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Dear Dr Richards

**Submission in Response to *Review of Retail Payments Regulation: Issues Paper***

Tyro Payments Limited (**Tyro**) appreciates the opportunity to provide a submission in response to the Reserve Bank of Australia's *Review of Retail Payments: Issues Paper* as released on 29 November 2019 (**Issues Paper**).

To place our submission in context, some understanding of our history, mission and position in the market is required. Tyro was launched in 2003, responding to the RBA's call for greater competition in the payments industry, with an ambition to be the most efficient acquirer of electronic payments in Australia. In pursuit of this ambition Tyro became the first technology company to receive (in 2005) a special credit card institution licence and that licence (in 2015) was replaced by the award of an Authorised Deposit-taking Institution licence – making Tyro the first new domestic banking licensee in over a decade.

Tyro has grown to become the fifth largest merchant acquiring bank in Australia (measured by EFTPOS terminals in market), serving over 30,000 merchants. A significant contributor to this success has been our focus on providing simple, flexible and reliable payment solutions to Australian small and medium-sized enterprises (more than 80% of our transaction value was generated from merchants with annual turnover between \$50,000 and \$5 million, in the year ending 30 June 2019). We are not a card issuer, however have membership in the major schemes for the purpose of acquiring. Tyro has a strong history of innovation and industry firsts including, most recently and of relevance to this review, being the first Australian bank to introduce a least cost routing solution for merchants (in March 2018) and an integrated QR-code based Alipay solution (in October 2018).

Noting the RBA comment that there are not as many 'burning issues' to cover when compared to 2015/16<sup>1</sup>, we nonetheless believe a number of important issues remain for consideration to ensure Australia is at the forefront of electronic commerce globally.

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<sup>1</sup> Tony Richards, Head of Payments Policy Department, What's on the Cards? - Sydney, 10 December 2019.





While the Issues Paper raises a wide-ranging set of topics and questions for consideration, we have limited our submission to those areas where we feel most qualified to comment and which are of importance in achieving the stated goals of the review namely, promoting the efficiency of, and competition within, the Australian payments system.

### Least Cost Routing (Section 3.2.1 + Q4)

Tyro was the first Australian bank to launch least cost routing, doing so ahead of the House of Representatives Standing Committee on Economics recommended deadline of 1 April 2018.<sup>2</sup> We saw the enablement of this capability for merchants as an opportunity to introduce an innovative feature to market which also aligned with our organisational values, specifically in doing the right thing for our merchants.

Our least-cost routing feature, called 'Tap & Save', allows merchants to save money by processing each eligible contactless dual network debit card payment through the scheme that we determine to cost the merchant the least – whether that be the domestic eftpos scheme or one of the international schemes, with this determination being based on transaction size. 'Tap & Save' is available to all of our merchants on any of our terminals<sup>3</sup> on an 'opt-in' basis (close to 30% of our terminal fleet are opted into least cost routing).

A number of large merchant acquirers objected to the introduction of least cost routing in their submissions to the RBA's 2015/16 Review<sup>4</sup>. In contrast Tyro fully supported this merchant friendly initiative. The Issues Paper notes the lack of pace in offering least cost routing by the four major banks with the feature being launched "*only between March and July 2019*" and noting "*there are key differences in the [least cost routing] capabilities offered by different acquirers, with some not yet offering a version that maximises merchant savings by enabling routing based on transaction size and payment network*".

As understood, some acquirers have introduced least-cost routing in a form that requires a merchant to designate whether all of their subsequent contactless dual-network debit card transactions are routed via the eftpos scheme or via the international schemes. This seems at odds with the intent of least cost routing.

We continue to be supportive of a least cost routing construct:

- based on transaction size;
- available to all merchants who desire it; and
- for those merchants that choose to adopt the functionality, they should reap any benefits accrued in the form of lower fees.

Whether the RBA needs to regulate to ensure this outcome is an open question particularly if merchants have a complete unfettered ability to change service provider acquirers if the functionality is not available from their incumbent merchant acquirer.

