A GEMIC WHITEPAPER

We don’t need more credit. We need credit to be more.

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Trust enables credit: if both parties in an agreement trust each other, and can prove this trustworthiness, a mutually beneficial relationship is born.

"I'm scared of credit cards."

"Honestly? I don't understand them."

"I'm pretty sure my bank is out to get me."

This just in and all over the business press: Millennials are afraid of being duped by credit cards. How did this happen?

In 1950, a man forgot his wallet when it was time to pay at a restaurant. Being a true innovator and entrepreneur, he came up with an idea from his predicament. What if you had a card that you could use to pay for things now, and you take care of what you had spent at the end of the month in one go?

With that, the first credit card was born. It was based on two pillars: convenience and trust. Convenience, because you can carry a card that works almost everywhere and for almost anything. Trust, because credit card companies decide to issue loans based on your history of credibility, and you trust them to only give you money that you can pay back.

Today, the appeal of credit cards is still based on two pillars, although different from the first ones: build credit and accumulate rewards. On the surface, the shift seems benign. Yet the proliferation of credit as a prerequisite for modern life and its associated rewards game are fundamentally incompatible with the principles of both trust and convenience. Neither encourage sustainable credit card use. Both are becoming less attractive by the day. Why?

Credit: the erosion of trust

The very beginning, conventional wisdom declares, is a good place to start. Credit among people has existed for much longer than credit cards, but there are some fundamentals of credit that should be considered. In Chinese, the word for credit is 信用, which roughly translates as "use of trust." Trust enables credit: if both parties in an agreement trust each other, and can prove this trustworthiness, a mutually beneficial relationship is born. One person gets convenience and immediacy. The other gets profit through interest.

Following this model, credit card companies used to be the good guys who enabled people to reach their goals by purchasing things they could not (yet) afford. They set up payment plans that translated convenience into dollars. They helped people achieve the American Dream by enabling them to invest in fridges, mattresses, and other signs of modernity in and for the home.

But this is no longer true. To Millennials, credit cards are enablers in the most insidious sense: they trap people into buying things they do not need. When 73% of Millennials are carrying student debt over $10 000, the last thing they need is more debt and more temptation. They know that, which is why 71% of millennials intentionally leave the credit card at home when they go shopping. Steeped in a culture that constantly tempts them to buy, Millennials feel that one of the two pillars – trust – has been betrayed by credit card issuers that allow people to go over their means by increasing credit limits even when unprompted, and then punish them for it, all at a profit. That said, it's not only the structure of credit cards that makes them untrustworthy. Another reason can be traced back to 1986 and the genesis of rewards.

Gamification of credit cards

What sounds familiar: it's double cashback day for apparel, double the air miles, double cashback for entertainment! This card has an annual fee of $500 but the sign-up bonus is $300 if you spend over $1000 in the first two months, and you get 2% cashback on all your purchases!

What a headache. You can blame — or thank — Sears for

the constellation of reward mechanisms in the credit card industry today. In 1986, Sears introduced a truly disruptive concept: to differentiate themselves from competitors, they issued a cashback credit card. Coinciding with the age-old American tradition of discounts and feel-good consumerism, this move set off a flurry of copycats.

Today, the world of credit cards is a cesspool of rotating points, various cashback policies, and dissimilar redemption options. This is difficult to navigate, which is partially the reason for the popularity of personal finance advising websites like NerdWallet. Online financial advisors make their living by compiling rankings of credit cards based on their aggregated rewards value. Think about this for a second: people make money by telling you which credit card to sign up for, because wading through rewards information is both complicated and tedious. The fact that the world of credit cards requires a group of professional mediators is concerning. When you trust something, you do not need a guide. The fact that you can make a "best" decision means there are "bad" decisions. In other words, the credit card reward system has become a game.

Much like how extreme couponing has fallen out of fashion with younger people, Millennials don't care for games between an issuer and a customer. Games do not nurture trust: in fact, they do the opposite. The cardholder is playing against an adversary, the issuer, whose primary aim is to win. The cardholder "wins" when she accumulates the maximum number of points which can be translated into the maximum value of rewards; the issuer wins when points lie unredeemed or are redeemed for low-value rewards. This relationship is not mutually beneficial, because there are losers and winners by definition. There is no incentive for either party to trust the other. The new mindset is mercenary: "get what I need out of this arrangement, and get out."

The new question, then, is what do people get out of this arrangement? Rewards will soon be insufficient, but credit card companies still have a glimmer of hope: credit cards build credit scores, which shape contemporary life.

