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Payments Policy Department  
Dr Christopher Kent  
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Dear Chris

### **Submission – Strategic Review of Innovation in the Payment System**

Tyro Payments Limited is a Specialist Credit Card Institution authorised by the Australian Prudential Regulation Authority. It has launched acquiring services for credit, scheme debit and EFTPOS cards and electronic Medicare processing services for patient paid and bulk-bill claims.

Tyro Payments is responding to the Reserve Bank of Australia's consultation from the perspective of the only new entrant into the payment space competing with the incumbent banks as an acquirer only i.e. an ADI that does not issue cards and does not take deposits and as a technology innovator.

Innovation in the core of the Australian payment system has been excruciatingly slow. Australia, once perceived as leading in payment solutions has been falling behind. Faith was put into the banks to foster innovation and they have not done it.

There has been lots of talks around current challenges and narratives around industry self-regulation, but the fact is that there have been no deliveries in many areas where the payment system falls behind the consumers' and community's expectation; years of talking about the need to move from the overnight batch settlement to multiple and same day settlement on all week and weekend days, years of talking and working without delivering an online payment facility.

A case in point is the major banks admitting to failure terminating the MAMBO project after five years and \$225 million in investment. They were incapable to deliver a domestic secure online payment and account portability solution to Australian consumers leaving the field to the alternative global payment players.

The Reserve Bank and the Payment System Board have been demanding innovation in core areas such as timeliness and reliability of settlements and online payments for years, the banking industry has not delivered.

It is high noon for the regulator to mandate the performance standards and set appropriate incentives so as to force the banks to make the necessary investments.

While the industry is currently swept by the hype of new payment schemes and mobile payment, the stress on the legacy systems' short comings in terms of access, speed and security is increasing.

Fees and standards can be regulated, but it is often new entrants that bring innovation to a market. Tyro is the only new entrant and the only banking institution competing on the merchant side of the two-sided payment system. In that role it

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puts the torchlight on access and expansion barriers and imbalanced and discriminatory structures and behaviors.

As an innovator, Tyro has delivered. Tyro introduced IP based EFTPOS with real-time reporting, followed by integrated Medicare Easyclaim, a redundant live-live acquiring platform and a PCI PA-DSS certified POS integration architecture. All these innovations have raised the bar in terms of speed, security and reliability.

As a business, Tyro success is still outstanding. Tyro was founded in 2003, obtained the bank license (SCCI) in 2006 and achieved a market share of 0.55 per cent in 2011. AUD 30 million were invested. Break-even has not yet been reached. The attractiveness for investors to enter the core payment space with new banking models (SCCI) and new acquiring solutions (IP EFTPOS) remains to be proven.

The score card for the industry's ability of allowing a new entrant to bring innovation and competition to the Australian Payments System has fallen short.

**While the designation of the payment system has led to a reduced level of interchange fees and an increased level of transparency, the access regime and the surcharging handling remains broken.**

While the interchange fees have been reduced overall, since the payment system reforms began, the ones applied to the Tyro SME community have been creeping up. That might very well reflect that Coles and Woolworths have been granted lower interchange fees that allowed to raise the interchange fees for the rest of the market while keeping within the RBA regulated average (if that is the case).

**Tyro SME portfolio interchange fee**

	Jun-08	Jun-10	RBA Cap
DOMESTIC	0.570%	0.632%	0.500%
INTERNATIONAL	1.449%	1.507%	n/a

EFTPOS Payments Australia Limited (ePAL) has announced a raise in the domestic debit card interchange fees by 10 cents for the standard EFTPOS transaction, while Coles and Woolworths are not impacted.

The EFTPOS access regime was left to the industry self-regulation and has failed. In all these years, Tyro has not been able to implement direct connection agreement under the regulated bilateral fee regime with two of the four major retail banks. Tyro has not been able to achieve any commercial fee regime with the two three-party charge systems. Tyro has remained so far the only new entrant under the SCCI regime.

The surcharging handling has suffered by the schemes' and acquiring banks' lack of any effort to provide the merchant community with an efficient and transparent system. Left alone, merchants have implemented their own solutions, some of which have led to cardholder dissatisfaction and brought the surcharging right into disrepute.



**While the Payment System Board was demanding cost based interchange fees and cost based price signals as well as choices for merchants and consumers, the industry undermined these goals.**

The industry has not cooperated in providing a cost-based surcharging facility. Instead, merchants with dominant market positions have used surcharging as a new revenue line, disconnected with the significantly variant actual costs of the different payment cards.

The global scheme's interchange fees have been increased to or beyond the cap, the domestic interchange fees have been reversed and increased and the scheme fees have been increased. Coles and Woolworths have obtained significant interchange and scheme fee advantages versus the remaining merchant community.

The implementation of contactless payments, the announced changes in handling card type identification and the treatment of currency conversion at the point of sale all remove or reduce choices for merchants and consumers.

