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Submission on Review of Card Payment Systems Reforms

MoneySwitch Limited trading as Tyro Payments is a Specialist Credit Card Institution authorised by the Australian Prudential Regulation Authority. It has launched acquiring services for credit, scheme debit and EFTPOS card transactions in Australia. In the future, it may expand its offer to include the acquiring of direct debit, BPAY, stored value, ATM and other electronic transactions as well as card issuer support services.

Tyro Payments is responding to the Reserve Bank of Australia's invitation for submissions on the *Review of Card Payment Systems Reform* seeking views on how to best promote competition and efficiency.

The fact that Tyro Payments has so far been the only new competitor to have entered the acquiring space might very well reflect the subsistence of significant barriers to entry in this portion of the payment industry.

The barriers to enter the Australian bilateral EFTPOS system remain very high.

A new competitor in the credit and debit card acquiring market must accept all cards to be viable. Consequently, they need interconnect agreements with all issuers participating in the EFTPOS system or they are forced to conclude a commercial arrangement with an existing participant (and competitor) to switch and settle on their behalf with those issuers that they have no direct connection and interchange agreement with.

In addition, were they to migrate the indirect arrangement(s) of switching and settlement through a competitor to direct connector status, the EFTPOS Access Regime states that they would need to establish and maintain a minimum of three links within twelve months and a fourth within 36 months. Given those constraints and the complicated negotiation and implementation process, a new entrant de facto has to live with an indirect connection set-up allowing a competitor to impose significant additional set-up, switching and settlement fees.

The bilateral EFTPOS system lacks efficiency and redundancy especially for a new entrant forced to use switching and settlement arrangements.

The existing interconnection between participants uses many point to point links between the Tier 1 Financial Institutions, together with gateways and switching and settlement arrangements to link Tier 2 members and new entrants. In the past 20 years there have been significant developments in networking and security technology, but the bilateral point to point links in the EFTPOS network have not changed.

The new networking technology has been embraced by banks for communications with their Internet customers for online banking, but has been ignored in the EFTPOS system. The fact that these obsolete point to point links still exist adds significant cost to the provision of an EFTPOS payment system and constitute a significant barrier to entry for new participants.

A state-of-the-art architecture would allow each new entrant to connect once to the network that would provide the physical connectivity to all other participants. There would be no central payment switch, but participants would still clear and settle bilaterally.

The volume driven pricing structures of the major card schemes put a new entrant at a significant disadvantage.

With the decline in interchange rates working its way through to the markets, acquiring margins have fallen even further. In March 2007, the merchant fee declined to 84 basis points. With an average interchange of 50 basis points, the margin available to the Acquirer to cover scheme fees and its own costs dropped to 34 basis points.

Consequently, the major card scheme fees have become a significant cost barrier for a new entrant with large financial institutions benefiting from transaction scheme fees that are 40 percent below the ones a new entrant has to face until they reach significant volumes. Since there are, in addition, fixed scheme fees, there appears to be no justification for such tiered schedules of transaction scheme fees.

In addition, while interchange fees have been reduced, scheme fees have been raised.

From an industry point of view, simpler, more transparent and cost based pricing of scheme fees would send a clearer price signal, allow new entrants to proceed with more investment confidence and create more trust among merchants and consumers.

The increasing proliferation of electronic payment products requires a comprehensive access and interchange fee regime.

Merchants and recurring volume billers are faced with an increasingly complex and broad range of electronic payment solutions. Card products and interchange fees proliferate as do capture devices, switching and processing options.

A new entrant will not be able to compete in most of the attractive market segments and certainly in larger and more demanding projects, if he can not offer a solution

covering credit, scheme debit, EFTPOS with and without cash out, direct debit, BPAY, stored value, ATM and other electronic transactions as well as card issuer support services.

The ATM and EFTPOS payment systems use very similar underlying encryption, switching and communicating technology, and the same card and PIN is used in both systems. The EFTPOS system can also provide the cardholder with cash, in the same way as the ATM system. It is important that the ATM systems and the EFTPOS systems are benefiting from the same consistent regulatory approach. There needs to be access and a level playing field spanning all these segments of the payment industry.

Setting interchange fees on the basis of cost continues to be a prerequisite of survival for new entrants that are acquirers or issuers only.

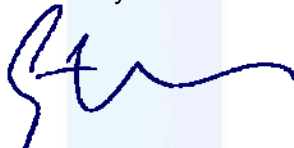
The interchange rate remains the most important cost element of the merchant services fee. Since the Australian acquiring market is dominated by financial institutions who are at the same time the main issuers, any new entrant is exposed to transfer pricing and cross subsidies between the two sides of the business. Consequently, the level of the interchange fees must be cost based, if it is not to distort the market. It is not sufficient that the rate is the same for all acquirers. Fees must always be reciprocal in terms of both issued and acquired transactions to maintain a level playing field.

We here at Tyro Payments wholeheartedly support the reforms undertaken by the Reserve Bank of Australia. We remain committed to bringing innovation and competition to the Australian payment space.

Looking in the future, we would encourage broadening the scope of the regulatory framework so as to comprehensively encompass all segments of the payment space. We would also see the need to create a context instigating the industry to migrate the payment infrastructure into the new world of modern network design, internet protocol and real time processing.

Should you wish to discuss this submission, please do not hesitate to contact me.

Sincerely



Jost Stollmann
Chief Executive Officer

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