WILL THE CREDIT CARD INDUSTRY BE AFFECTED BY THE CORONAVIRUS?

A MyChargeBack™ White Paper

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Will the Credit Card Industry Be Affected by the Coronavirus?

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Judging by the plethora of news articles published in the media, the conventional wisdom is that credit card companies are going to take a hit due to COVID-19, the coronavirus first identified in the fall of 2019. The primary reason why that's the conventional wisdom is that the credit card companies are predicting it themselves. Mastercard and Visa both claim that their revenue will decrease due to the anticipated reduction in transactions. Their stock prices indeed fell in anticipation of that happening. After all, whether due to a lack of demand or government order, malls are shut, hotels are empty, sports seasons are suspended, flights are few and far between, and no one even thinks of booking a cruise.

We sense, however, that the use of credit cards will not significantly diminish as a result of the pandemic. As an international fund recovery service focusing on card-not-present transactions and complex dispute resolution, MyChargeBack receives thousands of inquiries every month from cardholders around the globe. Based on our conversations with our clients, we believe that credit and debit cards will remain the world's primary means of payment. Nonetheless, cardholders do have concerns that the spread of the coronavirus will affect the card services their banks are expected to provide.

Coronavirus and the Credit Card Industry

Here are the main reasons why the conventional wisdom may be wrong, and the credit card industry is not necessarily going to experience a downturn:

I. The Culture of Purchasing Is Changing

Yes, malls are being shut worldwide in order to reduce the chances that the coronavirus will spread. And yes, that means fewer people are making purchases in brick and mortar stores and charging them to their credit and debit cards. But is that going to lead to a massive decline in revenue for the credit card companies?

From what cardholders tell us, the answer is probably no. The reason is that the culture of purchasing is changing. In fact, it has been changing for a few years already. And that's due to the unprecedented rapid growth of card-not-present, or remote transactions.

According to the 2018 Annual Supplement of the Federal Reserve Payments Study, *"Remote payments continued to grow as a share of total general-purpose card payments. The number of remote payments increased 22.8 percent from 2016 to 2017, compared with in-person payments, which grew 7.2 percent."*

That's over three-times faster.

This is, of course, due to the rise of online shopping. It's convenient and it saves time. Online, the consumer can compare the prices of competing vendors in seconds, and purchases can be made at any time of day or night, before the mall opens or after it closes.

Indeed, most retail sales are now made online in the United States. February 2019 was a historic month for American commerce. According to the U.S. Department of Commerce, that was when the total market share of "non-store" retail sales surpassed that of "general merchandise." A Digital Commerce 360 study of Commerce Department data concluded that e-commerce, as it is also known, increased 14.9% in 2019, compared to 13.6% the previous year.

While online shopping was once thought of as the preserve of millennials, it has now become mainstream. And while in-person payments can be made with cash or checks, online shopping requires a credit or debit card. There's no alternative to it. Very simply put, the growth in online shopping guarantees a growth in the use of credit and debit cards.

II. Cash and Checks Were Already Declining in Popularity

Here's something that slipped below everyone's radar. Cash and checks were becoming less popular means of payment long before COVID-19. Again, according to Federal Reserve Board statistics, between 2016 and 2017, "the value of remote payments increased 14.8 percent, compared with in-person payments, which increased 4.4 percent." That's also over three-times faster. So not only have consumers been using their credit and debit cards to pay for increasing numbers of transactions, but they are also using their credit and debit cards to purchase more expensive items than they did in the past. This trend shows no sign it will reverse, and therefore, credit card companies will continue to reap the benefits.

Moreover, the Fed has long been documenting the steady decline in check use. "The use of checks has been declining since the mid-1990s," it reported in 2008 in its *Federal Reserve Bulletin*, "generally because check payments — and most likely some cash payments — are being replaced by payments made with electronic instruments." In addition, the Fed revealed that the number of non-cash payments in the U.S. had "increased from 81 billion to 93 billion between 2003 and 2006, or 4.6 percent a year" while their value "increased from $68 trillion to $76 trillion, or 3.9 percent a year, over the same period."

