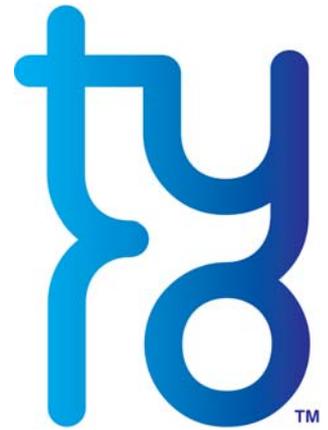


8 July 2013

VIA EMAIL : pysubmissions@rba.gov.au

Payments Policy Department
Tony Richards
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001



Dear Tony

Submission to the Review of Card System Access Regimes – May 2013

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

Tyro 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 a technology innovator and a sole-acquirer i.e. an ADI that does not issue cards and does not take money on deposit.

Tyro has been operating as a sole-acquirer in the payments market for 6 years.

Tyro's participation in the Australian payment system became possible through the engaged support by the Reserve Bank of Australia (RBA) forcing an access regime in 2004 and 2005 on the global card system and in 2005 and 2006 on the domestic debit card system (EFTPOS) and the clearing and settlement streams BECS and CECS.

Tyro's success is also owed to the Australian Prudential Regulation Authority (APRA) making the new license regime Specialist Credit Card Institution (SCCI) workable within the requirements of banking regulatory oversight and the needs and resources of a start-up innovative banking institution.

However, Tyro's progress has been slowed by many persistent entry and expansion barriers that continue to persist, mostly the broken eftpos access regime, the eftpos interchange fee regimes and the settling and bundling behavior by the dominant retail banks.

Nonetheless Tyro has built a business that caters for and is well suited to the small and medium business community raising the bar for Australian merchant acquiring in terms of speed, security, reliability and ease of use.

In recent years there has been a wave of announcements by technology companies eager to position themselves for a future in the payment space. The change is driven by the increasing preponderance of smartphones and ever more present broadband access.

We have seen mostly global players like Apple, Google, PayPal, VeriFone, Visa and MasterCard announce their ambitions in the mobile payment space. There is also much hype around start-ups like Square and other international and local start-ups innovating around the new mobile devices.

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There will be heightened competition between four-party and three-party schemes leading to a proliferation of payment instruments and channels. These schemes are all predominantly driven by issuer interests translating into merchant service fees, interchange fees and financial float.

Schemes and issuers are on the consumers' side, not the merchants'. Without an active regulator as arbiter, players that provide services to the merchant side may be barred access or put at a competitive disadvantage.

Before the regulator's intervention schemes only accepted as member acquirers who were also issuers, interchange fees increased at the expense of the acquiring and merchant side and merchants were prohibited from recovering their reasonable cost of card acceptance.

While the schemes have privatized and pursue shareholder interests, the card payment market left alone is malfunctioning.

Looking forward, internet economics favor global players. They pursue their own global interests and not necessarily Australian domestic ones.

The significant further growth and proliferation in IP based electronic payments instruments and business models will put stress on the Australian back-end banking systems and on the regulatory and competitive oversight and consumer protection.

For example Apple iTunes and Skype have become huge deposit takers of Australian consumers' funds and are beyond any reach of Australian regulatory or prudential supervision.

Square has global ambitions with exponential growth rate. If they were to establish their business model successful in the Australian retail and hospitality industry, Australian retailers and consumers would be exposed to significant operational and financial risk.

For domestic transactions with the card systems, each issuer is responsible for providing the funds to settle. In day to day operations, if an issuer has a settlement issue for some technical reason, the scheme acquirers then decide whether to settle the merchant prior to receipt of the funds or await the receipt of the funds.

Thus technical settlement failures can cause disruption in the flow of funds to merchants.

If any issuer were unable to settle due to, for example, a credit occurrence, the scheme rules provide that the scheme would make the payment for the issuer. The scheme rules then provide that an assessment would then be made of the still solvent members of the scheme to cover this payment. Thus, ultimately, all of the domestic members of the scheme are taking the credit risk of each other.

