**China's credit card market: Getting a foot in the open door**

Will open competition among EPS providers become a reality in previously-closed China?

by Jeffrey Wang and Trevor Roberts

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According to a recent announcement on the Chinese government's English website, foreign providers of electronic payment services (EPS) may soon be allowed to set up operations in China. This could be great news for companies like Visa and MasterCard that have been longing for the opportunity to participate in China's $2 trillion credit card market.

At present, only state-run UnionPay is allowed to provide clearing services or issue cards in all of China. And with over 4.2 billion cards in circulation, UnionPay has surpassed Visa and MasterCard to become the world's largest issuer of credit cards – not bad for an institution that is only 12 years old. But now, for the first time, UnionPay may have to face direct competition in China.

The statement reads in part:

> *At an executive meeting of the council, top leaders decided to allow domestic and foreign companies that meet the authorities' requirements to apply to set up bank card transaction clearing institutions.*
>
> *Currently, only China UnionPay Co., the national bank card association, is approved by the People's Bank of China to provide clearing services for bank card transactions in the country.*

**Why the sudden welcome mat?**

According to recent statistics, China's economy has been slowing amid decreased output in the manufacturing sector. China could be hoping that competition will lead to a more efficient credit card system that will help promote the flow of more money in the system. The growing number of U.S. businesses operating in China, could also benefit from such increased spending.

If and when the market does open up, one can only hope that Chinese consumers will be more responsible with their use of credit cards than their U.S. counterparts. Currently, total U.S. credit card debt is over $880 billion, which averages out to about $7,274 per household. Unfortunately, it looks like it will not take long for China to catch up with the U.S. as outstanding credit card in that country already amounts to $300.9 billion – a 62% increase from 2013.

**The first four in the door**

China's announcement does not clarify what requirements must be met for a company to qualify for entry, so it remains to be seen which foreign firms will actually be allowed to enter the market. But two of the biggest names in the industry, **Visa** and **MasterCard**, have been jockeying for position in anticipation of this opportunity for years, and it can be presumed they will be among the first entrants.
However, it is important to understand that neither Visa nor MasterCard actually issues credit cards. Rather, these two companies make their money by providing credit card clearing services, processing transactions between the points of purchase and the institutions that issue the cards.

**American Express** and **Discover**, on the other hand, *do* issue their own cards in addition to providing clearing services. These two companies have unparalleled experience operating this type of "closed-loop" system, so it is likely that they will also qualify to compete in China's credit card market.

**Who will get locked out?**

However, it is unclear how the new rules will impact "issuing" banks like **Chase**, **Citibank** or **Bank of America**, the institutions that actually provide the plastic. In America's credit card industry, these banks wield a great deal of power and collect the biggest cut of interchange fees, but it remains to be seen what role, if any, such firms will play in China's credit card market. Even less certain is how mobile payment processors, like **Apple Pay**, or **AliPay**, will fare under the new rules.

Internet-based service providers like ApplePay and AliPay are difficult to categorize because their technology and systems are so new. Apple Pay, for example, can turn any smartphone into a "virtual" credit card or debit card. And AliPay, the third-party payment platform for Alibaba, has swiftly gained control of about half of all online payments in China (readers will recall that in November, 2014, Alibaba reported more than $9 billion in sales in a single day!).

Unfortunately for AliPay, this rapid ascent has attracted the unwanted attention of UnionPay. Immediately after Alibaba posted its record-breaking sales numbers, UnionPay announced that it is asking (i.e., demanding) that its members transfer all online transactions back onto the UnionPay platform by the end of the year. In other words, direct links that have allowed merchants, banks, and AliPay to completely bypass UnionPay will no longer be tolerated.

**Did you see the "Beware of dog!" sign?**

American companies should not expect that, just because they may soon be allowed to enter China's credit card market, the People's Bank of China (PBoC) has plans to put a leash on UnionPay. The competition promises to be very fierce and the field may not be exactly level.

At present, every ATM or credit card issued in China must bear the UnionPay logo even if the card also bears the logo of Visa or MasterCard**,** and every card must be compatible with the UnionPay network. More importantly, only UnionPay is allowed to clear transactions in renminbi (RMB). In 2011, the U.S. brought a complaint about this situation before the World Trade Organization (WTO).

In this complaint, referred to as Dispute DS413, the U.S. alleged that UnionPay held monopoly control of China's credit card market. The WTO established a panel in 2012 to investigate, and ultimately rejected the United States' claim that UnionPay was an "across-the-board" monopoly. However, the panel did conclude that China's actions were inconsistent with its commitments under the General Agreement on Trade in Services (GATS), finding the following:

1. By granting UnionPay a monopoly for the clearing of certain types of RMB payment card transactions, China has acted inconsistently with its mode 3 market access commitment under Article XVI: 2(a) of the GATS. This article requires that Members not limit the number of service suppliers where market access commitments have been undertaken.

2. By requiring that all domestically-issued payment cards bear the UnionPay logo *and* be interoperable with that network, and that all point of service (POS) terminal equipment in China be capable of accepting UnionPay cards, China has acted inconsistently with its mode 1 and mode 3 national treatment obligations under Article XVII of the GATS.

Thus, while the WTO stopped short of declaring UnionPay an across-the-board monopoly, it did find that China failed to provide fair market access and equal national treatment to foreign EPS suppliers. Therefore, China's recent announcement is seen by some as an overdue response to the WTO's findings.

**Conclusion**

Whatever the reason for the change, foreign EPS providers are clearly pleased to learn that China may soon be easing its restrictions, and that they may soon have access to one of the world's largest credit card markets. But they will understandably remain skeptical until they are actually ushered inside.

If open competition does become a reality, it could provide many benefits both within China, and without. But, as the U.S. discovered during the 2007 Credit Crisis, dependence on borrowed money (a.k.a., an addiction to plastic) can have serious consequences. Hopefully, China will not have to learn this lesson the hard way – like we did!

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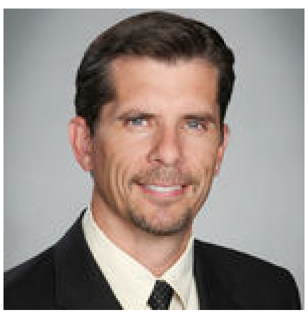

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