the primary offer on the card. For the example below, the Purchase led card has a purchase offer of 20 months, and so activity rates will fall until month on book 20, when the purchase offer ends, the balance transfer offer for 6 months will have little effect on the curve.

Figure 10: Illsutrative active rate by product type



Revolve rate base curve

53. The peak change in revolve rate will occur when the promotional period ends on the primary offer. In the examples below, each curve will have two peaks, corresponding to the two offers.

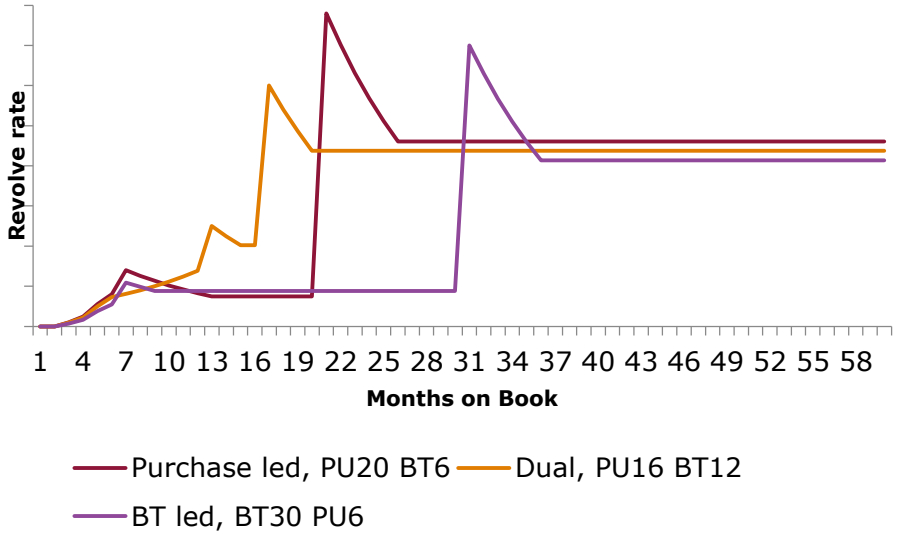
- **Purchase led product.** The Purchase led product will have a smaller peak at month 7 corresponding to the balance transfer promotional period, and the small uptake of

the balance transfer offer. The second and larger peak will occur when the purchase period ends, after 20 months. This will form a larger peak as this is the primary offer, and drives the majority of consumer behaviour.

- **Balance transfer led product.** The balance transfer led product will have a smaller peak at month 7 corresponding to the purchase promotional period, and the small uptake of the purchase offer. The second and larger peak will occur when the balance transfer period ends, after 30 months. This will form a larger peak as this is the primary offer on the product, and drives the majority of consumer behaviour.

- **Dual product.** The dual product will tend to have two peaks of similar proportions and both being lower than the Balance transfer or Purchase led products. This is due to the dual having no clear consumer target, and of mixture of both, with less convincing consumers.

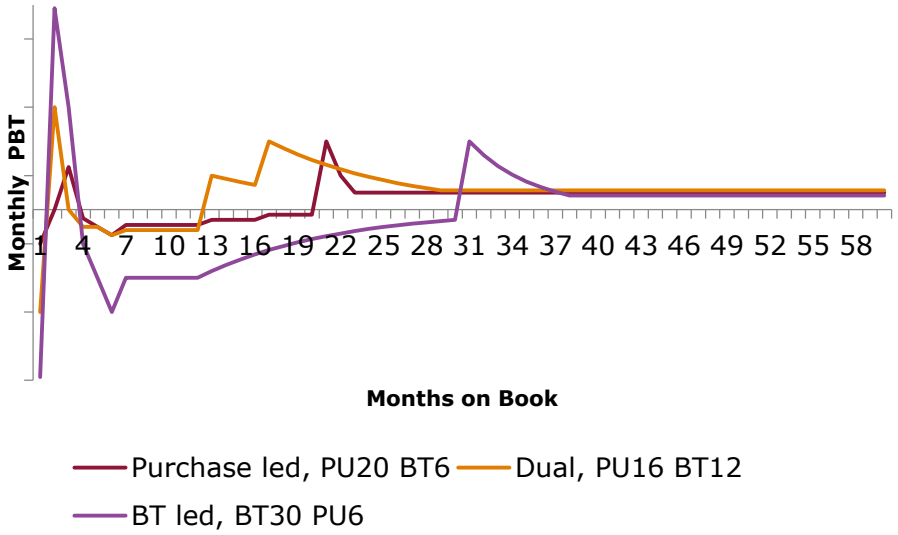
Figure 11: Illustrative revolve rates by product type