Currently, as all members of the schemes are regulated by APRA, there is a very minimal credit premium priced into the scheme settlements. If certain participants were not APRA regulated, it would necessitate an evaluation of the increased credit risk by the other members of the scheme. It is possible that this would lead to a situation where frictional credit costs (due to uncertainty) were included in the cost of transactions. This effect could occur even without any realized losses.



If there were to be a failure of a counterparty (arguably more likely if the entities were not APRA regulated), the frictional credit costs in the transaction system could be greatly increased to the detriment of the real economy.

Thus, all these new players warrant and their customers benefit from access through the established and proven SCCI banking license and prudential supervision model. They could not possibly claim to suffer from an inadequate burden with the complexities and costs of the existing SCCI regime.

Smaller specialized players, for instance issuing virtual cards for vertical segments, can gain indirect access through the sponsorship of bank participants. This model allows easy access and ensures the integrity and trust model of the payment system.

If their access aspiration were frustrated by the anti-competitive behavior of the major broad line banks trying to limit competition with their own offering, these new players could partner with specialized ADIs like Tyro Payments.

Thus, Tyro has always advocated for an open and competitive payment environment AND for an engaged regulator ensuring consumer protection, stability, access and level playing field.

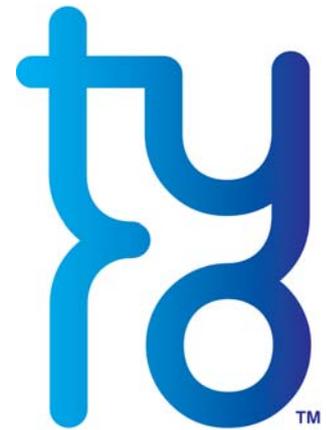
For instance, we are encouraged and supportive of the more proactive approach announced by the Reserve Bank of Australia in terms of setting goals and timelines for system-wide payment innovation to overcome the coordination challenges and investment disincentives of the major retail banks.

In the current consultation, we are concerned to see the RBA might confide the access and membership rules in the two dominant global card systems to them alone, trusting that they will ensure that the Australian payment infrastructure and framework becomes an open system, where all participants and new entrants can compete within fair rules and on a level playing field.

An efficient and frictionless payment system – an essential prerequisite for a safe, healthy and growing economy - requires the regulator and the prudential supervisor to eliminate the credit risk between participants. The direct participants that are in the settlement as members of the schemes and the clearing systems need to be regulated and trusted.

An innovative and competitive payment system – another essential for productivity gains and growth – requires the regulator and competition authority to ensure open and fair access. Otherwise parallel payment worlds will develop without regulatory oversight and thus with all the risks and failures that this engenders for the community.

It is in the public interest to have an open but regulated payment system where innovation can happen inside the system with trust and security maintained.



1. What is the nature of the risks faced by the card schemes and their members if a participant were to fail?

For Tyro as the only Australian sole-acquirer the most significant risk is the failure of a counterparty participant in the daily interbank settlement.

The inability or unwillingness of any Australian bank issuer, the global scheme or Australian settling agent bank for a global scheme to meet its settlement obligations to the extent that they exceed an acquirer's stand-in liquidity would impede the acquirer's ability to timely settle its merchants.

For the card schemes and their members, such an operational failure, liquidity crisis or default of a member would disrupt the daily operation of retailers, practices, service providers and many others.

It would severely inconvenience Australian cardholders and disrupt their transactions with the possibility of significant consequential damages. As a consequence there would be brand damage and loss of trust in the Australian payment system.

While Tyro itself would not be at risk in such a counterparty failure scenario, since it is only obliged to settle its merchants when it has received the respective funds, it maintains a high level of prudential capital and cash in its exchange settlement account so as to be able to stand-in to the extent possible.

2. What is the most appropriate way to address those risks?

For Tyro as the only new entrant into the Australian clearing and settlement system, Tier One member of CECS and BECS, Participant in EFTPOS as well as Principal Member of Visa and MasterCard, the qualification for the banking authority as Specialist Credit Card Institution (SCCI) was the most essential mitigation of risk.

