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Big Techs vs. Banks: Payments first then Banking?

Can the regulator save the day?

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June 2022
Blogpost

Public

Key Facts

- EU Competition Commission communicated objections to Apple in May 2022, finding that access to the NFC interface may have been unlawfully restricted
- The regulatory intervention should be seen in the context of the tendency of big techs like Apple, Google & Co. to successively open up finance value chains
- The xPays do not necessarily act only as competitors, but also as (sometimes asymmetrical) business partners.
- Should Apple be forced to open the NFC interface, potentially far-reaching market movements in mobile finance could result
- Undeterred, Apple launches next finance product with integrated BNPL solution and enters lending business
- For the first time, and contrary to expectations, with its own licence and operational management.
- Banks should therefore not assume that the regulator alone will solve this challenge for them, but use the opportunity to reflect on their own positioning between cooperation and competition with the xPays and update their (payments) strategies

EU Commission: Blocking the iPhone NFC interface may be illegal

The European Commission published its preliminary view on 2nd of May 2022 that Apple has abused its dominant position in the markets for mobile wallets on iOS devices: By blocking access to the NFC interface as a standard technology, Apple restricts competition in the field of mobile wallets on iOS devices - thereby benefiting the company's own solution, Apple Pay.

Commission Vice-President in charge of the case, Margrethe Vestager, said: "[...] We have evidence that Apple has restricted third parties' access to key technologies needed for the development of competing mobile wallets for Apple devices. In our Statement of Objections, we preliminarily find that Apple may have restricted competition in favour of its own Apple Pay solution. Such conduct would constitute a breach of our competition rules."

Since then, comments have been pouring in on social media and specialist forums and product managers are already developing approaches to use the anticipated opening of the NFC interface for individual institutions: a proprietary, functionally superior and, above all, confidential mobile payment app from house banks or fintechs - now also conceivable uniformly on all devices? Will an end to customer segregation in the mobile payment environment encourage new investments and what does this mean for QR code-based payment methods?

Yearly greets the groundhog

The discussion of legal levers to force Apple to open the NFC interface is anything but new: as early as 2016, a consortium of well-known banks in Australia tried to take legal action against Apple to force the opening of the NFC interface so that they could launch their own NFC wallets on iOS devices. The case was dismissed in Apple's favour just under a year later. In 2017, an investigation was launched in Switzerland by the Competition Commission with analogous accusations against Apple, while some Swiss banks joined forces for a strategic counter-initiative called TWINT, which in turn was criticised by Apple as being critical in terms of competition law. Here, too, the proceedings were eventually dropped, although a lively exchange of blows between Swiss banks and Apple is still being fought out via the Competition Commission and the Consumer Protection Authority, now more with a focus on a potential competition agreement on the part of TWINT: Apple Pay can be found in Switzerland in the usual model, but TWINT was able to use the momentum and develop into the dominant payment wallet in Switzerland even without NFC - obviously to Apple's annoyance. Probably the most prominent example of such lawsuits against Apple in this country comes from Germany itself: In 2019, the so-called "Lex Apple Pay" was introduced as § 58a ZAG. This was intended to oblige system operators to make technical infrastructure services available immediately upon request by a payment service provider for an appropriate fee and using appropriate access conditions. However, since the law was not sufficiently stringently formulated in part, in practice no provider could (or wanted to?) de facto fulfil the requirements postulated by Apple on the basis of the law and launch a 3rd party NFC wallet on an iOS device. Accordingly, the Bundestag tightened up the law again in June 2021, but it has not yet taken effect due to the lack of ratification.

Why perhaps a different outcome this time?

First of all, with the EU Competition Commission, a comparatively high body has taken up the issue and a corresponding enforcement would presumably apply to the entire EU and thus increase the reach as well as the corresponding market potential of new solutions made possible by this accordingly.