Profit before tax (PBT)

54. The PBT is a reflection of revolve rate and any balance transfer fees.

Figure 12: Illustrative monthly profit before tax by product type



Rewards

55. The rewards product curves will look similar to the shapes of a standard product; however the levels and values may differ. The Rewards products work by increasing spend through rewards incentives, and therefore increase interchange income. The total NPV will depend on the ratio of rewards costs to increased interchange.

56. The rewards products can have further features to enhance the product that could cause changes to the shapes of the curve. These offers tend to include 0% purchase or balance transfer offers. This will then cause the curves to fall between a standard product and purchase/balance transfer product.

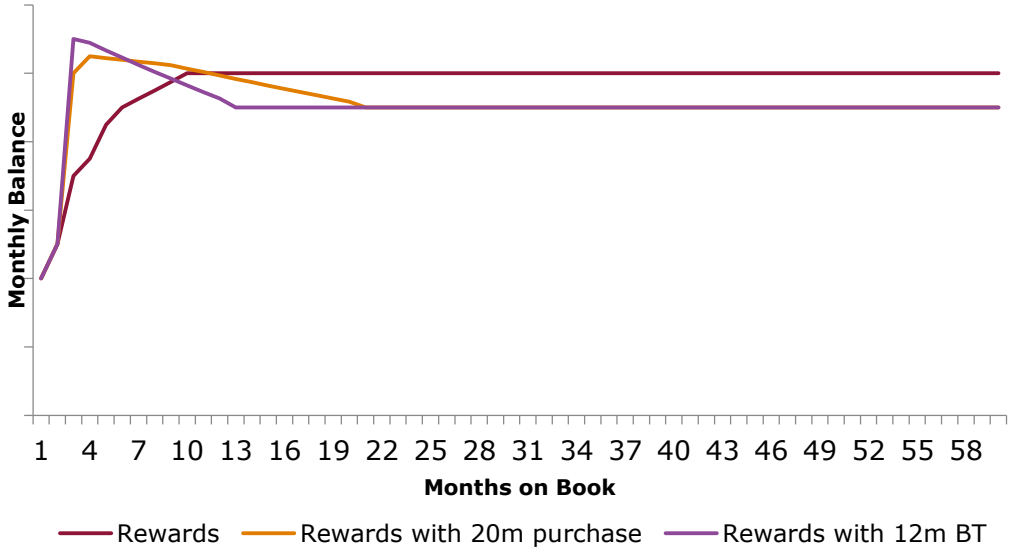
57. The shapes will primarily be driven by the most significant offer on the card, and therefore the consumer type that the products will attract. The demand and consumer behaviour will also be driven by the value of rewards.

58. A good rewards scheme proposition would attract more spending and engagement compared to a poor rewards scheme proposition. Some affinity products will have higher spending due to the affinity with the rewards brand. Affinity card behaviour may depend on the brand of affinity. Many affinity products, such as airline/hotel groups will be skewed towards business travel and higher spending with lower risk. However store card affinity products may have higher risk.

Balance base curve

59. The graph compares a typical rewards balance curve with a rewards curve that may include a 0% for 20 months purchase offer or a 0% balance transfer offer for 12 months. The magnitude of the effect of this offer on the curve will be based on the firm's expectation of how many consumers will be attracted to the product for the purchase offer only. In the example, the offers have minimal impact on balances, as the rewards feature is the primary feature attracting consumers.