**While the Payment System Board has been demanding innovation in core areas such as timeliness and reliability of settlements as well as transmission of additional data, the industry has not delivered.**

The move to intraday settlement as well as weekend settlement although a vocal requirement from the merchant industry remains stalled. The project of a new hub-based retail payments system has recently been abandoned by key participants.

Interestingly, the only innovations in recent years were at the periphery of the payment system in the payment card and terminal space such as 3DES encryption, EMV and contactless technology. These upgrades were mandated and forced by the international schemes against significant reluctance and with substantial delays.

Other innovations were bolt-on and frontline additions bridging the requirements of the new world with the legacy infrastructure. There is the risk that as the banking system does not address the requirements of a changing market place, entire new payment systems appear totally outside the banking space or new payment solution import grave security concerns into the banking space.

**The only innovation in the core of the payment system has been delivered to our knowledge by the new entrant Tyro. However, significant barriers to access and expansion as well as bundling behavior by the dominant competitors have kept Tyro's growth in the market place modest.**

Tyro experienced in the initial phase of the payment system reform a very engaged regulator that was then followed by the concept of a reluctant regulator. Years have passed and the industry has not delivered the expected outcomes under the self-regulatory approach.

If Australia wants to meet the changing needs of end-users, innovation and competition is critical. The reality is that the Australian payment industry is



dominated by two international schemes, four major retail banks and two big retailers. Industry self-regulation has failed.

**The only domestic scheme (ePAL) providing contestability in the debit card space and the only new entrant (Tyro) providing innovation in the acquiring space need a countervailing power in form of an engaged regulator setting industry performance and access standards.**

**There is no basic infrastructure granting access to providers and real time payments to participants to enable innovative, secure and efficient solutions.**

Tyro Payments recommends that the Payment System Board and the Reserve Bank mandates:

### **1. Banks and schemes have to grant non-discriminatory access**

Interchange rates are distorted to the benefit of issuers. The recent interchange reversal and increase as announced by ePAL has given a further competitive advantage to the issuing side of the two-sided payment system. Acquirer-only participants see their cost of business increase commensurately.

That means that the issuer-acquirer banks have to maintain or grant acquirers-only - as they do with self-acquirers Woolworths and Coles - direct connection agreements with the regulated bilateral fee regime. This way the acquirer-only is at a level playing field with the dominant acquirer-issuer and its merchant community at a level playing field with the dominant retailers.

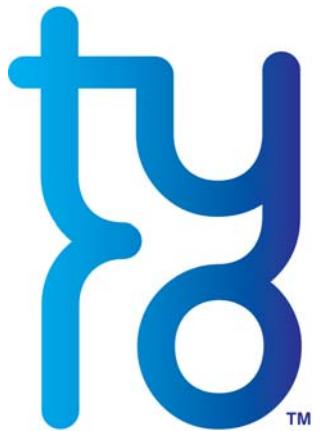
Equally, the charge card schemes have to offer access on non-discriminatory terms. American Express and Diners have to offer direct connection agreements with a fair fee regime.

### **2. Banks have to provide multiple and ultimately real-time settlement**

New alternatives providing faster and safer payment services require a back-end infrastructure that itself provides the faster and safer funds settlement. An efficient real-time settlement infrastructure eliminates the risks and the funding needs covering the delays introduced by the misalignment of infrequent settlement.

The SME community has moved to extended trading hours including weekend days while the banking industry has remained operating within work days. Merchants rightly expect from the acquirer and transaction bank near real-time availability of their funds and that in some important merchant segments every day. The merchant pays a merchant service fee, mainly the cost of the interchange fee, to get money slower than cash.

The hospitality industry for instance suffers from receiving the funds for the peak Friday and Saturday evening business only on Tuesday or Wednesday. Today's overnight batching increases unnecessarily the probability and scope of payment failures in the Australian system.



### **3. Banks cannot discriminate in settlement terms**

As long as there are no real-time settlement systems, the banks have to settle their own merchants at the same time as merchants from competing acquirers. Today and increasingly, banks offer same-day settlement, while they settle the merchants of competing acquirers that bank with them only a day or two later.

This bundling of the acquiring and transaction account locks out acquirers-only and thus lessens competition.

### **4. Schemes cannot discriminate in settlement terms**

The schemes have to settle acquirers for international transaction the next day, so as to not disadvantage acquirers-only who cannot net off. Today, an acquirer-only pre-funds the settlement of international schemes with their own funds.

The settlement delays of global schemes of one to three days introduce an unnecessary risk to the Australian payment system. A solution would require a change in the settlement process that the banks have not implemented, surely seeing no business case for the required work that would result in opening the system to more competition.

### **5. Issuers have to offer network choice**

The banks have to issue their card products and deploy their terminal technology in a way that allows cardholders and merchants to make easy-to-use network routing decisions.