Furthermore, the publication is in line with a movement of the regulator that has been observed for about two years: the "Retail Payment Strategy" of the EU published in September 2020 postulated, among other things, the promotion of a European scheme, the further liberalisation of the European payment market and defined instant payments as the "new normal". Between the lines, therefore, a quite clear call for competition with non-European card schemes and technology providers, motivated by the political will to reduce international dependencies. The fact that Visa and Mastercard recently shut down large parts of their business in Russia at the push of a button and the damage this caused to the Russian economy proves that these are by no means purely dystopian thought games, but rather that payment traffic as a critical infrastructure can certainly be instrumentalised as a geopolitical weapon and that diversification would therefore be in the European interest. And at least in theory, a wider reach for Apple devices would also suit the EPI initiative, which was politically pushed but has since fallen into serious disarray.

In addition, there is a strong dynamic in the market for so-called SoftPOS solutions, i.e. the use of an NFC device as a payment terminal. For example, Apple has expanded its own capabilities with significant acquisitions in recent years and announced the "Tap to Pay" function for iPhones in February 2022. This no longer only affects the issuing side, but also the acquiring side.

One more thing remains

And how does Apple react to the EU investigation? The accusations of unfair competition are of course rejected, after all, there are enough finance and payments apps for Apple devices as well - you won't find any based on NFC, but Apple continues to argue with the security aspect.

Apparently unimpressed by the accusations, Apple recently followed up and announced an integrated Buy-Now-Pay-Later (BNPL) solution called Apple Pay Later on 6 June 2022, which is to be launched in the USA with iOS 16 in autumn this year. After the payment wallet on the customer side, the acceptance solution for the merchant side, the P2P solution and the credit card, Apple is now also entering the original credit business - even if initially limited to the US market, as with the Apple Card. This is made possible by significant acquisitions with which Apple expanded its own capabilities in the financial sector (such as the recently completed takeover of Credit Kudos from the UK) and with the BNPL product - contrary to all expectations not with Goldman Sachs and MasterCard - but for the very first time acts itself under its own licence. Apple Financing LLC does not (yet) have a full banking licence, but it has all the necessary permissions to process BNPL.

Can the regulator provide the solution for banks?

Rumour has it that the initiated investigation by the EU Commission is due to a complaint by PayPal, which was, however, already placed in 2021. The fact that the regulator has now shown an initial reaction can be seen as positive from the point of view of the affected parties, but looking at the timeline is rather sobering: if the EU Commission needs the same amount of time in which Apple introduces two new products that exacerbate the situation, it will hardly be the bearer of hope from the banks' point of view. The fact that the efforts around the EU Retail Payment Strategy and EPI are spurring the proactivity of the regulator also seems rather optimistic in view of the progress of the EPI initiative.

Moreover, it must be stated: Even with a well-implemented NFC-based alternative from the bank, only a few users would probably turn their backs on the native Apple products and switch to the solutions of the house bank. This is because the comfort of an app that is on the device by default and easy to use must first be overcompensated by a corresponding alternative in order to be attractive enough for the user to initiate a change in the previous user behaviour. In addition, on sober reflection, examples such as TWINT show that access to NFC is by no means a necessary condition for a solution that is superior from the customer's point of view, and the battle for the customer interface is now entering a new round, allowing new hope for banks: the boundaries between POS and eCommerce are increasingly disappearing. "Integrated" and "invisible" payments are increasingly reaching our everyday lives: concepts such as Amazon Go may still seem exotic or even futuristic today, but background payments have been established at Uber since 2009, FreeNow (formerly Mytaxi) has also switched to this model since 2021 and many retail shops are also converting, which proves: if customers apparently trust the taxi driver to collect the right amount, why not the supermarket cashier, bartender or hairdresser? Conventional payments will not disappear overnight, but classic POS payments and thus NFC could become less important in the foreseeable future.

In summary: A regulatory forced, short-term opening of the NFC interface by Apple seems rather over-optimistic and even in this scenario the positive effect for the local financial industry would be manageable. It is therefore more important for financial institutions to move forward.