As a specialised Australian Deposit Taking Institution (ADI), Tyro benefitted from best practices, consultancy and surveillance by the Australian Prudential Regulation Authority (APRA). While complexities and costs are involved, the resulting risk frameworks and risk culture protects the new participant and the system against failure.

Tyro would in our view never have been able to become a member of Visa and MasterCard would it not have enjoyed the support of the Reserve Bank of Australia and been granted its banking authority.

Whether in terms of access or in terms of stability, the requirement of a specialist banking authority (SCCI) is the most appropriate way to address the risk incumbent with conducting the card system business in Australia.

What rules and procedures do the schemes currently have in place?

Our understanding is that the schemes will mitigate their risk of admitting new participants relying on financial analysis of audited financial statements, ratings from independent agencies and adherence to regulatory requirements.



Their systems allow some permanent performance monitoring in terms of transaction types, growth, charge backs and settlement volumes.

The depth of understanding of the local context and the involvement in the organization of a specific participant is in no way comparable to the oversight of a prudential supervisor.

Thus they rely more on ratings, letters of credit and excess capital. Depending on their handling, these rules can be significant barriers to entry.

3. To what extent should the means of addressing risk be left in the hands of the scheme: that is, is there any role for regulatory oversight of these practices?

The card scheme will have their own risk appetite and risk management. Their programs involve significant different risks in different market segments and geographies. They pursue their own shareholder interest and assume liabilities for their members failing to pay another member, merchants or cardholders.

The interest of the Australian public is not covered by them pursuing their own interests.

MasterCard and Visa are importing systemic risk into the Australian Payment space. A failure of a Visa or MasterCard member operating in the Australian market would disrupt and shake public confidence in the Australian payment system.

The new three party systems are injecting significant risk into the Australian system through their fast growing deposit holdings in stored value card programs, be it iTunes, Skype, gift or travel cards.

The card schemes have or have an interest to limit competition, especially on the acquiring and merchant side. They are not interested in the sole-acquirer models or dynamic currency conversion at the point of sale.

By way of contrast, Tyro has contributed to the welfare of Australians by offering merchants and consumers a faster, safer and simpler way to use card payments in face-to-face transactions.

Tyro has deployed for Australian merchants a fully redundant retail payment system raising the bar in terms of resilience and non-stop operation and it has delivered to Australian patients a real-time Medicare rebating system through the domestic debit card system.

At the beginning Tyro was a start-up. It would not have been able to overcome the access barriers of the card schemes without the support of the RBA and APRA. Tyro would not have become a card system member.

As Tyro developed under RBA guidance and APRA supervision, it was able to build the level of risk management, capital adequacy and business continuity that it has to be required from a payment institution in the banking space.



It seems ill advised, that when more systemic risk is injected into the payment system through new technologies, new business models and new entrants, whilst the incumbent major banks are recalcitrant to invest into the necessary upgrade of the backbone payment systems. And then domestic payment participants like the eftpos debit card system (ePAL) are threatened by the relentless advance of the global players, yet the RBA and APRA is disengaging losing oversight, the skills and influence.

If new members conduct Visa and MasterCard business issuing credit, debit and prepaid cards and acquiring those in Australia, they should be subjected to APRA's national surveillance to an appropriate degree. The SCCI was a suitable approach, because it sought to trade off the weight of full regulatory and compliance burden against the specific risks of a sole payment participant taking no deposits.

4. Is it appropriate to retain the access regimes in their current form?

The current access regime i.e. the requirement for a Visa and MasterCard member to be an ADI and thus be under the supervision of the Australian Prudential Regulation Authority is adequate. The Specialist Credit Card Institution is the suitable licensing vehicle to lower the regulatory regime and compliance burden to the specific requirements of a sole payments business, not taking deposits.

Tyro has obtained the SCCI banking authority in 2005. Tyro has benefitted from the regulatory side and suffered from access barriers and anti-competitive behaviors by the dominant Australian retail banks.

