

# The challenges facing Apple Pay on the Chinese market

Apple Pay launched in China on 18 February through a strategic alliance with China UnionPay. As the biggest bank card association in China, China UnionPay operates an inter-bank transaction settlement system through which the connection and switch between banking systems and the inter-bank, cross-region and cross-border usages of bank cards issued by its associate banks is undertaken. Currently, Apple Pay transactions can only be made via UnionPay QuickPass Point-Of-Sale ('POS') terminals in China. Kevin Wang and Lilith Chen of CMS, China discuss Apple Pay's presence and prospects in China.

## The legal landscape

According to the Administrative Measures for the Payment Services Provided by Non-financial Institutions promulgated by the People's Bank of China ('PBOC') on 14 June 2010, a payment institution must obtain a Payment Business Permit to provide payment services through the network. The Administrative Measures for Online Payment Services of Non-banking Payment Institutions promulgated by the PBOC on 28 December 2015 further interpret the concept of 'payment services through the network,' i.e. the payee or payer sends long-distance payment orders through electronic equipment by relying on the public network information system, and the payment institution provides monetary transfer services for the payer and payee, during which the payer's electronic equipment is not connected to the payee's equipment.

Based on Apple Pay's operating mechanism, Apple Pay does not

have its own payment account or virtual intermediate account, which means that Apple Pay is not involved in any deposit or flow of funds during the payment. Instead, Apple Pay only provides a virtual card package technical service to help the payer's Apple device connect to the payee's UnionPay QuickPass POS terminal, which does not constitute 'payment services through the network' as defined in the above regulations.

The role that Apple Pay plays in the payment process means that it will not be regulated by the current PRC payment-related laws and regulations as a payment institution. Furthermore, compared to other m-payment service providers, all the funds of Apple Pay transactions are completely circulated in the banking system, which allows the traditional commercial banks to collect the relevant transaction information and also avoids the risk of misappropriation of transaction funds by m-payment service providers. Thus, Apple Pay might be favoured by the commercial banks in China.

## The 'four party' system

The traditional 'four party' system of the bank card acquiring business<sup>1</sup> in China involves the following parties: the merchant, the bank card acquirer (which is the bank receiving the relevant payment on behalf of the merchant), the bank card issuer, and the bank card settlement agency, i.e. China UnionPay. According to this system, when a consumer uses China UnionPay's POS terminals to pay, the bank card acquirer shall transmit the transaction information through China UnionPay to the bank card issuer, and the merchants shall bear the commission charge of the above procedures. The profit-sharing ratio of such commission

charge among the bank card issuer, the bank card acquirer, and China UnionPay is 7:2:1.

Compared to the traditional 'four party' system the flourishing private m-payment platforms in China have introduced a different process in the past 10 years, which has included QR-code based payments adopted by Alipay and WeChat Pay. For example, when a consumer uses Alipay to pay, he/she scans the QR-code provided by Alipay through the mobile device, and Alipay will transmit the transaction information directly to the bank card issuer. During this process, China UnionPay is bypassed, and therefore is unable to participate in the dividing up of the m-payment market's 'cake.'

Moreover, China UnionPay's m-payment marketshare is not optimistic. According to the Quarterly Monitoring Report on China's Mobile Payment Market 2015 Q3 published by Analysys, in 2015 Q3, China's third party m-payment market reached RMB 4,391.4 billion in size, a jump of 26.39% quarter on quarter. Alipay ranked first with a marketshare of 71.51%. Tencent Pay (including WeChat and QQ) grew rapidly and took a marketshare of 15.99%. However, China UnionPay only took a marketshare of 0.49%.

