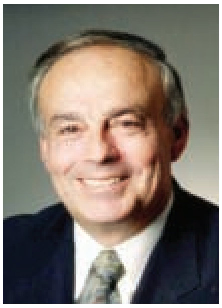
The greed of the banking industry in the mortgage and home-equity markets is being matched by the greed demonstrated in the credit card market.

The Wrong Instrument for Recurring Payments

In their lust for more transaction revenue, banks are pushing credit cards for online bill payments, including payments for recurring services like utilities, says George Thomas, who warns banks and consumers will end up worse off.



George F. Thomas is president of Radix Consulting, Oakdale, N.Y. Reach him at gfthomas@radixconsulting.com.

You don't need to be a Harvard economist to realize that the next shoe to drop in the financial crisis will be huge banking-industry losses from credit card defaults. Indeed, over the next year there will be a large number of consumers who will begin to default on their credit card debt.

In 1990, the average household credit card debt in the U.S. was $2,966. By 2007, it was $9,840. Sixty percent of U.S. consumers usually pay off their bill in full each month, but the other 40% who don't pay off their bills paid $18.1 billion in penalty fees alone to credit card issuers. That's up more than 50% since 2003 and accounts for a large segment of the industry's $40.7 billion in profits.

According to a study released in February 2008 by Bankrate Inc, 60% of Americans who incurred credit card debt did so usually as the result of bad decisions. One of those bad decisions is to use a credit card for the purchase of food and recurring monthly payments. The average interest rate for standard bank credit cards topped 19% in March 2007, compared to 16.5% in 2003. This is a hefty premium that consumers are adding to their monthly payments.

Consumer advocates caution that paying utility bills with credit cards is unwise for budget-conscious families. Despite the convenience that paying with credit cards offers, short-term consumable expenses such as utility bills or groceries should be paid with cash whenever possible, experts say.

The Golden Goose

Banks, in their zeal to generate huge profits, are killing the golden goose that has generated a very nice revenue stream for them over the past several decades. This slow death began with the banks' unreasonable approach to interchange rates, which resulted in online and brick-and-mortar merchants looking for new ways to avoid credit and debit card costs. Rather than working reasonably with retailers, banks and the card associations thumbed their noses at them. It's no surprise that merchants such as Amazon.com now offer multiple payment options, such as "pay directly from checking account," a cobranded Visa or MasterCard, store cards, and Bill Me Later.

Not satisfied with the revenue from point-of-sale and online purchases, banks began promoting credit cards for all types of recurring payments, using reward points to entice consumers to use plastic. Monthly payments for household services such as electric, gas, fuel oil, phone, and cable and satellite services became a potential new revenue stream for issuers.

These payments were traditionally made through the automated clearing house or by check, with the funds coming directly from the consumer's checking account. Credit cards are far from the ideal payment instrument to be used for these types of recurring payments. In fact, for some consumers, using credit cards for everyday necessities contributes to the downward spiral in household finances.

There are a number of negative attributes associated with using credit cards for recurring payments:

- Cards are clumsy and inefficient. The cards have expiration dates, which require update from the consumer before the service is disrupted for non-payment.
- It is not uncommon in this age of daily security breaches for a card to be canceled because of a breach. Think of the havoc that is created if that card has been set up for recurring monthly payments and has to be replaced.
- Recurring payments increase the debt burden for those consumers who do not pay off the balances. The interest expense adds significantly to the cost of these services to the consumer, with the addition in many cases of penalty fees for late payments and interest rates well over 20%.

How can anyone in good conscience say that paying monthly bills by credit card is a smarter way to pay?

Wisdom of Solomon

As a payments expert, I have long noticed that, in most banks, the managers of each of the various payment silos believe that their individual payment instrument (card, wire, ACH) should be used for every payment. But, just as the ACH is not the appropriate payment instrument for all payment types, the credit card is not the appropriate vehicle for all payments, either.

Unfortunately, that is not the view of many bankers, who have stated the need to push payments to cards because card payments are much more profitable than ACH or check payments. While this may have been true initially, I contend that in the near future it will become apparent that these payments were ultimately more costly to banks as legions of consumers begin to default on their card balances and banks have to write off bad debts.

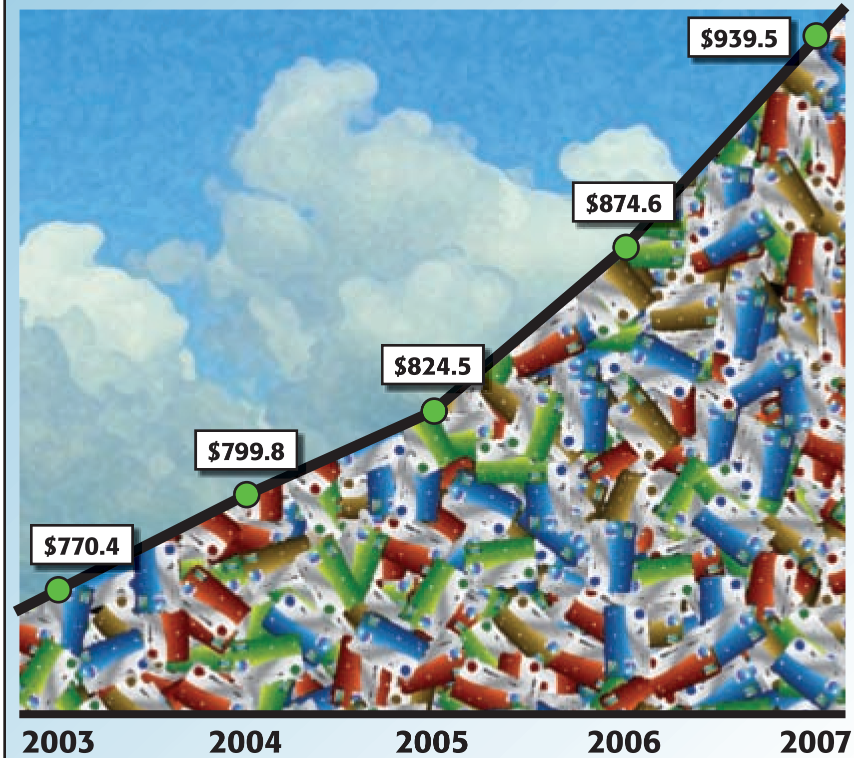
Greed was recognized early in the Scriptures with the following passage: "Whoever loves money, never has money enough; whoever loves wealth is never satisfied with his income. This too is meaningless." (Ecclesiastes 5:10).

This passage fits the banking industry to a tee when it comes to credit cards. The greed of the banking industry in the mortgage and home-equity markets is being matched by the greed demonstrated in the credit card market. This is creating a bubble that will soon burst, resulting in a continuation of the financial crisis that we see today.

How many additional financial institutions will fail as a result of the push to increase the use of credit cards for payments that should be made with cash, check, or ACH directly from a consumer's bank account? It seems like the failures of Washington Mutual and IndyMac Bank, and the fire sale of Wachovia, have not caused the industry to recognize that "[t]his too is meaningless." DT

The Relentless Rise of Card Debt

(U.S. revolving credit, in billions)



Source: Federal Reserve G.19 report

How can anyone in good conscience say paying bills by credit card is smart?