<sup>2</sup> House of Representatives Standing Committee on Economics, Review of the Four Major Banks (Third Report), December 2017.

<sup>3</sup> 95% of our fleet with 3,500 terminals being excluded from LCR due mainly as a result of not having contactless capability.

<sup>4</sup> Reserve Bank of Australia, '2015-16 Review of Card Payments Regulation', Submissions received, February 2016.



Where there may be reason to regulate is where merchants are unable to receive a fully functioning least cost routing solution from their acquirer, yet are inhibited from switching due to structural impediments (refer to the section below entitled “**Competition in Card Acquiring**”).

### Competition in Card Acquiring (Section 3.2.2 + Q6)

Tyro considers competition in the provision of payments services to Australian businesses to be strong, whether that be as a merchant acquirer, reseller or payment facilitator.

The Issues Paper rightly cites the entrance of a number of international payment providers into the acquiring segment as evidence of improved competition through increased access to the segment, since modification of card scheme access regimes in 2015. In addition to this, the sustained downward trajectory of merchant acquiring margins in Australia is further evidence of healthy competition in payments acceptance.

Tyro is particularly focused on the acquiring market for smaller merchants and has been instrumental in providing an alternative and competitive proposition for Australian businesses. Our success is demonstrated by the strong growth rates in merchants switching to Tyro – driving a 5-year compound annual growth rate circa 24%. We compete not only on a pricing basis but also by leveraging our proprietary technology platform to provide superior payments solutions previously not available for smaller merchants. The competitive environment, together with an ability to achieve some operating leverage from scale, has seen some compression in our average merchant service fee over the last three financial years - delivering direct financial benefit to our merchant base.

It is an indisputable fact however that the market does remain heavily concentrated and is dominated by the four major banks. To put it into perspective as the fifth largest acquiring bank in Australia (measured by EFTPOS terminals<sup>5</sup>) we still only hold circa 5% market share by transaction value acquired<sup>6</sup>. This presents a continuing and significant opportunity for Tyro and other market participants outside the four majors. Whilst we are well placed to continue to compete on functionality, reliability, service and price to attract and retain merchants and grow our market share, there are a number of structural impediments we face which if removed would provide a more level playing field to the benefit of merchants, specifically:

- **Product ‘bundling’ or ‘tying’** is employed by a number of competitors that hold significantly more market power in horizontal product adjacencies, such as business lending, to ensure ‘stickiness’ in payments. We encounter instances regularly in which prospective merchants decline to join, and some existing merchants depart, due to a concern that their existing or prospective lending facilities will be hampered by a switch away from the provider of both the loan and merchant acquiring. This is in part likely due to the concentration in the business lending market in which approximately 70 per cent of lending to non-

<sup>5</sup> Australian Prudential Regulation Authority, ‘Authorised deposit-taking institutions’ points of presence statistics, 30 June 2019.

<sup>6</sup> Internal company estimate based on Reserve Bank of Australia statistics.



financial businesses is controlled by the four major banks.<sup>7</sup> In contrast, circa 97% of Tyro's revenue is generated from payments.

- **cross-subsidisation** of merchant acquiring by some competitors through other income streams, particularly interchange income earned on 'on us' transactions and lending interest, to enable artificially reduced pricing and 'loss leading' customer acquisition. We are an acquirer and not an issuer, therefore we pay but do not receive interchange fees. A number of our competitors are significant card issuers which means they process 'on us' transactions, whereby they can effectively cross subsidise between their issuing and their acquiring business lines. In effect this means that one entity can 'discount' interchange when pricing a merchant acquiring customer to an extent dependent on their estimated card issuance coverage. Similarly, we are aware of instances where competitors price merchant acquiring as a 'loss leader' in order to obtain more lucrative product commitments from the merchant such as lending or broader transaction banking. These actions can distort pricing, obscure true costs, produce sub-optimal outcomes for merchants, stifle competition and reduce the ability for new entrants to scale.

Some of these issues were raised by the Productivity Commission's 2018 *Competition in the Australian Financial System* Inquiry Report. In particular, but not necessarily directly related to retail payments, strategic bundling through horizontal and conglomerate integration was called out as potentially giving rise to potential competition concerns around leveraging or protecting market power and hiding true costs<sup>8</sup>.