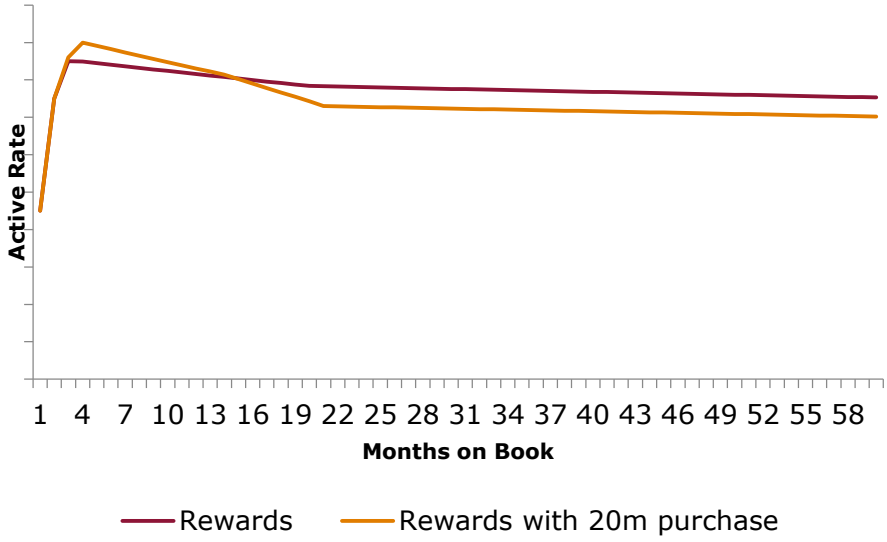
Figure 13: Illustrative monthly balance for reward card products



Active Rate base curve

60. Similarly to the balance curve, the 20 month purchase offer will affect the active rate curve due to a reduction in activity following the end of the promotion period. On the pure rewards card, the activity is fairly flat, with drop off in the outer years. The level of rewards offered will have an impact on retention and activity.

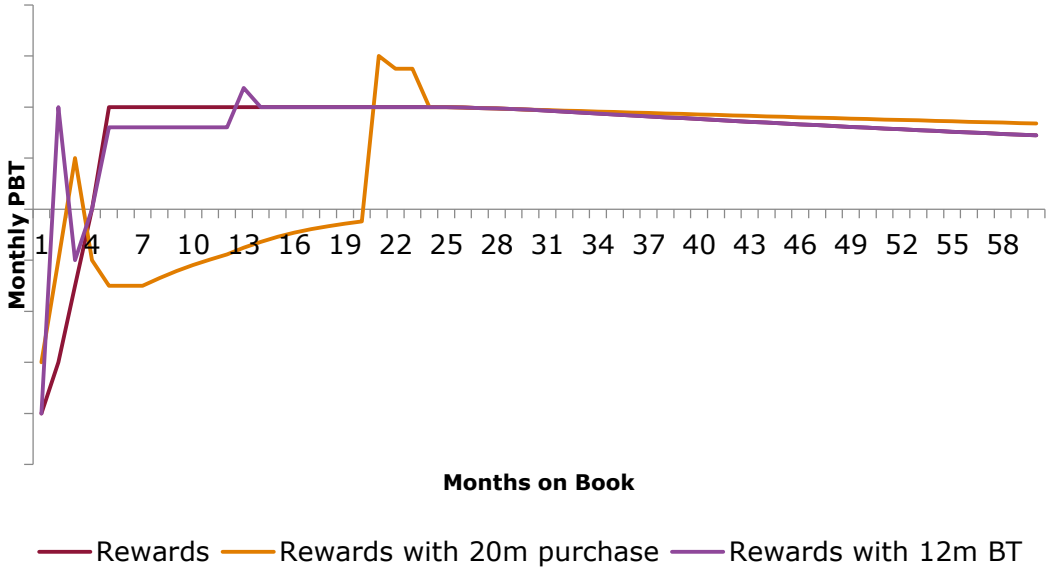
Figure 14: Illustrative active rates for reward card products



