Why Apple Pay Is a Threat to Royal Bank of Canada

Description

Although it has yet to be formally confirmed, there is widespread speculation that **Apple's** (NASDAQ:AAPL) popular new mobile payment service Apple Pay could be rolling out in Canada as early as November.

Currently the Big Six banks are in negotiations with the tech giant, and Apple is eager to break into the Canadian market due its relatively high iPhone market share. The new technology—which would allow consumers to pay for products using their mobile phone by swiping near a terminal at check-out—requires the banks as partners since it is their credit, debit, and loyalty cards that would be loaded onto the Apple Pay app.

While this does present somewhat of an opportunity, it also an enormous threat, which was corroborated recently when **Royal Bank of Canada's** (TSX:RY)(NYSE:RY) CEO Dave McKay recently stated the bank was "on a collision course with the Googles and the Apples of the world." Just how big of a threat is Apple Pay to Royal Bank, and what is the bank doing to respond?

Why Apple Pay poses a risk

Credit card issuers like RBC currently make money in three basic ways. The first way is on interest rates for unpaid balances, and with credit card interest rates nearing 20%, this is a sizable source of revenue.

The second way is by charging various fees to cardholders, including annual fees, cash advance fees, late fees, balance transfer fees, and a host of other fees.

The final means in which a bank makes money from credit cards is through the interchange fee. The interchange fee is a part of what is known as the "merchant discount fee," and this is a fee that is typically between 1-3% of the goods purchased, and charged to the merchant by deducting it from their end.

A small part of this merchant discount fee goes to the provider of the payment terminals, as well to the actual credit card companies (like VISA or MasterCard). The remainder goes to the card-issuing bank, and this is the interchange fee, which is the financial incentive banks receive for issuing a credit card company's cards.

Currently in the U.S. Apple Pay is making money not from charging merchants, but rather from charging banks, and in the U.S. it is estimated that Apple is charging 15 cents per $100 credit card transaction (or 15 basis points), and many are suggesting that Canadian banks could face even higher fees in the 15-25 cent range. By having Apple as an intermediary between the bank and its customer, RBC stands to lose credit card revenues through needing to cede some of its interchange fee.

This comes at a time when Canadian banks are already receiving reduced revenues from the recent reduction of swipe fees to benefit Canadian merchants, as well as the recent decision by the government to allow merchants to reject mobile payments if they are higher cost then physical card transactions, even if the merchant accepts transactions with the same physical card. This puts banks in the potential position of needing to absorb higher costs for mobile payments.

In addition to lower credit card revenues, Apple Pay poses a risk to RBC by coming between the bank and its customer, a concern recently express by RBC's CEO Dave McKay. The fear is that customers would no longer be directly using the bank for payments, which could reduce the bank's ability to communicate with its customers, and could potentially allow Apple to gain more market share in the payments/banking space as customers become more confident.

While RBC has launched its own mobile payment service known as RBC digital wallet, which will allow the company to retain some revenues. It will be facing an extremely competitive marketplace, especially given the recent success of Apple Pay in the U.S., where the app currently accounts for more than two-thirds of payments made using mobile payment services.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:AAPL (Apple Inc.)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:RY (Royal Bank of Canada)

Category

1. Bank Stocks
2. Investing

Date
2025/08/26
Date Created
2015/05/04
Author
amancini