Credit as a prerequisite for modern life

Millennials acknowledge that credit scores can affect anything from a job search to an apartment rental. Those with any financial literacy realize that building credit is an important part of modern life, and cautiously use credit cards to reap benefits down the line. However, they view credit card companies and most financial institutions with deep distrust and are only connected to the credit card business because they need to build credit scores. But building a credit history has become less and less of an incentive. More than a year ago, My Bank Tracker reported that almost 50% of Millennials do not have credit cards. More worryingly for credit card companies, 35% of those aged 25-34 have never even applied for one. Already, some credit unions are moving to a strategy where credit scores are not necessary for mortgage applications. Instead, they use a combination of paystubs, recommendation letters, and rental payment history to gauge if a borrower could be trusted. In 2015, credit unions accounted for 8% of American mortgages. Unconventional credit history is no longer the kiss of death for aspiring homeowners. And there is no reason to believe that this trend will change any time soon. On the contrary, trust in credit scores as an institution has been plummeting because of the Equifax data breach. Many articles and columns advised—rightfully—that consumers freeze their credits to protect their identities, putting a halt on credit card applications.

What comes next?

As seems to be usual these days, look to Silicon Valley where Affirm, PayPal, and Klarna belong to the new Instant Online Credit club. All three pride themselves on their proprietary algorithms that can determine the trustworthiness of a borrower within minutes and then allow their borrowers to purchase big-ticket items (such as a laptop, or a mattress) with

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several payment options. Unlike traditional banks, instant online credit companies do not rely on credit scores, which people recognize as both arbitrary and insufficient. Unlike credit unions, which will conduct holistic evaluations but take a long time to evaluate paystubs and letters of recommendations, instant online credit is quick. Tech saves the day, right?

It's true that the proprietary algorithms are both sophisticated and efficient. It's also true that Affirm, PayPal, and Klarna have tapped into a desire for more simplicity by offering few services, and offering them well. Recall the original credit card, which is based on trust and convenience. If nothing else, these tech companies have got convenience down pat.

In addition, instant online personal loan companies pride themselves in transparency. They proclaim to have no hidden fees and send borrowers reminders to pay their bills — a nice peace of mind. So, is this the future of credit? Trust determined by algorithms? Personal loans approved in an instant? All easy to do and to understand?

Maybe it would be the future of credit had companies like PayPal not been fined $10 million (plus $15 million in refunds) for signing up PayPal customers for their credit program without their explicit permission. In doing so, the company placed itself, for many people, into a Do Not Trust category that has seeped deeper into the instant online credit industry. Despite claims of radical transparency, there is still room for unexpected disappointment. Some customers are dismayed to find that a positive payment history with Affirm do not improve credit, but late payments still affect their credit score. The one-foot-in, one-foot-out engagement with credit scores at the customer's detriment can quickly mushroom into more and more distrust.

Touting themselves as an alternative to credit cards for Millennials, we are seeing online instant credit companies make the same mistakes to alienate their customers as their old-world credit card masters. They capture the convenience aspect of credit cards and use holistic evaluations of trustworthiness, but fail to deliver trust from their end. One rotten apple does, in fact, spoil the whole bunch. If PayPal Credit can't be trusted, why should Klarna be any different? We see the cycle repeat all over again: customer gets burned by credit, uses it reluctantly, and perhaps stops using it at all.

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A new trust

60% of Millennials trust AirBnB. That's right: they're willing to sleep in the home of a random stranger. But 50% of them don't have a credit card because, unlike the stranger in the strange land, they don't trust them.

This phenomenon tells us several things. One, Millennials trust individuals. Two, institutions that are too big to fail are also too big to trust. Scale is no longer a meaningful heuristic. Three, Millennials are not risk-averse, they are risk-discerning. There is always a risk that a new AirBnB host is a serial killer, but that doesn't stop travellers from flocking to new listings. Four, AirBnB emphasizes its ability to bring people together for the good of all. Hosts get to make friends and money, guests get to save money and have a local experience in an unfamiliar place.

What can financial companies learn from the AirBnB phenomenon? Millennials like it when actions that benefit them also benefit others – no foreclosures, no repossessions, thank you. Millennials also value the personal touch. There is a certain pleasure in knowing that your money is going towards an Italian grandmother, and not the ether of the Hilton. Overall, trust is between people, but mediated by an institution that has your back.

Yes, online instant credit companies are stealing a few customers who used to rely on banks. But the credit industry will continue. For it, the question is: Which institutions can continue to operate and profit without running off a cliff in a hasty attempt to solely profit like the old days? And for the online instant credit industry, the question is: How many hustles, missteps and betrayals do you have until your existing and potential customers lose all trust in you?

From radical simplicity and transparency, merchant fees instead of late payments, help with financial literacy, communities of consumption, micro-financing support and other initiatives, it's clear that the traditional credit industry is going to need some better ideas if it hopes to survive the Millennial purge (and the Gen Z eradication that could arguably follow).

They've told you: They don't want games. They don't want to build credit after Equifax. They don't want to look like the bankrupt families on TV back in 2008. And they find the idea of an industry profiting on people's bad financial decisions and behaviors to be absolutely reprehensible.

The big question is, How will you respond to them?

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