Revolve rate and profit before tax (PBT)

61. The revolve rate on the rewards product will follow the trend of the other curves, with revolver rate remaining fairly flat. In the example with a 0% purchase promotion, the revolve rate will be affected across all accounts. This is reflected in the PBT of the two product types. The balance transfer has minimal impact on the PBT, as there is limited uptake of the offer

Figure 15: Illustrative monthly profit before tax for reward products.



Higher Risk

62. Higher risk products are a variation of the standard product. High rates of risk on higher risk products will have an effect on the products' base curves.

63. The most significant impact will be on the balance curves and the rate of default. The credit limits on higher risk products will be lower, causing average balances to be lower, however this will be combined with high utilisation of credit limits. Furthermore, higher risk products tend to assign credit limits using a low and grow strategy, therefore average balances grow over the 60 month time period. The controlled growth in balances contributes to increased PBT over the 60 month period.

Figure 16a: Illustrative monthly balance for higher risk cards

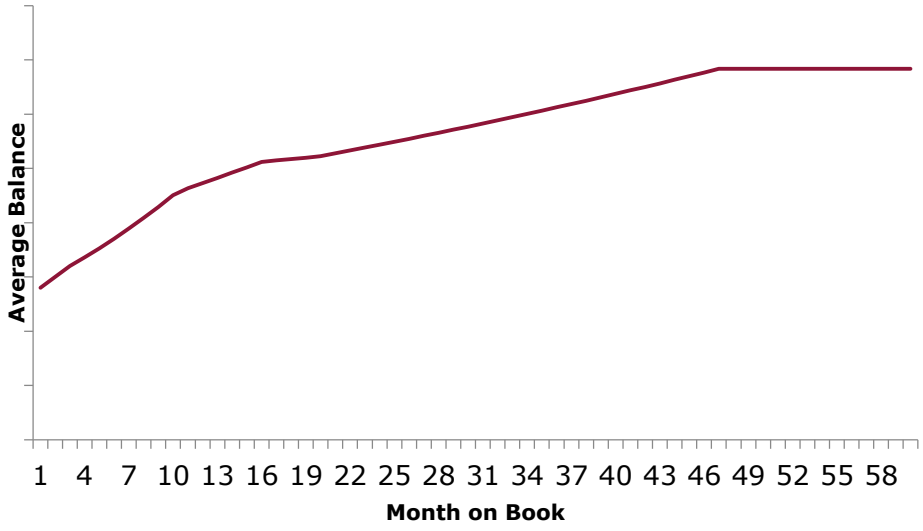


Figure 16b: Illustrative active rate for higher risk cards

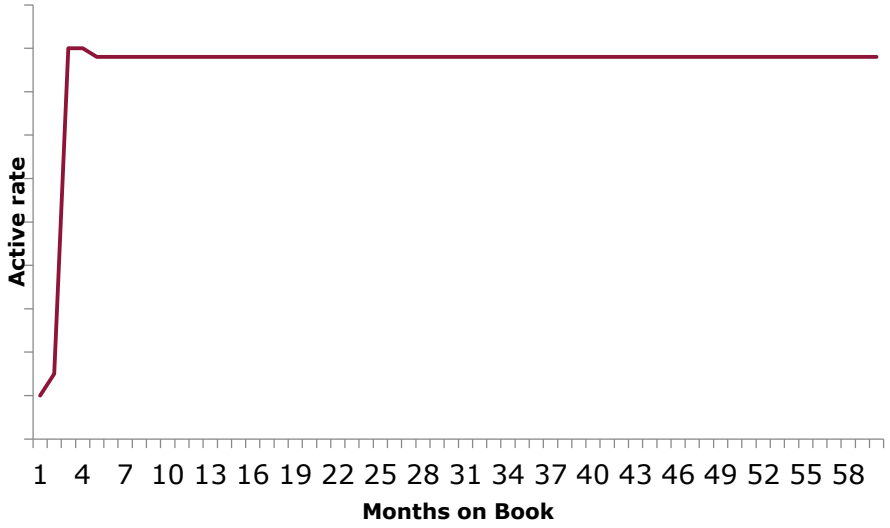


Figure 16c: Illustrative revolve rate for higher risk cards

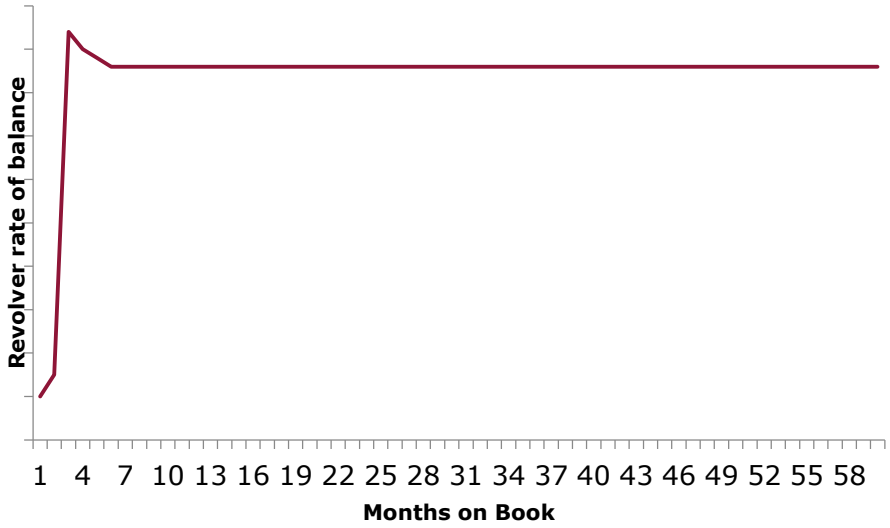
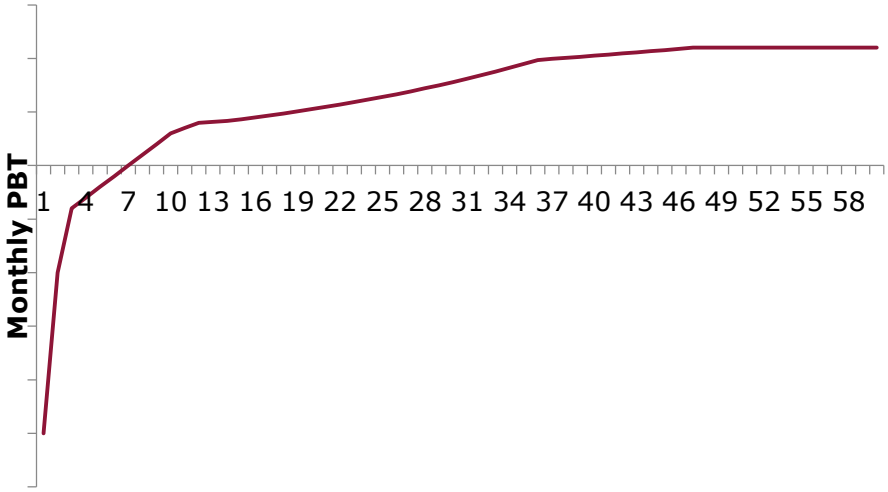


Figure 16d: Illustrative profit before tax for higher risk cards



Co-brand/ Affinity credit cards

64. This section provides a description of what we mean by co-brand/ affinity credit cards and describes the key trends and main reward propositions available in this segment of the market. It also explains the main benefits of co-brand/ affinity partnerships to the issuer and partner, as well as the consumer and outlines the implications of the Interchange Fee Regulation on this segment of the market.