That trend has continued and shows no sign it will stop. "Large-institution check payments showed an accelerated decline of 4.8 percent by number from 2016 to 2017," the Fed's 2018 report informs us. In addition, "the decline in the national total number of check payments was 3.0 percent per year from 2012 to 2015 compared with steeper declines from 2000 to 2012." The following charts also show that Automated Clearing House (ACH) contactless payments, chiefly credit transfers and direct debit payments, and prepaid debit card transactions, are also steadily increasing side-by-side with credit cards and non-prepaid debit cards.

Billions of payments

Period	Checks	ACH debit transfers	ACH credit transfers	Credit cards	Non-prepaid debit cards	Prepaid debit cards
2016	16.9	14.8	10.6	37.2	60.4	11.8
2017	15.7	15.7	11.2	40.8	66.8	13.1
2018	14.5	16.6	11.9	44.7	72.7	13.8

Trends in Non-Cash Payments, by Value, According to the Federal Reserve

Trillions of dollars

Period	Checks	ACH Debit Transfers	ACH Credit Transfers	Credit cards	Non-prepaid debit cards	Prepaid debit cards
2016	28.05	20.83	35.28	3.27	2.31	0.29
2017	26.93	22.06	38.07	3.60	2.47	0.30
2018	25.80	23.28	40.87	3.98	2.75	0.35

Note: Card payments were estimated for 2016 and 2017. Credit card payments include general-purpose and private-label versions. Prepaid debit card payments include general-purpose, private-label, and electronic benefits transfer (EBT) versions.

And cash? "Data from the largest depository institutions showed a 2.8 percent decline in the number of ATM withdrawals from 2016 to 2017 and an increase of ATM withdrawals from 2016 to 2017 of only 0.5 percent, less than the rate of inflation over the period (roughly 2 percent)."

It is widely assumed that a "cashless" economy is becoming inevitable. Eventually, the first country to go cashless may be Sweden. Most payments made there are already processed electronically, principally by debit card. As a result, ATM withdrawals and cash in circulation in that country are declining year by year. So much so that many Swedes no longer even find a need to carry cash.

III. Online Vendors Are Continuing to Expand Operations

If there is any doubt that consumers will take out their credit and debit cards and increase their purchases from online vendors, then someone ought to inform Amazon. In the midst of the coronavirus crisis, the company announced that it is bolstering its workforce by 12.5% by hiring an additional 100,000 employees – and pay them $2 more an hour than otherwise – in order to make sure it is able to fill all its orders on time. CNN reports that CVS is hiring 50,000 more people, Walmart 150,000, Instacart a whopping 300,000, Albertson's 30,000, Dollar General 50,000, PepsiCo 6,000, Papa John's

20,000, Domino's 10,000, Pizza Hut 20,000, and 7-Eleven 20,000. Those new hires are in addition to a substantial number of new employees who will be put to work by companies retooling in order to mass produce ventilators and other equipment required by hospitals for the duration of the pandemic.

And no, it's not just Amazon that is benefitting. With more and more people confined to their homes due to quarantines, mall closures or even fear, consumers are spending money on liquor, buying video games, signing up for TV streaming services, and ordering meals delivered to the door. In Britain, for example, digital content and subscription services rose by an impressive 12.4% since February. Takeaway meals and fast food sales jumped 8.7% the same month.

Of course, traditional retailers in malls and brick and mortar shops who want to compete successfully with their online competitors can follow the example set by a growing number of Chinese companies ever since COVID-19 was first identified. They can shift their sales channel mix and rebrand themselves as online merchants. Starbucks, which began to close stores in high-risk U.S. locations on March 15, has already done that. Its brews can continue to be ordered through "Mobile Order & Pay" apps and at drive-thru windows. And to make it even easier, home delivery is available as well.