We have a history of being strong advocates for merchant choice and increased transparency. Apart from a handful of exceptions, our merchants can switch providers with 30 days' notice and have a range of pricing structures available to them. Notably, we do not offer a pricing plan that includes a preset monthly value of transactions with a fixed marginal cost for additional transactions as cited in the Issues Paper (the Issues Paper uses a 1.5% example). We also welcomed the Reserve Bank and ACCC reforms that improved reporting transparency and consistency regarding payments acceptance costs for merchants and are hopeful that Open Banking will afford merchants further informational transparency and improved switching capability.

In the case of potential higher costs of accepting payments for smaller merchants, as the Issues Paper notes, there are a number of fixed costs associated with acquiring and servicing each merchant regardless of their size (for example, terminal hardware). With smaller merchants, these costs are necessarily distributed over a smaller value of transactions. In order to operate sustainably as a merchant acquirer and continue to serve smaller merchants, our pricing needs to reflect these economies of scale. It is also worth highlighting that the largest portion of our average merchant service fee comprises interchange and scheme 'direct' costs (refer to section below entitled "Interchange Fees").

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<sup>7</sup> Reserve Bank of Australia, D7.3 Bank Lending to Business – Total credit outstanding by size and by sector, to 30 June 2019.

<sup>8</sup> Productivity Commission, 'Competition in the Australian Financial System Inquiry Report', June 2018.



### Resilience of the Payments System (Section 3.1 )

Tyro supports the RBA's focus on resilience in electronic payments and stated intention to publish institutional performance metrics. As a technology focused company we pride ourselves on our core system reliability and fully recognise the harm outages cause to merchants. In determining the appropriate operational statistics for disclosure consideration should be given to:

- the varying definitions of reliability, which range from uptime to event-based definitions, amongst others, noting that an 'event' rather than 'duration' basis may more accurately reflect the impact of service disruptions during periods of high frequency transactions (for example, peak trading windows such as lunchtimes); and
- the causation of a service disruption given a number of reported 'outages' in accepting card payments has been a result of components in the value chain not within the acquirer's control for instance telecommunications provision, card issuing or underlying communication infrastructure.

### Interchange Fees (Section 3.3.1 + Q10)

We are strong advocates for the broader societal and economic benefits of a strong and secure electronic payments system in Australia. We believe participants should be able to generate income for creating and progressing the necessary tools and infrastructure required to achieve such a system. Without the ability to generate a reasonable return the incentive to provide better functionality will diminish. This is an important consideration in evaluating whether (and the level of) fees that should be legitimately earned across the card payments value chain.

However, one of our tenets at Tyro is to offer merchants choice, whether that be point-of-sale system, payment type or pricing structure. The reality of interchange fees runs counter to that principle in that the vast majority of merchants can neither negotiate nor realistically refuse to pay them. This is due largely to the ubiquity of cards as a payment method, the duopolistic nature of the card scheme market and high levels of competition faced in modern day retailing. Whilst it is true that merchants can increase the price of goods or surcharge to cover merchant service fees, many choose not to. Moreover, if they do, it can introduce unfairness into the system. This, as the Issues Paper points out, is a result of the disconnect between consumer choice of card and the cost burden associated with that choice, in which consumers using lower cost cards (often those ineligible to receive more 'premium' cards) and merchants subsidising the fees associated with premium card selection.

There may be legitimate claims that the interchange fees raised are a prerequisite to facilitating innovation and features (including security and fraud prevention) on the card issuing side. However, the European Commission suggests that there is no evidence that high interchanges fees would lead to more innovation and, in fact, they conclude that in some instances the fee arrangements create anti-competitive barriers-to-entry,





thereby inhibiting rather than encouraging innovation.<sup>9</sup> As they also note, a significant level of innovation has occurred on the acceptance side of payments by acquirers that pay interchange, rather than receive it. Were the revenues necessary, as the Productivity Commission noted, issuers could increase charges to the cardholders that select more expensive cards to subsidise the lost interchange income, since it is these consumers that receive the majority of the card benefits.<sup>10</sup> This would have the added effect of 'price transparency' to these consumers – something that is currently lacking.