The real Big Picture

Payment traffic is primarily a commodity for banks and only profitable to a limited extent - often even loss-making. However, the customer contact and data points are essential for cross- and up-selling as well as the data basis for further products and services. Banks generally continue to regard payment transactions/payment instruments as original products and are always in the situation of having to monetise payment transactions directly, or at least to ratify them financially via the interaction with other financial products. For Apple and others, on the other hand, payments are not a product but a feature of their hardware- and software-based ecosystems, which helps to maximise customer loyalty and contact points. Generating direct revenue is a welcome side effect, but by no means a necessary condition: If, when searching for the nearest pizzeria via Google Maps, the order can be paid for directly with one click via Google Pay, Google Pay may not be a revenue stream for Google, but it reinforces the need for merchants to be present in the Google ecosystem, which ultimately brings Google advertising revenue.

Until 6.6.2022, sceptical observers could always cite that xPays themselves did not seem to want to become a bank, despite all their forays into the generic banking business. After all, typically their financial products involved banks as cooperation partners: For Apple Pay it is the card-issuing banks themselves, for Apple Pay Cash it is Greendot as a central partner and for the Apple Card they cooperated with Goldman Sachs. Google even planned to go one step further with Google Plex and provide a complete banking front end to which banks can dock in the background and thus, in extreme cases, no longer have to operate their own front end - even though this project is now on hold.

The widespread assumption was that the xPays offer banking, but do not want to become a bank themselves. Regulatory requirements with regard to reporting, risk provisioning, fraud prevention, capital requirements, etc. are already complex at the regional level, and coping with them globally in divergent forms was apparently painful enough to prefer to outsource this unattractive part to external partners.

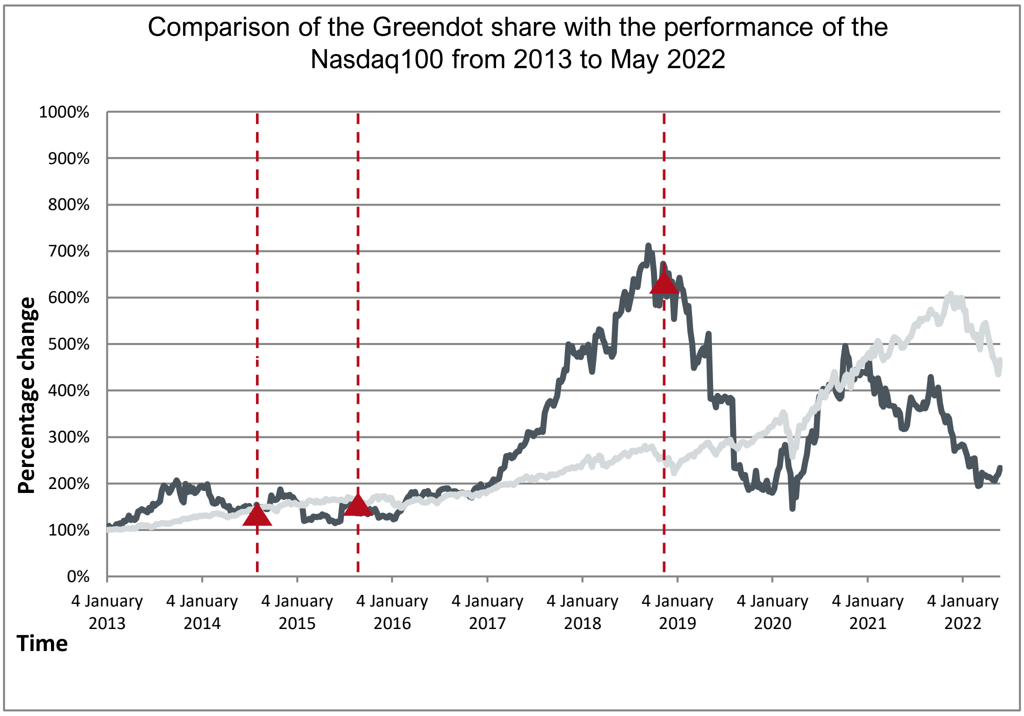

Fig. 1 - Comparison of the Greendot share to the Nasdaq 100 on the basis of daily average values from 2013 to May 2022

But has this cooperation paid off, at least for the cooperating banks, so that it would be a desirable strategy for local banks to seek a more far-reaching cooperation with Apple? A look at Greendot reveals: Only to a limited extent. Although significant customer growth could be achieved through the cooperation, this obviously could not be sufficiently monetised: After the introduction of the programme, the share price shot up from about 25 USD to over 85 USD - the profit, however, was almost completely lost, so that the share is valued at about 28 USD again today, while the NASDAQ has more than doubled in the same time and despite current market tensions.