IV. The Coronavirus Itself

Ironically, one of the most pressing reasons why the coronavirus may not compromise credit and debit card use is the COVID-19 virus itself.

The World Health Organization (W.H.O.) advises consumers across the globe not to make cash payments, since banknotes may be spreading COVID-19 (among a plethora of other diseases). It turns out that the virus can remain on the surface of banknotes for days after an infected person touches them. During that time there is no way to determine how many other people will handle the banknote and become infected themselves before the virus on the surface dies.

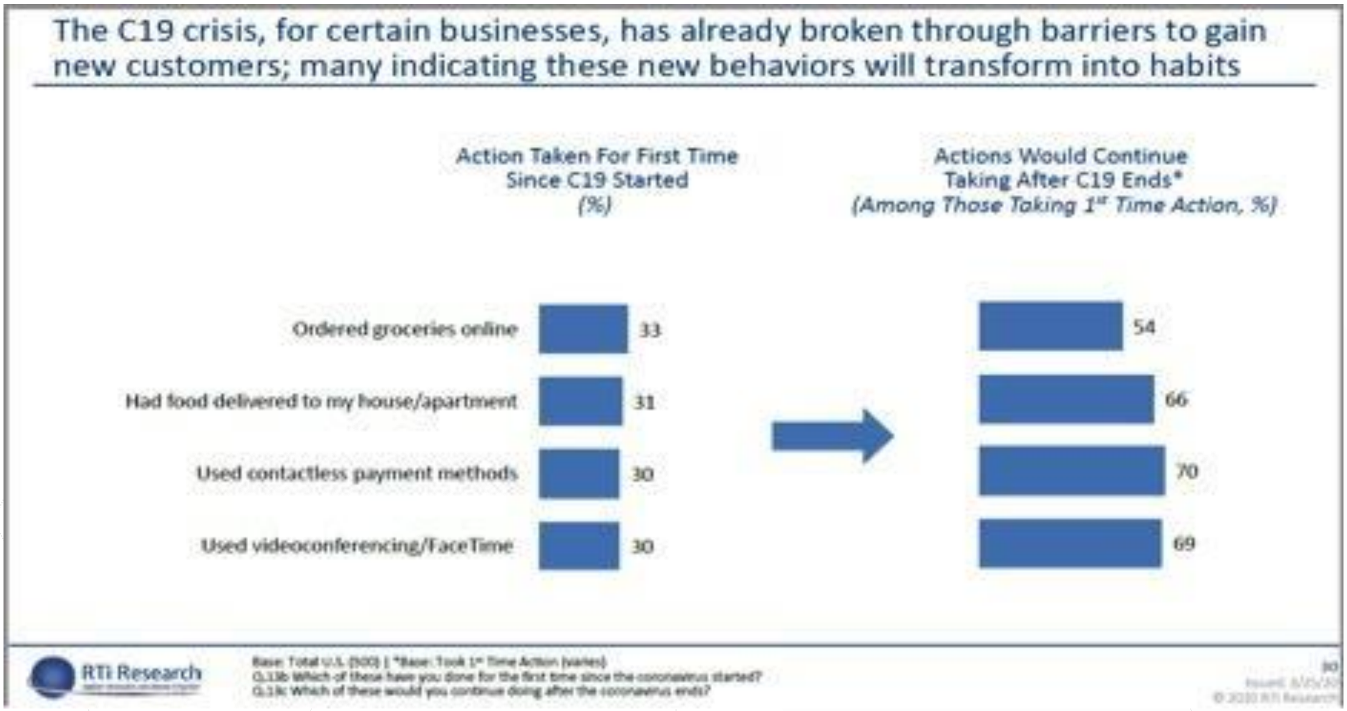
"The virus on the hands doesn't last anywhere near as long as it does on cash," one prominent Australian microbiologist explained. "It definitely survives longer on inanimate objects like money."

