DOW JONES

THE WALL STREET JOURNAL.

Letters to the Editor
Capital One-Discover and the Payments Moat

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English

Sen. Elizabeth Warren (D., Mass.) called for the Biden administration to block Capital One's acquisition of Discover ("Block Capital One's Merger With Discover," op-ed, March 8) because she believes that two firms are always better than one. But this is a misunderstanding of how competition works. One need only look at the broader industry -- Visa, Mastercard and American Express control more than 95% of credit-clearing transactions -- to realize the folly of the many-small-firms approach. If the deal is approved, there will be more competition in the industry, not less.

Competition in the market over the past three decades has streamlined **technology** and reduced costs to the point where credit-card acceptance is nearly universal. Providing a smaller network like Discover with the financial power of Capital One creates an environment where fees can fall and security can improve.

It's time to put the Econ 101 definition of competition back on college blackboards and bring real competition to the financial-services industry.

Prof. Michael C. Munger

Duke University

Durham, N.C.

Mastercard and Visa have a combined $1 trillion market capitalization, reflecting the persistent profits resulting from their control of card payments.

The pricing power they enjoy has repeatedly been shown by academics and others to be to the detriment of consumers and merchants alike. Discover is a potentially potent tool to breach the moat protecting this payments oligopoly, yet the deal announced by Capital One has provoked a rather tepid market response.

The deal value of $35 billion and potential incremental profits of $1.2 billion referenced by Sen. Warren and additional benefits not referenced by her are rounding errors compared with the magnitude of the issue at hand. She should be asking why the deal seems to have generated such a muted response.

It isn't the merger introducing more concentration and risk that makes the deal of questionable social value, it is that the deal grossly fails to realize the potential to enhance market competition.

Adam Hurwich

New York

Sen. Warren presents many reasons for blocking the merger, including its potential to "increase risks in our economy." Would the merger be more harmful to our economy than the country's $34 trillion national debt? I think not.

Perhaps she and her congressional colleagues should worry about the financial problems they have created and the resultant risks to our economy.

Paul Stewart

Quincy, Mass.

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Capital One Set To Buy Card Rival Discover --- Acquisition of smaller competitor is valued at $35 billion in all-stock deal

By AnnaMaria Andriotis and Lauren Thomas
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Capital One said it will buy Discover Financial Services for more than $35 billion, in a deal that will marry two of the largest credit-card companies in the U.S.

Under the terms of the all-stock deal, Discover shareholders are set to receive 1.0192 Capital One shares for each Discover share, representing a premium of about 27% based on Discover's closing price Friday. After the deal closes, Capital One shareholders will hold roughly 60% of the combined company, with Discover shareholders owning the rest.

Capital One is making a big bet at a booming time in the credit-card sector. More consumers are moving from paying with cash to cards as a result of generous rewards programs and the digitization of commerce -- a transition that accelerated with the pandemic. A recent increase in credit-card-debt has provided a further boost to issuers.

Buying Discover would give Capital One, a credit-card lender with a market value of a little over $52 billion, a network that would vastly increase its power in the payments ecosystem.

Card networks are critical to enabling transactions and setting fees that merchants pay when consumers shop with credit cards. Though much smaller than Visa and Mastercard, Discover is one of the few competitors to those companies in the U.S., and it is one of a small number of card issuers that also has a payments network.

Capital One, the ninth-largest bank in the country and a major credit-card issuer, uses Visa and Mastercard for most of its cards. The bank plans to switch at least some of its cards to the Discover network, while continuing to use Visa and Mastercard on others. Those larger networks have more merchant acceptance abroad than Discover does.

Capital One also plans to maintain the Discover brand on the cards and network -- assuming regulators sign off and the deal is consummated.

Discover, based in Riverwoods, Ill., is an online institution so the takeover wouldn't come with physical bank branches, except for one location in Delaware.

The deal follows a tumultuous period for Discover that has included increased regulatory scrutiny and a change in leadership.

The company disclosed last year that an internal review found it had misclassified certain credit-card accounts beginning in 2007, incorrectly placing them in the highest merchant-and-acquirer pricing tier. The company established a liability of $365 million to account for estimated compensation owed to merchants and acquirers.

Separately, Discover received a consent order from the Federal Deposit Insurance Corp. In October, Discover said it would address the FDIC order to improve its consumer-compliance operations.

In December, Discover said financial-industry executive Michael Rhodes would become its chief executive officer and president. He took over from John Owen, who had been serving in the interim after Roger Hochschild stepped down in August.

Discover has been approached by large banks and **technology** companies about an acquisition of all or a part of its business over the past decade or more.

Tech companies have been interested in acquiring its network so that they can play a more central role in payments, but prior senior executives at Discover weren't interested in separating the company's credit-card lending side from the network.

For Capital One, the deal would also further expand the number of cardholders it will count as customers for its credit-card lending business. Many Discover cardholders have high credit scores.

Discover also has consumer deposits, most of which are in savings accounts, allowing Capital One to continue to expand its already large presence in that area.

For about a decade now, big U.S. banks have aggressively competed for customers by rolling out new credit cards or enhancing their existing ones with more cash-back offers or points programs that dangle the possibility of free or discounted airfare, hotel stays or other travel perks.

Credit-card debt fell during the pandemic but is rising again. That translates into lucrative interest charges that cardholders pay to the banks that issue their credit cards.

Issuers face the risk of rising delinquencies and loan losses, however, if unemployment rises or a recession occurs.