Tyro also suffered and continues to suffer competitive disadvantages from rules and processes imposed or arranged by the card schemes. As an Australian ADI, Tyro has always seen in the Reserve Bank of Australia an essential and fair arbiter whose intervention or possible intervention entices the dominant participants to abstain from anti-competitive behavior.

The SCCI access regime for the global card systems works and the compliance costs are appropriate. The access regime for the domestic debit card system is broken.

5. How should the access regimes be varied if change is appropriate?

There is no change required.

6. What criteria should be used to determine eligibility in the absence of the regulatory requirements on access?

There should be the continued requirement to have a banking license in order to conduct Visa and MasterCard issuing and acquiring business.



7. What would be the potential effect on incumbent participants of extending eligibility for participation?

All incumbent participants would see the risks in the payment system increase to the extent that new participants like iTunes and Skype are not subject to anything like the same level of adequate expertise and supervision as provided by APRA.

Some domestic stakeholders, be it the domestic debit card system, Medicare Australia and the small business community would suffer from the secondary effect of an accelerated further growth in the dominance by the global card schemes and thus the loss of contestability in the Australian market.

Some dominant domestic stakeholders like the two big retailers would enjoy access to the global card system des-intermediating entirely the domestic banking system thus solidifying an already oppressive advantage in payments.

A new entrant into the payment system must at least be able to process the global card system's payment instruments given their dominant market position. The ADI requirement is a hurdle, but it also affords access, risk reduction, reliance and protection.

In Tyro's view the ADI requirement provides open and fair access to the global card systems. Without the RBA and APRA involvement, a new entrant is at the mercy of the large card systems, their powerful national members and their global interests.

8. Do scheme participants need to be authorised and subject to prudential oversight by APRA and what is the purpose of APRA oversight should it continue?

Tyro has always argued for an open and competitive but regulated and supervised payments environment.

The reality is that despite all the hype around technology and new players, the payment space is dominated by the four major retail banks and the two global schemes.

New entrants and scheme participants will only have a chance to thrive and survive in the long run, if there is on the one hand a level playing field and on the other hand a suitable regulatory framework.

Membership (access) and risk management (oversight) cannot be left to global schemes alone. Either new players never scale up because of the persisting schemes entry and expansion barriers, or they do so by introducing significant systematic risk to the entire payment system.

The result will be massive payments flows and deposits that are beyond the regulator's reach. Where would Apple, Skype and Paypal rank with their deposits measured against the league of global banks. The new small or giant players have to be brought under adequate regulatory oversight.



9. Are there alternative approaches that would allow a wider range of prospective entrants into the card schemes?

Tyro has to our knowledge been the one and only one who has used the SCCI banking authority to conduct the business of acquiring credit and debit card transactions in Australia and not take money on deposit.

We would expect that with further new participants under this license regime, the specific rules and practices could be reviewed as to their adequacy to the requirements of the new participants and their new business models.

But Tyro's experience has been gratifying in that regard, because our years with regulatory supervision helped us to build a stable and secure payment business. To achieve this is in our view an essential requirement for new participants.

All participants in a payment system, regulators, schemes, bank and non-bank participants, merchants and cardholders share an interest in preserving the reliability, confidence in and integrity of the overall system.

Technological advancements and increasing numbers and types of bank and non-bank participants have increased the complexity and vulnerability of the payment landscape.

However, given that payments are an essential vein of the modern economy and society, there needs to be an even more elaborate regulatory risk framework to mitigate the increased risks arising from the growing number and diversity of new global and local entities, their interdependence, their systemic risk and the impact a failure would have on public confidence in the core payment systems.

The regulator has the obligation, skills and credibility to understand the risks and intervene in increasingly complex and interdependent payment systems and to ensure that system wide exposures are appropriately identified and managed.

Yours Sincerely

A handwritten signature in blue ink, appearing to read 'Jost Stollmann', is written over a light blue horizontal line.

Jost Stollmann
CEO