In the US, the Dodd-Frank Act prohibits an issuer from restricting the processing of its electronic debit transactions to networks it owns or networks affiliated with the issuer and prohibits rules or measures “inhibiting” retailers’ ability to route debit transactions to the issuer over any debit card network.

### **6. Schemes have to provide card cost data at the point of payment**

The schemes have to design their payment solutions in a way that allows cardholders and merchants to make easy cost and functionality based decisions on alternative product offerings.

In the US, Visa revised U.S. Acceptance Rules following a settlement with the Department of Justice agreeing to communicate to a customer the reasonably estimated or actual costs incurred by the merchant when a customer uses a particular brand or type of general purpose card or a particular form of payment or the relative costs of using different brands or types of general purpose cards or different forms of payment.

**Progress of the payments system reform and innovation agenda as well as the effectiveness of new entrants requires the engaged regulator.**

The success of global schemes has shown that the only way to maintain a level of innovation commensurate with the changing requirements of consumers in such a complex and networked environment as the payment system is the ability to



mandate binding decisions and to enforce deadlines of mandates with significant financial incentives or penalties. It was only due to the later that the industry and business case to upgrade security and functionality became compelling for the dominant banks.

The Payment Systems Board has the power to set the performance and access standard as well as incentives and penalties for the industry. The current institutions and frameworks are capable to deliver against those performance standards. The major retail banks have the capacity but lack the willingness to innovate.

Tyro's endeavor has advanced when it enjoyed the support of the regulator. For the Tyro endeavor to scale up, succeed and make a difference, the persisting barriers to access and expansion need to be lowered. We trust in the regulator who created the reform initiative that we responded to.

Yours Sincerely

A handwritten signature in blue ink, appearing to read "Jost Stollmann".

Jost Stollmann  
CEO

## Appendix



## **APPENDIX: Specific issues raised for discussion regarding Australian payment industry governance**

### **10. Do current governance arrangements adequately promote payments system innovation?**

No. There has been no innovation in the core payment systems. Intra-day settlement and online retail payment systems have not advanced or stalled. The access and surcharging regime is broken. It is all known since years, but the major retail banks are not pursuing an innovation agenda in the payment space.

### **11. Are the needs of payments system users and non-ADI payment service providers adequately considered in decisions about the direction of the payments system?**

No. Tyro is a good example. It has raised since years vocally the existing barriers to access and expansion with the industry associations and forum and the major retail banks. It was all to no avail. The requests were and are ignored. The initial progress Tyro made was due to the Reserve Banks engaged support.

Interestingly enough, even the Payments System Board is another good example. Its guidance regarding network choice and cost based price signalling are being ignored. Recent implementations and announcements in the contactless area and in card processing undermine the PSBs stated intentions.

### **12. Are there ways of altering current governance structures to make innovation easier?**

The Payments System Board and Reserve Bank have to set performance and access standards as well as create legal certainty. The mandates have to be underpinned by incentives and penalties and monitored in their execution. The implementation can be left to the existing industry structures in the form of schemes including ePAL and APCA and the banking community.

### **13. Are there ways of altering current governance structures to take more account of the views of end-users?**

May be, but at this stage, it is not about consulting users. They are frustrated by the lack of innovation and delivery against basic requirements that are known since years. All the recent hype around new payment schemes and mobile payments cannot cover up the fact that first the underlying infrastructure is in dire need of investment. Recent complete outages of the payment system have made the entire community aware of the growing gap between shiny online real-time front-ends and the reality of out-dated legacy batch system in the back office.



**14. Could a new decision-making body with broad representation of payments system participants, service providers and end-users provide a better strategic focus for the payments system, taking adequate account of costs and the public interest?**

No. With the APCA Stakeholder Forum and the Australian Payments Forum there are formats for stakeholder involvement that are functioning. The challenge to overcome the lack of innovation in the Australian payment system is around setting the standards and mobilising the required investment by the major retail banks.

**15. How could such a body have the capacity to reach decisions across a diverse group of members?**

Given the dominance of the four major retail banks and their competitive position, industry decision making has and will fail. For binding decision and progress to be made, the regulator is required.

**16. Could such a group make binding decisions and how could they be enforced?**

We cannot see a mechanism that provides for fair decision making and overcomes the de facto veto capability of a major retail bank.

**17. Could formalisation of a broader mandate for APCA, coupled with broader representation, provide better industry-wide outcomes?**

No. APCA has been hamstrung to progressing pending issues even when they are clearly within its mandate.

**18. What role should the Reserve Bank and the Payments System Board play in setting the reform agenda for the industry?**

As in the past, the Reserve Bank and the Payments System Bank should consult extensively with industry. But then it should mandate the performance standards and set appropriate incentives, similar to the processes that have made the global schemes successful in driving their worldwide innovation agenda.