Although Apple has always been the primary beneficiary in past cooperations, Apple's subsidiary Apple Financing LLC is now to take over the handling of the BNPL solution - truly a turning point that can be seen as a declaration of war against the established financial industry.

Now, it could be argued that the BNPL market seems overstretched anyway and is not a substantial source of revenue for most banks, or that the customer interface in retail payments has already been lost uncatchably anyway. But the real question is: What will be the next "one more thing"? It seems rather dystopian that Apple would offer timely real estate financing, but if Apple were to launch, for example, an "Apple Broker" with attractive conditions that can be activated directly from the Apple Wallet with just a few clicks, the respective product managers of the banks would probably wish for competition with their current attackers a la Trade Republic to return.

So what should banks do?

The first question to be answered is which parts of the value chain banks want to cover in the long term: Do they really want to be at the front of the customer, or do they perhaps prefer to optimise processing in the background and see themselves more as an IaaS/BaaS provider? Examples such as Railsbank show that this can also be an attractive business and the direct competition with xPays for the end customer is more or less passed on to the bank's own BaaS customers. Such an approach could be particularly interesting for banks for which the retail business plays a rather subordinate role or which already have a distinct B2B business. In addition, this strategic approach requires a technologically modern IT landscape geared to this business model, which is rarely found in traditional institutions.

Therefore, if it is considered necessary to act at the customer interface in the retail segment, one is automatically in competition with the xPays, whereby there are basically 3 alternatives for action:

1. **Opportunistic approach**

No clear strategic direction and opportunistic decisions on whether to integrate xPay solutions. This is probably the most frequently observed approach in the market, which is at the same time associated with strong risks, because often there is no real possibility to make a decision once the xPays have reached a critical mass in the target market. Such an opportunistic stance thus allows the xPays to shape the market in their interest and therefore exacerbates the problem in the medium term. This approach is therefore usually seen as a lack of a consistent strategy and is therefore not recommended.

2. Accept competition

Avoid xPay products where possible and create your own (and necessarily at least equivalent) alternatives.

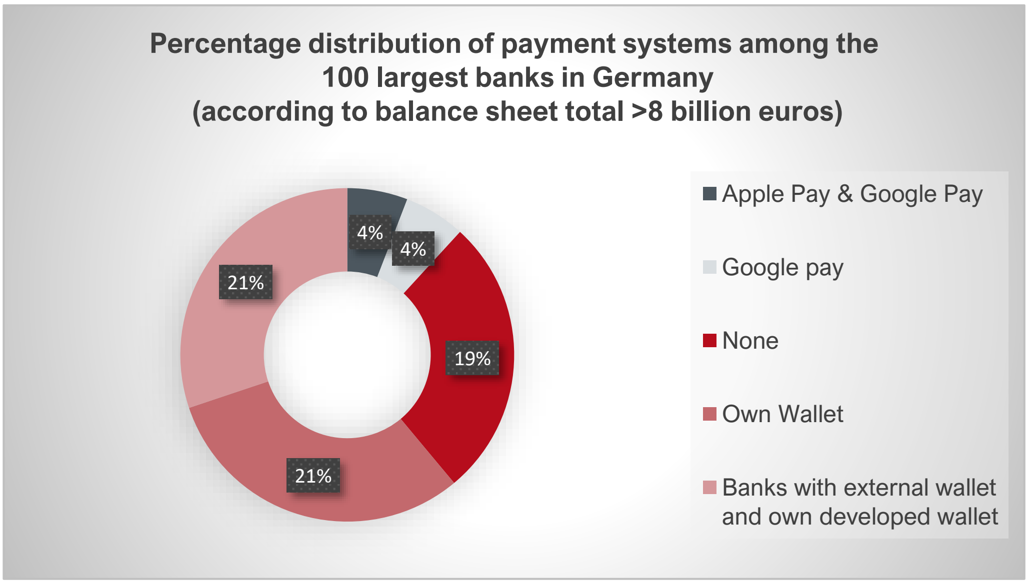

Fig. 2 - Percentage distribution of payment systems at Germany's 100 largest banks (by balance sheet total >8 billion euros) as of 2020