For that reason, the Fed is now purposely holding on to banknotes that were previously circulating in Asia before releasing them back into the U.S. market. China and South Korea actually disinfect their own currencies and quarantine them before they are re-released. Similarly, public transportation systems from Sydney to Dublin responded to the outbreak of coronavirus by banning cash payments entirely in favor of contactless alternatives.

In addition, government agencies are beginning to urge consumers to avoid all cash payments outright. For example, the Central Bank of Russia and the National Payment Corporation of India advise transactions should be made using digital payment systems instead of cash. Rather than stifle credit card company revenue, therefore, coronavirus-related closures may stimulate it by convincing even more consumers to migrate to credit and debit cards.

We can expect the raw numbers and aggregate value of card-not-present transactions to get a boost, perhaps even a permanent one, as a result. That's because an inexorable post-coronavirus migration to contactless alternatives has already begun. An RTi Research report issued after COVID-19 became a pandemic concludes that:

> *"… 30% of consumers have started using contactless payment methods (think NFC cards, smartphones, and wearables) since COVID-19 started. Furthermore, 70% of those who are new to contactless payments report that they will continue to use this payment method after the pandemic has died down."*



Coronavirus and Credit Card Services

While the credit card companies may not wind up suffering massive financial losses due to the coronavirus pandemic, credit card holders we speak with are indeed anxious about what it all means for them. For example, many who read that Visa and Mastercard are scaling down their revenue forecasts assume that will result in corporate layoffs that could affect the quality of service they receive. Adding to their concern is the news that Mastercard has been forced to close its Sao Paulo office and an annex in New York to prevent employees diagnosed with COVID-19 from infecting their office colleagues. That, in turn, has led them to consider the possibility of parallel scenarios in issuing banks.

I. What Happens if Bank Employees Are Quarantined?

"Experts predict that perhaps the most significant challenge likely from a severe pandemic event will be staffing shortages due to absenteeism," warned the Federal Financial Institutions Examination Council (FFIEC) in a directive issued to U.S. banks. (The FFIEC is comprised of representatives of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the State Liaison Committee.)

Like the rest of us, bank employees can test positive for the coronavirus. Their colleagues who come into contact with them must go into quarantine. When that happens, banks must react accordingly. Many banks have indeed been forced to close branches or reduce business hours. Customer services have been affected as a result. That includes dispute processing. If the issuing bank does not have the staff available to raise the dispute, the deadlines for doing so that are set by the credit card companies can easily be missed.

II. A Sudden Increase in Chargebacks Will Clog Up the System

Tourism has come to a standstill. Airlines have thinned out their flight schedules or suspended them entirely. The U.S. Department of State advises the public not to embark on cruises at all. Many countries have effectively closed their borders.

Of course, consumers who made travel reservations and paid in advance will want to recover their money. Should they have to do so by raising disputes with their banks, cardholders may fear that a sudden increase in chargeback requests will quickly clog up the system – even if the banks involved are functioning with full staff.

III. Merchants Can Disappear Overnight

The coronavirus is having a major destabilizing effect on commerce, especially international trade. Trade fairs and conferences are either being scaled down or cancelled, so businessmen are less likely to clinch new deals.

The precipitous drop in the number of flights, moreover, also means that it is becoming increasingly difficult to move merchandise between manufacturers, especially in China and other affected Far Eastern countries, and distributors abroad. As a result, there are reports that some distributors cannot adequately supply retailers.

Cardholders who are consulting with us and are considering raising disputes with merchants whose operations have been compromised by the virus are concerned that they may find themselves in a quandary. After all, money cannot be recovered from a bank account that has been closed.

IV. The Feared Chargeback Crunch

There is one additional factor worrying cardholders. Families affected by quarantines, layoffs and unemployment caused by the coronavirus may seek to replace at least part of their lost earnings by raising disputes with their banks that, for whatever reasons, they decided not to proceed with in the past.

