

How Toronto-Dominion Bank Is Preparing for Apple Pay's Arrival

Description

It seems virtually inevitable now that **Apple Inc.'s** ([NASDAQ:AAPL](#)) new mobile payment service, Apple Pay, will arrive in Canada. Apple Pay allows users to pay for goods and service at the checkout using credit and debit cards preloaded into the app by tapping their phones at a point-of-sale terminal. The app also enables users to use loyalty cards as well for redeeming and collecting points.

The market conditions in Canada are ideal for Apple Pay to flourish. Two-thirds of Canadians have financial apps on their smartphones and 2.5 million Canadians use mobile banking to conduct daily banking transactions. Couple this with the fact that iPhones enjoy a comparatively large market share in Canada—comprising 33% of the Canadian market relative to 20% globally—and Canadians have the willingness and the technology to adopt the service.

This may be great news for Apple and Apple consumers, but it represents a significant threat to Canadian banks, as the banks traditionally controlled the payment process. **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) is especially vulnerable, given the banks large exposure to credit cards.

The risk Apple poses to TD Bank

Apple Pay poses several risks to TD Bank. To begin, credit cards provide a decent amount of revenue to TD. About 5% of the bank's total loans outstanding are from credit cards, and this is high compared with its peers. **RBC**, for example, only has about 3.2% of its loans outstanding originating from credit cards.

This credit card portfolio generates revenue largely from fees, the largest of which is known as the interchange fee, which is typically between 1.5-3% of the purchase price, is charged to the merchant, and paid to the bank. This fee is set by credit card companies such as MasterCard, and banks have been grappling with the recent reduction of interchange fees to an average of 1.5%, effective April 2015, as a result of pressure from the federal government.

Apple's arrival in Canada will further exacerbate this, since banks will be required to pay a fee to Apple for every transaction. In the U.S., this fee amounts to approximately 0.15% of the transaction value, and Canadian banks could see fees between 0.15-0.25%. This approach differs from the approach **Google's** mobile payment system, Google Wallet, is using. Google profits by collecting data about customer transaction habits and using this data to offer ads.

Although fees are certainly a major risk, Apple poses an even greater threat—by inserting itself between the bank and its customer, TD is essentially losing access to its customers and would not have the same opportunity to interact with customers and learn about customer purchasing behaviour as it would if a customer were using a bank's mobile payment system.

How TD is responding

TD, in partnership with PC Financial, has responded to the threat of Apple Pay by developing its own mobile payments system called UGO, which will allow Android and Blackberry users on all major Canadian carriers to make mobile payments.

While other Canadian banks have also developed mobile payment apps, such as RBC's digital wallet, UGO has several key advantages, and is most suited to be able to effectively compete with Apple Pay. Unlike RBC's digital wallet, which is only available on the Bell network, UGO is available on Android and Blackberry phones, and on Apple phones in a more limited capacity.

In addition, UGO is currently the only Canadian product to offer two participating banks—allowing cards from both TD and PC Financial to be supported—with the ultimate goal of allowing all credit and loyalty cards from all institutions to be supported. UGO recently made large strides in this direction, announcing support for all loyalty cards.

This is a service Apple has been unable to offer due to the fact that Apple only supports loyalty programs by pre-approved partners. UGO is also available on Apple phones, although only loyalty cards can be stored, and payments cannot be made due to Apple not allowing third-party developers to use the phone's payment chip yet.

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2. NYSE:TD (The Toronto-Dominion Bank)
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