65. The information reported here draws on credit card issuers' responses to the market questionnaire and the responses of 20 co-brand/ affinity partners (both commercial and charitable partners) to a voluntary market questionnaire that we sent to affinity and co-brand providers in the market.

What are affinity and co-brand credit cards?

66. Co-brand / affinity credit cards are typically issued under both the brand of the credit card issuer (the 'issuer') and the brand of a charity, membership group or commercial business. The co-brand/ affinity partner (for example, a retail store or charity) is not directly involved in issuing the credit card or processing transactions. In essence it lends its brand to the issuer. The issuer retains the credit risk and bears the cost of funds and operating expenses.

Overview and key trends

67. The total number of co-brand / affinity credit cards on offer in the market has steadily declined in the last few years. The number of new credit cards accounts which are co-branded is also declining. This is largely because over time, the leading issuers have consolidated the number of partnership agreements included in their portfolios and are moving towards focusing on a few key co-brand/affinity partners.

68. Attractive co-brand partners tend to be those that have sufficient scale and brand loyalty to attract enough consumers to the credit card. In targeting particular co-brand/ affinity partners, issuers will often seek to partner with organisations that have a consumer base that is aligned with their own.

69. Nine credit card issuers currently offer co-brand / affinity cards. There are over 300 co-brand partners that tend to fall into four broad categories: Travel (such as hotels and airlines); Retail stores (such as large grocery stores) and websites; sports clubs (such as football clubs); and charitable organisations and membership groups.

Reward proposition

70. Co-brand/ affinity credit cards typically have three aspects to their reward propositions: rewards earned per pound spent on the card; introductory and bonus offers that may be related to spend; and other types of rewards.

71. The key reward propositions offered on partnerships with travel related firms, retail stores and websites, sports clubs and charitable organisations and membership groups are summarised below.

Travel (hotels and airlines)

72. Cards affiliated with airlines or hotels offer the consumer the opportunity to benefit from their rewards programme. This will typically be in the form of frequent flyer miles or loyalty points per £1 spent on the card. In many cases, the co-brand/affinity credit card may have an annual fee with a higher earn rate (i.e. higher rewards per pound spent on the card). Alternatively it may have no fee (or a lower fee) and a lower earn rate.

73. For travel co-brand/affinity credit cards, introductory offers are often available to encourage consumers to open an account as well as to encourage consumer engagement with the credit card once acquired. For example, if a consumer spends a certain amount within the first few months of opening their account, they will be rewarded with extra frequent flyer miles or loyalty points. In addition, many travel co-brand/ affinity credit cards typically offer 0% interest on purchases for a specified time period.

74. Travel co-brand/ affinity credit cards can offer a range of other benefits. These may include elite status in the partner's rewards programme, two-for-one offers or upgrade vouchers if the consumer spends more than a stated threshold amount and within the specified time period (typically 12 months).

Retail stores and websites

75. For co-brand/ affinity credit cards associated with retail stores, the consumer proposition is similar to travel co-brand cards. Typically, the consumer will be offered an introductory bonus (for example, a bonus voucher once the consumer's application has been approved, which can be redeemed at the relevant retailer's store) along with the opportunity to earn points based on amount spent, earning more per pound spent with the co-brand retailer than elsewhere. These points can then be converted into retail vouchers.

76. At present, retail store co-brand/ affinity credit cards do not typically charge an annual fee. However, as above, they tend to offer an introductory 0% interest on purchases for a specified time period. In addition, consumers are sometimes offered further benefits such as exclusive discounts.

Sports clubs

77. A number of sports clubs (mainly football clubs) offer co-brand/ affinity credit cards. On some of these cards, the consumer will have the opportunity to earn points based on spend. These can be converted into vouchers and used to buy official club merchandise and experiences.

78. As with retail and travel co-brand/ affinity credit cards, some cards offer a short 0% interest on purchase.

79. Along with points for retail spend which can be converted into vouchers, some sports club credit cards offer consumers exclusive experiences such as the opportunity to attend club training sessions and stadium tours. Some credit cards also offer in store discounts, and give consumers the opportunity to purchase priority tickets for club matches. Other sports club credit cards have a more limited reward proposition with the focus being more on having a club-branded credit card than any additional rewards it may offer.