In order to improve on this grim situation, China UnionPay earnestly seeks to cooperate with Apple Pay, which does not intend to break the traditional 'four party' system. Likewise, Apple Pay is also eager to exploit its own m-payment territory in China since China is the second largest market of Apple device users, beyond the US. Furthermore, from a practical point of view, the NFC technology used by Apple Pay can be utilised by the broad network of POS terminals owned by China UnionPay throughout China. Therefore, the cooperation

	Apple Pay	Alipay and WeChat Pay
<b>Requirement for the device on the consumers' side</b>	iPhone 6/6 plus, iPhone 6s/6s Plus, iPad Air 2, iPad mini 3/4/Pro with the software above iOS 9.2, and Apple Watch with the software above watch OS 2.1	Any type of device having the scan function
<b>Requirement for the device on the merchants' side</b>	China UnionPay QuickPass POS terminals	No device is required, only a QR-code is needed
<b>Cooperative banks</b>	12 commercial banks, i.e. the Agricultural Bank of China, CMBC, BOC, the Industrial Bank, CCB, ICBC, CGB, PSBC, China Citic Bank, SPD Bank, CMB and Bank of Shanghai	More than 100 banks
<b>Promotions provided to consumers</b>	Follow the cooperative banks' own special offers and bargains	Conduct their own promotions with heavy subsidy

between China UnionPay and Apple Pay serves the interests of both sides.

### Interchange revenue

Although the collaboration of China UnionPay and Apple Pay was rather obvious, the arrival of this strategic alliance took more than a year. As disclosed by an insider from a state-owned bank that participates in the Apple Pay project, the differences between these two parties on the business model and profit-sharing scheme might be a reason for the delay.

Apple Pay charges 0.15% and 0.5% respectively for credit card transactions and debit card transactions in the US market and wanted to copy this scheme on the Chinese market. However, Chinese banks seemed reluctant to follow. According to Chinese media group Caixin, Shi Wenchao, the Chairman of China UnionPay, once said that "Apple Pay intends to break the profit sharing pattern of the traditional '4 party' [system] which is a break with tradition."

As we can see, the two parties have finally reached a compromise in order to pursue their common goals. A person close to the matter at a joint-stock commercial bank has indicated that based on the traditional '7:2:1' profit-sharing

**Figure 1:**  
Localised services

mode of merchant interchange revenue in China, Apple Pay takes 10% from the '7' part, which means that Apple Pay is participating in the profit-sharing with the bank card issuers.

The amount of merchant interchange revenue charged depends on the different types of merchants in China. According to the Circular on Optimizing and Adjusting the Bankcard 'Swipe' Charges promulgated by the National Development and Reform Commission ('NDRC') on 25 February 2013, merchant interchange revenue ranges from 0.7% to 1.6%. Thus, the 10% charge of Apple Pay on the '7' part is around 0.049% to 0.112%. Compared to its charges on the US market.

### The challenges

The main competitors Apple Pay will face are Alipay and WeChat Pay, since together they controlled almost 90% of the m-payment marketshare in 2015, according to Big Data-Research. In 2015 Q3, Alipay had 190 million active users and WeChat Pay had 150 million active users.

Compared to Apple Pay, Alipay and WeChat have a more localised service style (see Figure 1). Based on this information, Apple Pay

now faces the biggest challenge in how it converts consumer payments from QR code to NFC-based - the latter requires more hardware and software support, covers less usage scenarios and provides comparatively less promotions. Furthermore, the coverage of the China UnionPay QuickPass POS terminals also limits the development of Apple Pay. According to Analysys, there are only three million China UnionPay QuickPass POS terminals among over 10 million POS terminals nationwide. Given these challenges, how Apple Pay helps China UnionPay to retake lost ground in the m-payment market in China remains to be seen.

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1. According to the Administrative Measures on Bankcard Acquiring Business promulgated by the PBOC on 5 July 2013, the 'bank card acquiring business' refers to the activities whereby bank card acquirers provide the transaction funds settlement services to the specially engaged merchants after they accept the bank cards and conclude transactions with related cardholders based on the bank card acceptance agreement signed between the bank card acquirers and the specially engaged merchants.