Rising credit-card usage is also a boon to the billions of dollars in interchange fees banks collect every year. The fees are set by card networks and paid by merchants when consumers shop with cards. By owning the Discover network, Capital One could negotiate interchange fees and other terms directly with merchants for card transactions that travel over its network, making Capital One more of a competitor to Visa and Mastercard.

An acquisition of Discover would rank among the biggest deals so far in 2024. After a lull in M&A activity in 2023 as economic and other uncertainty and increased interest rates took a bite out of the appetite for deals, volumes have gotten off to a relatively strong start and are up 90% in the U.S. compared with a year earlier, according to Dealogic.

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THE WALL STREET JOURNAL.

PERSONAL JOURNAL

The Tricky Math Behind Using A Credit Card's Travel Portal --- The price you see on an airline's website isn't always the same as the one on your credit card's booking tool

By Jacob Passy
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Chase, American Express and Capital One tout their travel-booking tools for cardholders as a way to maximize rewards and make dream vacations a reality. But are those sites a good deal?

The answer, travelers find, can take some math.

Travelers say differences in price make it tough to determine the best deal. And some grouse that they are already paying steep annual fees for certain cards.

Will Biesel, a Dallas attorney who pays $550 for his Chase Sapphire Reserve card, said he has found high prices on Chase's travel portal, such as a $456 American Airlines round-trip to North Carolina that the airline was offering for nearly $100 less. Another trip, on Southwest, cost 65% more on the portal than from the carrier directly, Biesel said.

Credit-card companies' booking tools often turn up higher fares and room rates than travelers might find on airlines' and hotels' own sites, fliers say. Part of the reason is the desire of airlines and hotels to get more travelers booking directly, rather than via third parties such as Expedia or Chase's travel portal.

With many trips booked for this year, Biesel had hoped to use his credit-card points to offset the travel costs. But often he felt like he wasn't getting his rewards' worth on the portal.

"You hope to get value out of that credit card by spending the points wisely," said Biesel, 28 years old. "It's harder to justify the total price if you're not using all the perks."

Premium credit cards such as the Chase Sapphire and American Express Platinum are geared to the jet-set crowd, and the portals are critical to their appeal. Many of these cards offer cardholders hundreds of dollars in travel credits that can be used only in their dedicated portals. They also entice people to spend their own money, versus their rewards, by offering significantly more points or miles for booking with them.

About 14% of U.S. cardholders typically went to their credit card's travel portal to research and book trips, according to a 2022 study from the Futurist Group, a payments-industry consulting firm. More than a third of those travelers said they weren't pleased with the experience.

"The No. 1 barrier to growth of these portals is the perception that the price is not necessarily the best deal," Futurist Group founder and Chief Executive Demitry Estrin said.

A Chase spokeswoman said the company is "committed to providing cardmembers with competitive pricing whether they're booking with points or cash."

Credit-card companies don't set prices for hotel rooms or plane tickets. Most don't even operate the travel-booking features connected to their cards -- major online travel agencies do. Hopper manages Capital One's website, and Expedia powers American Express's consumer-travel site.

Cardholders often find different prices based on where they check.

In some cases, these travelers might not be comparing apples to apples. With airfares, it is important to check which fare class is advertised when you search. Some websites advertise basic economy -- a type of fare with extra restrictions in exchange for a lower price -- as the default option. Others display regular economy-ticket prices.

Flight and hotel prices also fluctuate based on demand.

Not all websites update their pricing at the same time, said Cory Garner, an independent consultant who led sales and distribution strategy at American Airlines until 2020. If an airline lowers its fares from Chicago to Dallas, that change might not show up immediately for online booking sites.

Separately, airlines have started implementing new **technology** to distribute their seats to third parties such as online travel agencies, Garner said. That **technology** lets carriers more easily offer travelers extra options, including additional categories for seat selection.

As they push travel agencies and corporate-travel managers to adopt the **technology**, some carriers have limited which fares remain available on the old distribution systems. They are typically higher fares, Garner said.

"Credit-card travel portals who are using older distribution **technology** do not have the same access, despite American's best efforts to make these fares available to them," an American Airlines spokeswoman said.

Hotels generally don't reward points in their own loyalty programs and may not offer other benefits to people who booked anywhere but through the hotel itself, said Adam Morvitz, founder and CEO of point.me, a points and miles search aggregator and booking service.

And when travel snags occur, rebooking can become tougher. In many cases, airlines require travelers to hash out any problems via the site they booked on.

The Chase spokeswoman noted that the company can rebook cardmembers with multiple airline partners when service disruptions arise.

Using a credit card's travel site to book a vacation can sometimes provide enough advantages to outweigh potential price differences.

Joshua Gellers of Jacksonville, Fla., starts his travel research with Google Flights to get a read on prices. He then checks his credit card's travel site, factoring in additional rewards he would earn going that route. Credit-card companies sometimes have offers that can boost the rewards rate even higher for customers.

When booking a Sydney hotel last summer, he found booking directly with the hotel was cheaper than his credit-card company's site. But the rewards offered by the card site swayed him, since their value was greater than what he would save by cutting out the middleman.

Gellers, a professor at the University of North Florida, notes that his tactics aren't for everyone: "Think about how much extra effort that is for the average traveler."

Sometimes, credit cards will advertise special discounts on flights or vacation packages only for their cardholders.

Capital One Travel offers price-matching if lower prices are available at the time of booking and free price-drop protection for flights. The site monitors flight prices up to 10 days after customers book. If that itinerary's price falls, Capital One issues a travel credit of up to $50, with some limitations.

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