These four fears encourage cardholders to assume that banks are about to be deluged with credit card disputes. And that they will have to be even more patient than otherwise in dealing with a bureaucratic process that they assume will grind to something of a near-halt as the coronavirus takes its toll.

Crypto Is No Threat to Credit Cards

It ought to be obvious, but if anyone is toying with the idea, cryptocurrencies are not going to make credit and debit cards a relic of the past, at least anytime soon. No one who consults with us – even veteran crypto investors – has even suggested that. And the reasons are clear. Here are just some of them:

- Crypto is not as ubiquitous as plastic. Not among consumers and not among merchants. It's not even close. It cannot compete and is not suddenly going to start to compete. If you doubt that, consider this: The U.S. Bureau of Consumer Financial Protection found that in 2018 "general purpose" credit card purchase volume was $3.7 trillion (with a T). In comparison, Chainalysis, a blockchain analysis company, estimated that $4 billion in bitcoin was handled by payment processors that same year. Why is there such a wide gap? Here's a simple statistic from Down Under: The Reserve Bank of Australia, that country's central bank, says that only 1% of Australians paid for consumer goods using crypto in 2019.
- Paying with crypto is not a simple exercise, which is why it has not taken off. It can also be prohibitively expensive due to high transaction fees. "Bitcoin," as one crypto journalist bluntly commented, "is a pain in the butt to use." That, no doubt, is encouraging cryptocurrency exchanges to roll out their own debit cards, issued primarily in cooperation with Visa and Mastercard. Even people who want to pay by crypto cannot easily wean themselves off plastic.
- Everyone who has one understands how a credit card or debit card works. Far fewer understand crypto, and fewer yet own it. The learning curve has a long way to go before cryptocurrency can threaten plastic. Of course, crypto could evolve into a universal payment system. But that will not happen anytime soon. To do so it first will have to assemble a critical mass of consumers to compete with the near-universal pool of credit and debit card users. We are talking of a generational process, not an overnight phenomenon.

- Obtaining crypto and maintaining it in an e-wallet (and avoiding crypto scams along the way) requires a level of digital sophistication that most people do not have. That may change as blockchain technologies evolve and the last crypto scam is busted by a cyber-savvy reincarnation of Eliot Ness, but don't hold your breath.
- Finally, and perhaps most importantly, cryptocurrencies are perceived even by crypto enthusiasts more as an investment than as a payment mechanism. That explains why cryptocurrency prices experience patterns of volatility that tend to parallel those of the stock market. It also explains why you probably have never met anyone who buys a Caramel Brulée with Ethereum at Starbucks, even though it's possible.

Recession: The Wild Card

The possibility of a global recession exists, and indeed it would be a gamechanger. A recession means a reduction in consumer spending, lower demand and rising unemployment. Credit and debit card transactions would decrease as a result. Credit card companies would indeed lose significant revenue under those circumstances.

In any event, the historical record shows that the credit card industry has been remarkably resilient in the face of difficult economic conditions. On the eve of the Great Recession (Fall 2007 – Winter/Spring 2009), Americans held 474.74 million credit cards. That number fell to 412.38 million by the time the economy began to improve. Half-a-year later Americans held 576.4 million credit cards (plus 507 million debit cards). By any standard, that was a quick rebound.

We might also recall that Visa's IPO was on March 19, 2008, smack dab in the middle of the Great Recession. (Mastercard went public on May 25, 2016, after the Great Recession was over.) The largest IPO in history up until that time, Visa's common stock opened for $44 a share, which was above the forecast range of $37 to $42. It closed that day at $56.50 per share (a subsequent stock split reduced the price per share to $11). In other words, despite the recession, investors rushed to invest. While the share price was affected by the recession, it quickly rebounded. And it did so much faster than the stock market as a whole, which took about four years to fully recover.

The lesson, as we see it, is that the investing public has demonstrated its confidence in the credit card industry. It will do so again.

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MyChargeBack welcomes feedback regarding this White Paper.
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