The maturity of the card payments market in Australia, as evidenced by having one of the highest overall per person card usage rates globally,<sup>11</sup> also suggests that the goal of using interchange to balance the incentives in encouraging the uptake of cards as a payment method, has somewhat been achieved. However, banning interchange altogether could have the adverse consequence of inhibiting continued stability and security and further growth.

On balance, there seems to be scant evidence warranting high levels of interchange (it remains the largest component of our merchant service fees), yet removing them altogether could be detrimental to the ongoing development of payments in Australia. Despite the European Commission and United Kingdom's respective reviews into the effects of interchange caps not being available as yet, following their approach and reducing but not altogether removing interchange fees seems to be an appropriate next step. The fee caps could well be in line with the European Commission's interchange cap of 0.2% for debit cards and 0.3% for credit cards of the value of the transaction – thresholds set in consideration of 'merchant indifference'. This would also align to the Reserve Bank's 2007-08 Review which suggested the benchmark for credit card interchange fees could be reduced to 0.3 per cent.<sup>12</sup>

Furthermore, to facilitate fairness and reduce complexity, we see no strong reason to not include three-party schemes or all types of cards, including foreign-issued cards, within the regulatory scope. Furthermore, a hard cap rather than a weighted average (which, from the evidence, appears to be exceeded regularly) for interchange fee regulation would reduce the costly burden imposed across the card payments landscape caused by the need to continually accommodate adjustments to, and proliferation of, card categories. The continual but irregular card category adjustments need to be accommodated by acquirers like ourselves and communicated to merchants and consumers, both of which results in complexity and ultimately cost, in terms of operational fees and opportunities foregone for further innovation.

As a consequence of reasonably low interchange fees across all cards, it should unwind counterproductive consequences of previous regulation, such reducing or eliminating the gaming of card categories, complex surcharging regulation and functionality, and the ongoing complications involved in managing the checks and balances to cross-subsidisation.

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<sup>9</sup> European Commission, 'The Interchange Fees Regulation: Competition Policy Brief', June 2015.

<sup>10</sup> Productivity Commission, 'Competition in the Australian Financial System Inquiry Report', June 2018.

<sup>11</sup> Reserve Bank of Australia, Submission to the Senate Select Committee on Financial Technology and Regulatory Technology, December 2019.

<sup>12</sup> Reserve Bank of Australia, 'Reform of Australia's Payments System: Conclusions of the 2007/08 Review', September 2008.

In the case of an interchange fee reduction, monitoring how effectively these cost savings are passed through to merchants and, ultimately, end consumers would be warranted.

### Scheme Fees (Section 3.2.3 + Q7)

Scheme fees do form a not insignificant component of the merchant service fees that Tyro's charges merchants, and are subject to confidentiality arrangement required by the schemes preventing specific disclosure. Tyro generally agrees with the potential benefits flowing to merchants (and the RBA) from greater transparency as identified in section 3.2.3 of the Issues Paper.

In particular, as a merchant acquirer without the scale of the major banks and not being a card issuer, we are limited in our ability to negotiate scheme fees with the major card schemes. Increased transparency would enhance the RBA's ability to monitor and evaluate competition in this respect. Similarly, it would also enable the RBA to more effectively and holistically manage interchange fees, scheme fees and 'net compensation' revenue exchanges between schemes, issuers and acquirers.

As the RBA stated in its 2007/08 review, legitimate commercial confidentiality concerns could be managed without necessarily restricting meaningful disclosure for the purpose of enhancing transparency.<sup>13</sup> This should help address the concerns of some parties.

Tyro would welcome the opportunity to participate in further consultations if considered of assistance by the RBA.

Yours sincerely



**Robbie Cooke**  
CEO | Managing Director

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<sup>13</sup> Reserve Bank of Australia, 'Reform of Australia's Payments System: Conclusions of the 2007/08 Review', September 2008.