Charity Cards

80. For charity co-brand/ affinity credit cards, the reward proposition differs substantially. Consumers do not have the opportunity to earn rewards, discounts or exclusive experiences, but rather the card provides a way to support a nominated charity. When a consumer applies for a particular charity card, a contribution is typically made to the charity following the approval of the consumer's application for the card. Consumers also make indirect contributions to the charity each time they spend with the card, as the credit card issuer passes a proportion of interchange revenue to the charity partner with each transaction.

Issuer and co-brand/affinity partnership

81. Co-brand/ affinity partnerships (i.e. the relationship between the issuer and co-brand/affinity partner) attempts to balance the interests of the credit card issuer, the partner, and the consumer. A card which can benefit all three of these parties is one which is likely to perform well. For example, a card which provides consumers with the opportunity to earn generous rewards from spending is likely to attract more consumers and also drive higher levels of spending. This in turn will generate greater interchange fee income, benefiting both the credit card issuer and the co-brand/ affinity partner through negotiated profit sharing arrangements.

82. Co-brand/ affinity partnerships typically last between 5 and 10 years, with firms frequently reviewing the product to assess how a particular card is performing for all three of these parties. Often, product features will be changed or tweaked within the duration of the agreements in an attempt to secure the best and most balanced outcome for the credit card issuer, partner and consumer.

Benefits of Co-Brand and Affinity Credit Cards

Credit card issuer

83. For the credit card issuer, there are a number of benefits attached to offering co-brand/ affinity credit cards. Co-brand/affinity credit cards drive income revenue

through interchange fee. Offering rewards provides incentives for consumers to increase retail spend on the credit card, thus generating greater interchange fee revenue. As mentioned above, some co-brand/ affinity credit cards charge annual fees, which can also be significant sources of revenue.

84. Moreover, co-brand/ affinity credit cards can improve an issuers level of consumer acquisition, by providing them with access to a wider consumer base through new acquisition channels (such as in-store or online marketing). In addition, partnerships allow credit card issuers to appeal and access different consumer groups.

Co-brand/ affinity partners

85. For commercial business partners, co-brand/ affinity credit cards typically generate revenue in the form of a proportion of the profits generated under profit sharing agreements between the credit card issuer and the partner. The cards can also promote brand awareness and loyalty as well as increase sales, with consumers incentivised to purchase from the co-brand/ affinity partner in order to build up and take advantage of various rewards. Moreover, co-brand/ affinity credit cards allow commercial business partners the opportunity to access usage data gathered on cardholders. This data can be utilised to better understand consumer preferences and behaviours, and therefore influence future business strategies.

86. The benefits are similar for charitable partners and membership groups that form co-brand/ affinity partnerships. As discussed above, for these types of cards, the partner will receive income from the credit card issuer every time the card is used. Some co-brand/ affinity partners will also receive an 'activation fee' when the card is first used. The affinity cards are also significant for partners in terms of raising brand awareness, thus raising the profile of a particular charity or membership group.

Consumers

87. As discussed above, consumers can earn a number of rewards under the partner's respective loyalty programmes based upon their spending on the co-brand cards. These rewards range from cashback, frequent flyer miles, vouchers, loyalty points and exclusive discounts. Consumers that want to make charitable donations can also do so through spending on their credit card.

88. As discussed in Chapter 5 of the main report, the Interchange Fee Regulation will reduce the amount of interchange revenue credit card issuers will earn. This is likely to have implications for reward schemes, including those offered on co-brand /affinity credit cards.

Implications of new interchange fee regulation

89. As discussed in Chapter 5 of the main report, the Interchange Fee Regulation will reduce the amount of interchange revenue credit card issuers will earn. This is likely to have implications for reward schemes, including those offered on co-brand /affinity credit cards.

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