Because even today there are (still) opportunities for banks to launch products that are functionally superior to the xPay offerings: Examples of this would be a token management feature, which allows the end customer to administer which wallets and cards hold a digital image of the card and may use it in what way. Or global near-real-time P2P payments based on the Card Scheme solutions (Mastercard Moneysend and Visa direct). Virtual disposable cards and complementary card management and monitoring features (merchant whitelisting and blacklisting, debit vs. credit debit as a selection option in the app, ...) are also included in the offering of some innovative issuers. The potential to positively differentiate from xPays in terms of functionality is therefore there, but requires a certain agility and adaptability.

Beyond timing, what really determines success is also a) relevance for the end customer (cf. TWINT in Switzerland or Vipps in the Nordics) and b) relevance for the merchant, especially in terms of cost. In both dimensions, any solutions must not only exist, but be superior, because BigTech products are often excellent in UX, emotionally charged and integrated, which makes "rationally convincing" the customer challenging. At the same time, current market movements also represent an opportunity: the regulator wants to push instant payments and calls between the lines for competition with established card schemes. With R2P and instant payments, powerful tools for alternatives to the established card schemes are available and the classic POS business is increasingly being displaced in favour of remote transactions, which facilitates the substitution of card transactions and thus the previous processing model of xPays by eliminating the necessary hardware.

This alternative for action requires the necessary technological implementation capability and is particularly obvious for those banks that have a sufficiently large customer base so that the corresponding expenses can be legitimised. This is usually not the case at the level of individual institutions, but the existing associations can be used as a vehicle for corresponding implementations.

3. Partnering

Finding ways to support the xPay products in partnership and to position them profitably for themselves. The Greendot example shows that this option should be treated with caution and since Apple at least is trying to operate in the finance context without partnerships, the question arises as to whether this is a realistic option at all and if so, certainly only for a few and well-positioned banks. However, the market movements described under 2. could also mean that Apple Pay and the like will have to be adapted over time, for example because Apple Pay no longer triggers a card transaction via a terminal, but an instant payment via R2P. There are many elements in the value chain where a bank could position itself as a processing partner. And beyond that, there are still the challenges and the problems of regional regulation and the resulting opportunity, because there will be no provider who can address this comprehensively on a global scale.

This variant is particularly recommended for banks that would like to use a corresponding partner ring with Apple and Co as a growth catalyst with regard to the retail customer base. However, the expected restrictive specifications of the xPays in such a "partnership" require a strong commitment to the xPays as well as a correspondingly cost-optimised processing and are therefore to be implicitly combined with a mono-channel strategy in practice.

Conclusion

The past has shown that it is difficult to "force" Apple to do something - the opening of the NFC interface will be no exception. But even if this scenario will actually happen, it will probably not bring the redemption hoped for by many. This is because the actual strategic discussion is more comprehensive and various developments in the market are shifting the balance of power. Moreover, it cannot be assumed that competition with xPays in retail payments will stop. To "overtake" Apple and Co and win back the customer interface is possible, but seems very optimistic for most banks and time is running out. Therefore, actively designing partnerships and synergistic business models could be promising, at least for some market players. However, the most observable approach in the market of making opportunistic and thus not very consistent case-by-case decisions regarding cooperation with the xPays only leads to the hands of the xPay providers in the long run and thus poses strong risks for the local financial industry. It is therefore urgently necessary for banks to reflect on their own strategic positioning and to make correspondingly consistent deductions.

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